

EFFECTIVE



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Report Leadership is a multi-stakeholder group that aims to challenge established thinking on corporate reporting. The contributors to this initiative are the Chartered Institute of Management Accountants (CIMA), PricewaterhouseCoopers LLP, Radley Yeldar and Tomkins plc.

You can help shape the way that the Report Leadership project evolves by giving your comments, actively participating, or adopting the elements that appeal to you. Please provide any feedback, register your interest and keep up to date with developments at [www.reportleadership.com](http://www.reportleadership.com)

CIMA

The Chartered Institute of Management Accountants is a leading membership body that offers an internationally recognised professional qualification in management accountancy, which focuses on accounting in business.

PRICEWATERHOUSECOOPERS 

The firms of the PricewaterhouseCoopers global network provide industry-focused assurance, tax and advisory services to build public trust and enhance value for clients and their stakeholders. More than 130,000 people in 148 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

ry. radley yeldar  
consistently creative

Radley Yeldar is a creative communications consultancy offering a range of specialist services including brand identity, corporate reporting, corporate responsibility, digital media, internal communications and marketing communications.

Tomkins

Tomkins plc is a global engineering and manufacturing group listed on the London and New York stock exchanges. Tomkins operates over 130 manufacturing facilities, employs some 37,000 people worldwide and had annual sales of approximately £3 billion in 2005.

Corporate reporting should be more informative and accessible.

But can it provide the information investors want without swamping them in unnecessary detail?

The Report Leadership group came together to develop simple, practical ways to improve narrative and financial reporting. This publication outlines our initial thinking, which reflects input and feedback from a range of investors. It is intended to:

- 
- Help companies to report in ways that are more relevant and informative to their primary audience
- 
- Encourage investors to push for the information they want
- 
- Prompt standard setters to consider how they might foster beneficial change
- 

Above all, it is intended to stimulate further debate. We welcome your feedback.

# Corporate reporting... rethought

# Many investors see corporate reporting like this...

Management spends significant time aggregating and recalculating data from internal sources to construct the information demanded by regulatory reporting.

It is like the creation of a large building, which analysts and investors then spend a lot of time deconstructing so they can see the building blocks.

This process is wasteful and ineffective. So we are developing a better blueprint for corporate reporting that:

- 
- Aligns external reporting more closely with management reporting
- 
- Recognises the complexity of business today
- 
- Will adapt readily to other media
- 
- Is relevant and accessible to the investment community
-

## Why now?

In recent years there has been much tinkering with accounting and financial reporting standards. But surveys of analysts and investors across the globe indicate that current models are still too backward-looking and compliance-driven. As a result, the markets are finding other ways to get the information they need.

Investors are clear that 'corporate reporting' is not just about the numbers. As the diagram below shows, they also want access to greater contextual information and key underlying data points. So in response, Report Leadership has developed extracts from a fictional annual report that addresses these needs.

**To make our ideas practical and realistic, we've focused on what's achievable within current GAAP or IFRS models by improving disclosure and presentation of information.**

## Why the annual report?

It's easy to knock existing models, but more useful to propose alternatives.

Our ideas cover the whole field of corporate reporting. But to show how they might play out in practice we've applied them to the delivery vehicle that's most familiar – the annual report. You'll find an example in the folder with this handbook.

For most companies, the annual report remains the primary document of record. Yet, sadly, few investors pay it much attention. Why? In part, it's a matter of timing: by the time the report appears, much of its content has already been published elsewhere. But it's also a matter of relevance: not enough of the content tells investors what they want to know.

In our example report, we've shown how the content could be made more relevant and informative. Crucially, the same principles and structures can be applied to all forms of communication including briefings and websites, to ensure that a company's reporting gives all stakeholders information that they will find timely, relevant, sufficient, consistent and clear.

## What we've included

This is the first salvo in what we hope will be a continuing debate that engages people in the corporate, investor and regulatory communities.

We haven't attempted to do everything at once. Instead, we've focused on a few areas that are particularly topical and are widely seen as needing improvement. These are discussed in the following pages under three broad headings:

- **Effective communication** through clear messaging and navigation.
- **Modelling the future** through the provision of contextual information that allows investors to assess the quality and sustainability of future cash flows.
- **Rethinking the financials** to provide greater granularity on revenue, costs, segmental information, pensions and debt.

Everyone involved was encouraged to think outside the box of conventional reporting – but not to go completely off-piste. These are pragmatic ideas that draw heavily on the good practice we've seen in company reporting and other information provided outside the regulatory model.

## Corporate reporting

### Markets, Strategy, Governance, Remuneration

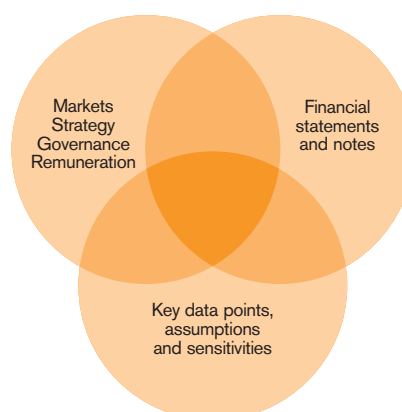
Provides analysts and investors with the contextual information necessary to truly understand the results.

### Financial statements and notes

The traditional focus of accounting and reporting presented in a more user-friendly way, allowing investors to assess management accountability as well as disaggregate the summary information.

### Key data points, assumptions and sensitivities

Provide key underlying information that helps analysts and investors to populate their own valuation models. Developments in technology mean this element will become more important.



## What we've left out

Additional disclosure needn't mean bulkier reports – if you can also leave out what investors *don't* need.

Sheer weight of information remains a problem. We certainly believe there is scope for greater use of company websites to provide supporting detail – and downloadable figures. Much of the information provided in our report lends itself to this medium.

We developed our ideas iteratively, sharing them with senior representatives of the UK capital markets whose insights prompted both additions and deletions.

Not everything we came up with was welcomed. For example, we suggested a section giving management's view on the value of the company. No, said users – putting a value on the company is *our* job. What they wanted was information that helped them formulate their own conclusions.

There is still much more to do. You'll see that our fictional annual report for Generico has gaps – notably in corporate governance, directors' remuneration and auditors' reports, and many of the notes to the financial statements. The only notes in our example accounts are those that illustrate specific proposals for disclosure or presentation.

## So what next?

We've subtitled this document *Tomorrow's reporting today*. Because we believe corporate reporting can and should be improved right now, not in five or ten years' time.

We've set out to provide practical ideas that readers can implement immediately. Some may seem too bold or too uncomfortable, but we hope all will stimulate further thinking – and participation in the Report Leadership project.

Are these initial suggestions a step in the right direction? Do they go too far, or not far enough? What other aspects of corporate reporting need urgent improvement? We'd like to know your views.

You can help to shape the way the Report Leadership project evolves by giving your comments, by actively participating, or by adopting the elements that appeal to you.

Please register your interest, suggest how the project should evolve, and keep up to date with developments at [www.reportleadership.com](http://www.reportleadership.com)

In the following pages we set out our initial ideas for improving corporate reporting. We explain how we've applied them in extracts from the annual report of a fictitious company, 'Generico'.

### Sources we consulted include:

#### External:

ASB Pensions ED Reporting Statement.

CESR Recommendations on Alternative Performance Measures.

CFA October 2005 *Eight criteria for development of effective and useful disclosure* and *Proposed disclosures: Revenue recognition*.

Deutsche Bank – *The Art of Accounting*.

IASB Management Commentary discussion paper – suggestions around narrative reporting.

#### Internal to Report Leadership:

PricewaterhouseCoopers face-to-face surveys of the views of analysts and investors in Canada, the UK and US.

PricewaterhouseCoopers – *Trends in Corporate Reporting*.

Radley Yeldar interviews with analysts and investors.

Radley Yeldar – *Narrative reporting content in the FTSE 100*.

# EFFECTIVE COMMUNICATION STRUCTURE

## The problem

There are more and more regulatory boxes to tick. In the effort to cover them all, key messages can be lost. The result: a mass of information, but no clear narrative thread.

Some companies follow the same structure every year. Others look at what peers are doing, and follow suit. But these are off-the-shelf approaches; are they really the best way of addressing the issues a company needs to explain to investors today?

Companies should take a step back from their reports and think about what they need to communicate – and what investors want to know.

People's retention of what they read can be alarmingly limited. But they'll absorb and remember much more if it fits into a compelling story... if facts and opinions are linked together by a rational structure... and if the investment case and strategy are presented step-by-step so that the logic is inescapable. They're also more likely to be convinced.

## What investors want

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Some form of narrative sequence with a beginning, a middle and an end.

---

Clear linkage from markets to strategy to key performance indicators to future goals.

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An integrated structure:

---

- Don't mention one thing as being important and then fail to mention it anywhere else in the report.
  - Don't hide important information away at the back of the report.
  - Don't suddenly introduce a new idea and say it's key to the business halfway through the annual report.
- 

Clear and logical structuring helps readers to retain more of the story – and to be convinced by it.



## What we've done to make it work

Organised information into a logical sequence: this is what we do; these are the opportunities and risks; this is how we're addressing them; here's how it's working (or not); these are our plans for the future.

Clearly linked strategy to results and key performance indicators, and reported on delivery of overall strategic goals.

Introduced key elements of the story early on – and expanded throughout the report.

Carried clear themes (eg margins vs falling prices) through the annual report from front to back, using consistent terminology.

04 Generico Annual report 2007

### What's our strategy?

Our goal is to create **shareholder value**.  
To achieve this we aim to:

- Lead in safety and navigation systems for the private leisure boat market
- Grow revenue while improving margins

We have two strategic priorities at group level:

- 1 Increase **market competitiveness** by:
  - Meeting customer expectations through the price, quality, delivery and responsiveness of our products and service
  - Developing next-generation products for our existing markets and leveraging our design and manufacturing technology into new growth markets
- 2 Deliver **operational excellence** that increases quality while reducing costs

Measuring strategic progress  
The 'output' measures shown opposite reflect overall progress towards our strategic priorities. Success in implementing these strategic priorities requires management of a number of activities. To assess the progress in these activities, management uses a broader set of key performance indicators (KPIs), which are often lead indicators of future financial performance. A summary of these KPIs is shown on pages 22 to 23.

06 Generico Annual report 2007

### Have we outperformed our markets?

As with many technology-based companies, our ability to create value for shareholders depends on growing unit sales and controlling costs in a declining price environment. These charts indicate the unit volume and pricing trends in our markets – and our response.

**Our markets**

**Maritime all weather beacons**

- North American sales forecast to maintain 9% pa growth
- European sales growth to slow to 2% pa by 2010
- Growth in sales volume partially offset by falling prices

**Boat positioning systems**

- European market growing fast, stimulated by falling prices
- Growth accelerating

**Our markets:**

**Maritime all weather beacons:**

- Total market sales in units sold
- Total market sales in units sold
- Total market sales in units sold

**Boat positioning systems:**

- Total market sales in units sold
- Total market sales in units sold
- Total market sales in units sold

**Outlook:**

- Continued sales contraction in 2008, offset by a declining price
- Increased market penetration in new markets
- New products and services will be developed
- Continued sales contraction in 2008, offset by a declining price
- Continued sales contraction in 2008, offset by a declining price
- Continued sales contraction in 2008, offset by a declining price

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### Our markets

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To achieve this we aim to:

# EFFECTIVE COMMUNICATION

# MESSAGING

### The problem

Companies often bury key messages in text or fail to spell them out at all.

As a result, investors and other audiences may have to read the whole document before they can work out the main issues.

Many reports also give out mixed messages. There are key investment points that a company needs to get across – but other, less crucial themes or transient issues are bolted on to support an attractive design concept.

Clear messaging helps guide the information that readers take from a report – and shape the conclusions that they draw from it.

Some companies still seem to believe that the way to present their investment case is to show a partial picture, or huff and puff. We disagree. If management talk to people as equals, mention the downs as well as the ups, and explain why they believe in the business – investors are more likely to get the message.

### What investors want

- Clarity.
- Messages backed-up by evidence.
- Plain speaking.
- Plain English.
- Balanced discussion of performance.

Reporting should focus on the key points, so that readers can't miss them.

## What we've done to make it work

Explained what the group believes are the critical issues, spelling out important messages.

Presented key messages in pull quotes, titles, bullet points, sub-headings etc.

Provided information visually through graphical summaries.

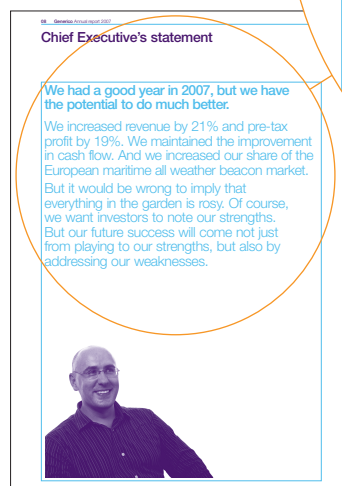
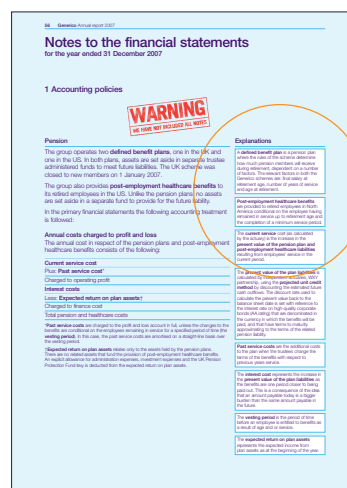
Applied the following golden rules for the text:

→ Tell it like it is.

→ Explain, don't spin.

→ Don't fudge the tricky bits.

→ Avoid jargon, unexplained acronyms, formality and pomposity.



## Executive's statement

**We had a good year in 2007, but we have the potential to do much better.**

We increased revenue by 21% and pre-tax profit by 19%. We maintained the improvement in cash flow. And we increased our share of the European maritime all weather beacon market.

But it would be wrong to imply that everything in the garden is rosy. Of course, we want investors to note our strengths. But our future success will come not just from playing to our strengths, but also by addressing our weaknesses.

## Explanations

UK and separate trustee scheme was

are benefits to plans, no assets future liability. accounting treatment

post-employment

A **defined benefit plan** is a pension plan where the rules of the scheme determine how much pension members will receive during retirement, dependent on a number of factors. The relevant factors in both the Generico schemes are: final salary at retirement age, number of years of service and age at retirement.

**Post-employment healthcare benefits** are provided to retired employees in North America conditional on the employee having remained in service up to retirement age and the completion of a minimum service period.

The **current service cost** (as calculated by the actuary) is the increase in the **present value of the pension plan and post-employment healthcare liabilities** resulting from employees' service in the current period.

The **present value of the plan liabilities** is calculated by independent actuaries, WXY partnership, using the **projected unit method** by discounting the estimated future cash flows.

# EFFECTIVE COMMUNICATION

## NAVIGATION

### The problem

As regulators, investors and others demand more and more disclosure, they find it harder and harder to locate the information they want.

The challenge for companies is to structure information so that investors can spend their time reading the investment case, not looking for it.

Companies are often reluctant to repeat information in different parts of the report. And certainly, excessive repetition can be tedious. But if they avoid it too ruthlessly, they can undermine communication with 'dip in and out' readers – probably the majority of their audience. A good test is to try reading individual sections on their own: do they tell a clear and complete story, or would the reader benefit from a little more context? Companies should not be afraid to repeat something that appears elsewhere; the average reader may well not see both instances.

### What investors want

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A good table of contents, or even an index.

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Summaries of the information included in each section or even each page or spread.

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Individual sections clearly delineated.

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Clear linkage between the narrative section of the annual report and the financial statements.

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Good navigational aids on each page/spread.

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Helpful navigation ensures readers can find the information companies have taken such trouble to publish.

## What we've done to make it work

Included a clear table of contents, supported by a thumb index and colour-coded sections, to help readers move quickly to the right part of the report. As far as possible, sections are self-explanatory if read on their own.

Repeated information or provided cross-references in order to provide context.

Provided a quick-read summary at the start of each section – supporting messaging and navigation.

Included clear titles and sub-headings, and a strong typographic hierarchy.

Used box-outs in financial statements to emphasise key figures.

Provided a glossary and an index.

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### Our markets

#### 14 What are our markets?

- Maritime all weather beacons
- Boat positioning systems

#### 15 Why are these markets attractive?

- Growth in leisure boat sales
- Products fitted into new boats

#### 16 Challenges and success factors

### Our group strategy

How are we making the group a reality?  
Our business's perspective

|   |
|---|
| Financing activities  |
| Payment of dividends to equity holders of the parent                        |
| Receipt of new bank loans   |
| Repayment of bank loans   |
| <b>Net cash flows from financing activities</b>                             |
| <b>Net increase in cash and cash equivalents</b>                            |
| Cash and cash equivalents at 1 January                                      |
| <b>Cash and cash equivalents at 31 December</b>                             |
|   |
| Movement in net debt <b>NON-GAAP</b>  |
| <b>Net increase in cash and cash equivalents</b>                            |
| <b>Decrease in financing net debt (excluding cash and cash equivalents)</b> |
| <b>(Increase) in operating net debt</b>                                     |
| <b>(Increase)/decrease in other debt-like liabilities</b>                   |
| <b>Decrease in net debt</b>   |
|   |
| Provision funds   |

| Cash flow statement for the year ended 31 December 2007                     |  |                 |                |
|---|--|-----------------|----------------|
| Cash flow statement for the year ended 31 December 2007                     |  |                 |                |
|   |  | 2007            | 2006           |
| Cash flows from operating activities  |  | 1,440           | 1,440          |
| Profit before tax and finance cost  |  | 27,202          | 25,111         |
| Depreciation and amortisation   |  | 6,688           | 5,483          |
| Loss on disposal of plant   |  | 250             | 180            |
| Operating cash flows before changes in working capital and provisions       |  | 34,140          | 30,854         |
| Decreases in net current assets   |  | 30              | (1,681)        |
| Additional cash contributions to reduce accounting pension deficit          |  | 824             | 648            |
| Increases/decreases in provisions   |  | 26,466          | 27,385         |
| <b>Cash generated from operations</b>                                       |  | <b>61,660</b>   | <b>63,266</b>  |
| Interest paid   |  | 5               | (1,048)        |
| Interest received   |  | 5               | 1              |
| Income tax paid   |  | (2,398)         | (2,073)        |
| <b>Net cash flow from operating activities</b>                              |  | <b>59,262</b>   | <b>60,146</b>  |
| Cash flows from investing activities  |  |                 |                |
| Proceeds from disposal of plant   |  | 130             | 80             |
| Purchases of property, plant and equipment                                  |  | (6,338)         | (5,143)        |
| Acquisition of subsidiaries (net of cash or cash equivalents)               |  | (4,003)         | (3,015)        |
| <b>Net cash flow from investing activities</b>                              |  | <b>(10,211)</b> | <b>(7,078)</b> |
| Cash flows from financing activities  |  |                 |                |
| Dividends paid to equity holders of the parent                              |  | (21)            | (2,062)        |
| Receipt of new bank loans   |  | 22              | 2,000          |
| Repayment of bank loans   |  | (22)            | (6,000)        |
| <b>Net cash flow from financing activities</b>                              |  | <b>(21)</b>     | <b>(6,062)</b> |
| <b>Net increase in cash and cash equivalents</b>                            |  | <b>48,030</b>   | <b>47,006</b>  |
| Cash and cash equivalents at 1 January                                      |  | 1,440           | 30             |
| <b>Cash and cash equivalents at 31 December</b>                             |  | <b>1,440</b>    | <b>30</b>      |
|   |  |                 |                |
| <b>Movement in net debt (NON-GAAP)</b>                                      |  |                 |                |
| <b>Net increase in cash and cash equivalents</b>                            |  | <b>48,030</b>   | <b>47,006</b>  |
| <b>Decrease in financing net debt (excluding cash and cash equivalents)</b> |  | <b>3,380</b>    | <b>8,517</b>   |
| <b>Decrease in operating net debt</b>                                       |  | <b>(2,468)</b>  | <b>(1,122)</b> |
| <b>Decreases/increases in other debt-like liabilities</b>                   |  | <b>(2,393)</b>  | <b>1,120</b>   |
| <b>Decreases in net debt</b>  |  | <b>8,169</b>    | <b>8,515</b>   |
|   |  |                 |                |
| <b>Net cash contributions to pension funds</b>                              |  |                 |                |
| Cash contributions to meet current year charges                             |  | 10              | 3,380          |
| Additional cash contribution to reduce accounting pension deficit           |  | 10              | 1,400          |
| <b>Total funding</b>  |  | <b>20</b>       | <b>4,780</b>   |

# MODELLING THE FUTURE VALUE CREATION

## The problem

Before investors can start modelling the future, they need to understand how value has been created in the past. History matters, because it allows users to gain a clearer understanding of how an entity generates returns, thereby providing investors with a tool for assessing what future returns may be. However, traditional financial statements fall short of explaining the value generated for shareholders given the company's asset base, risk profile and required returns.

Traditional financial measures take into account the returns paid to some company stakeholders – such as employees and debt holders – but fail to take into account a charge for the returns that equity investors expect to receive on their investment.

The Weighted Average Cost of Capital (WACC) indicates the return that can be expected from the capital employed (both debt and equity) in the business given its relative risk profile.

By having sufficient information to understand the quality and sustainability of future cash flows and assess whether the return generated on the capital invested exceeds the estimated WACC, investors can begin to form a view on whether value is being created or destroyed.

## What investors want

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Analysis of capital employed, by business segment.

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Management's view of the group's risk profile and that of its individual business segments.

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An understanding of the sensitivity of financial performance.

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An analysis of how management has used the cash generated.

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Insight into the quality and sustainability of future cash flows.

---

The accounting profit doesn't necessarily tell investors if the returns generated are sufficient.

Provided alternative scenarios and resulting sensitivities on key financial numbers to help users model the future.

**vs 2007 target**

... strong growth in our core markets have made us reconsider our R&D strategy, developing new products as well as improving existing lines.

... has provided an additional uplift to R&D activity.

|                                   | 2004<br>actual | 2005<br>actual | 2006<br>actual | 2007<br>target |
|-----------------------------------|----------------|----------------|----------------|----------------|
| Capital as percentage of revenue  | 20%            | 20%            | 20%            | 19%            |
| Net debt to capital <sup>1</sup>  | 203%           | 141%           | 68%            | 50%            |
| Net invested capital <sup>2</sup> | 25%            | 29%            | 27%            | 28%            |

**Capital reasons for capital movement vs 2007 target**

We continue to reduce the debt burden, and decided to pay off £4.0m in 2007 – more than originally planned. ROIC exceeded target due to sales outperformance.

**Non-GAAP measures<sup>3</sup>**

|                  | 2004<br>actual<br>£'000 | 2005<br>actual<br>£'000 | 2006<br>actual<br>£'000 | 2007<br>target<br>£'000 | 2007<br>actual<br>£'000 |
|------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| Free cash flow   | 16,441                  | 14,864                  | 14,328                  | 14,500                  | 14,645                  |
| Operating lease  | 74,698                  | 61,204                  | 56,715                  | 58,000                  | 59,156                  |
| WACC             | 9.5%                    | 9.4%                    | 9.8%                    | 9.7%                    | 9.8%                    |
| Cash added value | 10,817                  | 11,478                  | 11,025                  | 12,000                  | 13,359                  |
| Economic returns | 14%                     | 19%                     | 19%                     | 20%                     | 23%                     |

**Principal reasons for value creation movement vs 2007 target**

- Free cash flow increased broadly in line with the increase in profit for the year.
- Cash added value and economic return increased and exceeded the WACC. However, the rate of growth did not match our growth as we continued to invest heavily in the future (eg through our R&D pipeline).

1. Excludes £2.5m increase in off-balance sheet C&A and £1.5m increase in C&A and £6.5m increase in C&A.

| Base case scenarios   |  |
|---|--|
| <p>penetration of maritime all weather beacons</p> <p>price point (pp) in Europe, stable in North America</p> <p>and Generico captures 10% of the market</p> <p>system prices fall 16%</p> <p>including a positioning system contract from an existing AWB customer. Customer retention addressed, but falls in Europe to historical levels as a series of existing contracts come to the</p> |  |
| <p>North America sales faster</p> <p>1pp while share of</p> <p>including one AWB</p> <p>to GPS contracts</p> <p>market</p> <p>prior-year levels</p>   | <p><b>Worst case 2008</b></p> <p>→ Europe market share remains stable</p> <p>→ Poor customer response to quality and North America customer initiatives leads to further 1pp fall in market share</p> <p>→ 20% of contracts out for tender won and AWB customer retention levels remain at historically low levels in North America</p> <p>→ Take-up of boat positioning systems is slower than expected, with market growth of 15%</p> <p>→ GPS market share increases by 2pp to 8%</p> |
| <p>Change in assumption from base case (for FY 2008 only)</p>   |  |
|   | <p>+/-1pp</p> <p>+/-10%</p>  |
| <p>Financial impact</p>   |  |
|   | <p>+/-£11m (sa</p> <p>+/-£3m (gross</p>  |

[illegible]

# MODELLING THE FUTURE

## FORWARD-LOOKING ORIENTATION

### The problem

As investors model the future they typically have insufficient forward-looking contextual and non-financial information to underpin their cash flow projections. Traditional reporting focuses on past financial performance – which, as every investor knows, is not the only guide to future returns.

What's needed is more information on a company's expectations of future performance, and what will drive it. But, understandably, management are reluctant to make forecasts. They also want to avoid giving sensitive information to competitors. And they fear litigation prompted by forward-looking statements that turn out to be inaccurate.

But in briefings with the investment community they're more forthcoming. They have to be – their investment story depends on painting a convincing picture of the way the company's markets and performance could develop.

### What investors want

A medium-term picture made up of:

- Explanation of market trends and prospects.
- Explanation of long-term objectives.
- Understanding of short-term strategic priorities to deliver on the objectives.
- Key performance indicators used to measure strategic success, complete with targets.
- The principal risks and uncertainties that may impact long-term prospects.
- Understanding of how previous views on market trends and prospects compared with reality.

A rear-view mirror is not the only instrument for judging a company's future potential.



## What we've done to make it work

Applied forward-looking attitudes and language throughout the report.

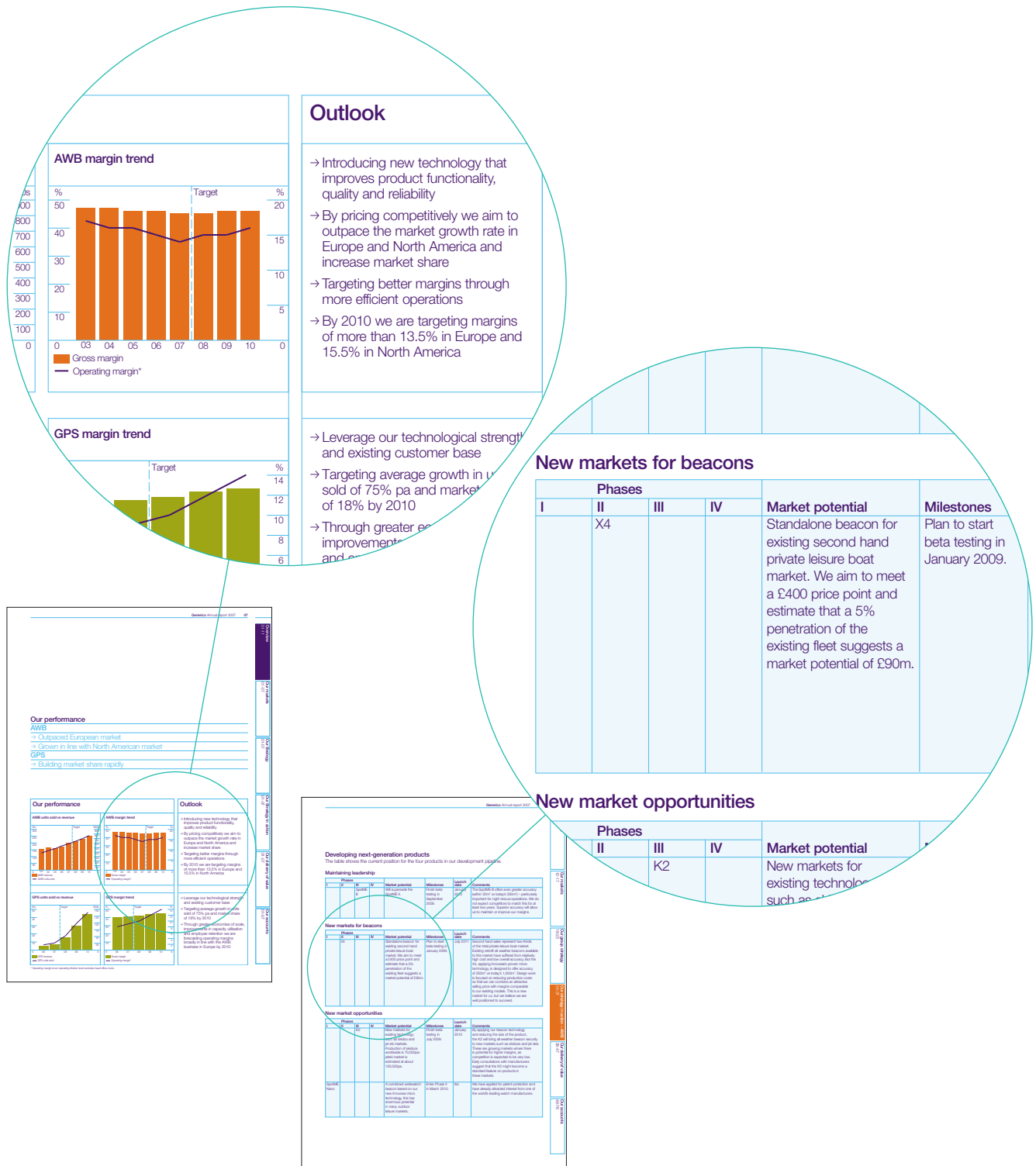
Used the group's strategy as the basis for describing both current and future performance.

Described external trends likely to affect the group's business environment, supported with quantifiable forecast data, externally sourced.

Given targets for each key performance indicator – and all other quantifiable data.

Identified products in the pipeline and their market potential.

Provided an outlook section for each operating division.



# MODELLING THE FUTURE BUSINESS ENVIRONMENT

## The problem

To understand and evaluate a company's strategy and performance, investors need a clear grasp of its business environment. What are its markets, and the competitive, regulatory and macroeconomic trends impacting it – now and in the future?

Too often, companies report their performance in isolation. Commentary on their business environment, if offered at all, is often too backward-looking or high level to be helpful: 'It has been another challenging year', '... against intensifying competition', 'prospects are good'.

Those who specialise in a sector will understand its markets well, and have their own views on strengths and weaknesses. But they will still be interested to know management's interpretation of market developments and trends. After all, this will impact strategic decision-making.

Other investors need help in understanding a company's markets. Without it, they may misjudge its performance – or fail to see the logic of its strategy. Clear exposition of the business context should enhance the credibility of a company's reporting on past performance, strategy, investment case and outlook.

## What investors want

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Understanding of market forces – regulatory, macro and competitive – that impact business performance.

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Forecasts of market trends and factors likely to impact the business.

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Statements supported with quantifiable evidence.

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Management's interpretation of the marketplace, its future challenges and opportunities, is a critical factor in the development of investors' cash flow models.

## What we've done to make it work

Included *Our markets*, a section setting the group's business activities in their market context.

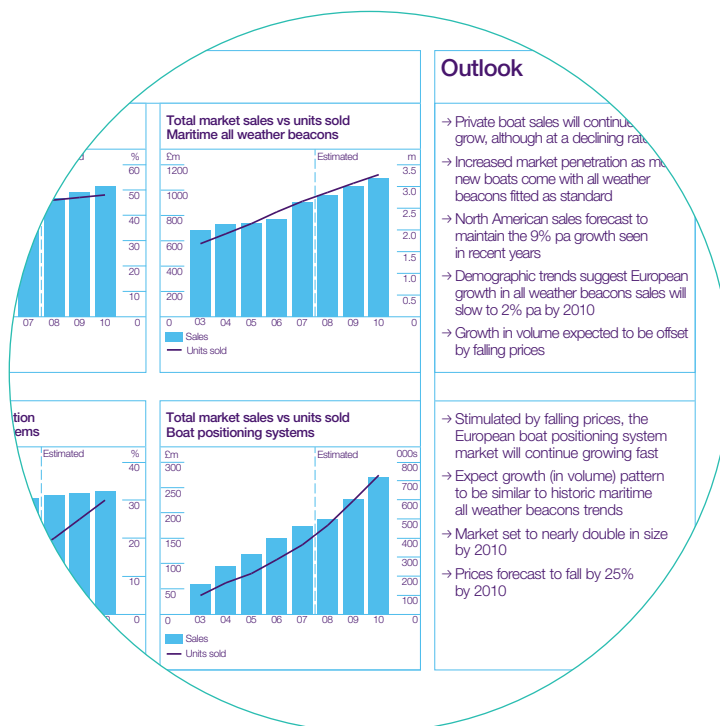
Discussed the marketplace and the trends and factors impacting the group's sales within it.

Discussed competitive and macroeconomic factors.

Reported market statistics, externally sourced.

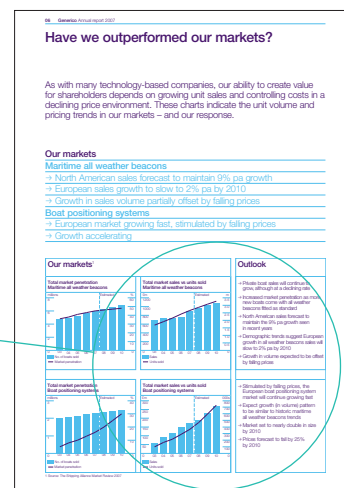
Identified competitors and quantified their market positions.

Included both historic and forecast market data.



### Outlook

- Private boat sales will continue to grow, although at a declining rate
  - Increased market penetration as more new boats come with all weather beacons fitted as standard
  - North American sales forecast to maintain the 9% pa growth seen in recent years
  - Demographic trends suggest European growth in all weather beacons sales will slow to 2% pa by 2010
  - Growth in volume expected to be offset by falling prices
- 
- Stimulated by falling prices, the European boat positioning system market will continue growing fast
  - Expect growth (in volume) pattern to be similar to historic maritime all weather beacons trends
  - Market set to nearly double in size by 2010
  - Prices forecast to fall by 25% by 2010



## Our markets

We operate in markets that offer excellent growth opportunities for innovative, efficient businesses.

In this section we address the following questions:

- What are our markets?
- Why are they attractive to us?
- What are the challenges – particularly in growing margins when prices are falling?
- What do we need to succeed?

### Key points:

- Leisure boat sales are growing
- More new boats have weather beacons and positioning systems
- Cheaper technology means prices are falling
- Strong growth in sales volume but pressure on margins



# MODELLING THE FUTURE STRATEGY

## The problem

What is a company trying to achieve? How? Why?  
To assess the quality and sustainability of a company's performance, investors need to be clear about its strategy.

They need to know how management intend to address market trends, the threats and opportunities that they represent. They also need to understand the relationship between strategic objectives, management actions and executive remuneration. Then they can judge the appropriateness and success of management actions to deliver the strategy... and what to expect in the future.

Many companies make reference to their objectives and strategies. Yet few strategic statements provide the detail that enables investors to understand the priorities for action or the resources that must be managed to deliver results. Few give explicit guidance on how success is measured, or over what period of time it should be assessed.

## What investors want

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A clear statement on where the company is heading.

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An understanding of:

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→ The company's strategic priorities.

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→ The resources that must be managed to deliver them.

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→ How strategic success is measured.

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A timeframe over which to assess strategic success.

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Explanation of performance against strategic objectives.

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A clear link between strategy, performance and executive remuneration.

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Many strategic statements lack the detail needed to understand the priorities for action, the resources that must be managed, and how success is measured.

What we've done to make it work

- Used the strategy to underpin the whole report.
- Clearly outlined the group's strategy and priorities early on, cross-referred to a more detailed *Our group strategy* section.
- Used graphics as well as text to express the strategy simply, consistently and memorably.
- Identified key actions necessary to make the strategy a reality.
- Set out a strategy progress statement providing a clear link between strategic priorities, key performance indicators, performance and risk.
- Used the strategic priorities as the basis for applying a consistent structure to the discussion of segmental performance.

...expectations through the responsiveness of our products and services

...ing next-generation products for our existing markets, leveraging our design and manufacturing technology into new markets

...deliver **operational excellence** that increases quality while reducing costs

1 Market competitiveness

Meeting customer expectations

Developing next-generation products

2 Operational excellence

Shareholder value

**Measuring strategic progress**

The 'output' measures shown opposite reflect overall progress towards our strategic priorities. Success in implementing these strategic priorities requires management of a number of activities. To assess the progress in these activities, management uses a broader set of key performance indicators (KPIs), which are often lead indicators of future financial performance. A summary of these KPIs is shown on pages 22 to 24.

14 December 2019 2019-2021

**What's our strategy?**

Our goal is to create **shareholder value**.  
To achieve this we aim to:

- Lead in safety and navigation systems for the private/semi-bus market
- Grow revenue while improving margins

We have two strategic priorities at group level:

**1 Increase market competitiveness by:**

- Meeting customer expectations through the range, quality, delivery and responsiveness of our products and services
- Developing next-generation products for our existing markets and leveraging our design and manufacturing technology into new markets

**2 Deliver operational excellence** that increases quality while reducing costs

1 Market competitiveness

Meeting customer expectations

Developing next-generation products

2 Operational excellence

Shareholder value

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14 December 2019 2019-2021

**Our group strategy**

We're confident about our prospects because we have a **clear and straightforward strategy**. See page 04.

In this section we address the following questions:

- How are we making the strategy a reality?
- How do we measure success?
- Are we making progress on our strategy?
- How are we addressing the risks that might derail our strategy?

**Key points:**

- Launched Fast Forward programme to transform culture
- Incubated our people to excel
- Enhanced new product development
- Defined and now monitor key performance indicators vs targets
- Identified and addressed main risks

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# MODELLING THE FUTURE

## KEY PERFORMANCE INDICATORS

### The problem

Managers identify critical measures that will help them track company performance and strategic progress. But they rarely share these with investors.

Yet these key performance indicators (KPIs) really help deepen investors' understanding of progress and movement in the business. Without them, external perceptions of performance may be at odds with management's own view.

Traditional metrics taken from the financial statements are not enough, as they tend to be output driven and historically focused. It takes both financial and non-financial KPIs (the latter tend to be lead indicators of future performance) to give a clear picture of strategic progress. A clear link should be made between strategic priorities and KPIs, and they should all be published together. Too often, KPIs bear no relevance to stated strategies or highly relevant KPIs are published separately, for example in a Corporate Social Responsibility report.

### What investors want

Explanation of what the KPIs are – preferably all in one place – and how they relate to the strategy.

A combination of financial and non-financial KPIs.

Explanation of the definition and source of each KPI.

Measurement of performance over time.

Targets for future performance.

Without KPIs, investors' perceptions of performance may be at odds with management's own view and their ability to model the future diminished.

## What we've done to make it work

Made a clear distinction between output measures and KPIs.

Stated early in the report where KPIs can be found.

Provided a clear link between strategy and KPIs, setting out a strategy progress statement giving the key measures of success for each strategic priority.

Given each KPI a definition, prior year comparisons of performance and targets for the forthcoming year.

Disclosed KPIs at a group and segmental level, depending on the availability of data.

Explained the actions taken by management to improve/maintain their performance around each KPI.

Successfully, we need to be able to measure our progress. Implementing each of our two strategic priorities have been assigned to a director whose remuneration is linked to achieving operational objectives. The key performance indicators for each strategic priority, with a measure of performance and targets for the forthcoming year. We also indicate potential challenges to success and the action we are taking

| Strategic priority  | Key performance indicators  | Definition/source   | Performance  |
|---|---|---|--|
| <b>1 Market competitiveness</b><br>Accountable director: Richard Black<br>See pages 26 and 34.<br><b>Making the expectations of our customers</b> | Market share – AWB, GPS   | Based on our share of European and North American sales by volume, as reported by the Shipping Alliance Market Review   | <b>Market share – AWB (%)</b><br>05: 22, 06: 22, 07: 22, 08 target: 22<br><b>Market share – GPS (%)**</b><br>05: 2, 06: 3, 07: 4, 08 target: 4   |
|   | Customer retention*   | The percentage of active customer accounts retained (active customer = one that has made a purchase within the preceding 12 months)                               | <b>Customer retention (%)</b><br>05: 94, 06: 95, 07: 95, 08 target: 94<br><b>Number of new boat lines – AWB, GPS</b><br>05: 5, 06: 4, 07: 4, 08 target: 4<br><b>Number of new boat lines – GPS (%)**</b><br>05: 2, 06: 4, 07: 4, 08 target: 13 |
|   | Percentage of revenue generated from new products†<br>Product pipeline‡ | New product – one which has been introduced within the previous two years<br>The number of products in the pipeline due to be launched in the following two years | <b>Revenue from new products (%)</b><br>05: 5, 06: 4, 07: 4, 08 target: 4<br><b>Product pipeline (number)</b><br>05: 0, 06: 1, 07: 1, 08 target: 2   |
| <b>Operational excellence</b><br>Accountable director: John Collins<br>See pages 30 and 36.   | Operating margin – AWB, GPS   | Operating margin, at the operating division level, is the ratio of operating profit to revenue expressed as a percentage excluding head office costs              | <b>Operating margin – AWB (%)</b><br>05: 18, 06: 15, 07: 14, 08 target: 14<br><b>Operating margin – GPS (%)**</b><br>05: 9, 06: 6, 07: 8, 08 target: 8   |
|   | Raw material cost per unit – AWB, GPS                                   | This represents the average material cost per unit  | <b>Raw material cost per unit – AWB (€)</b><br>05: 131, 06: 127, 07: 126, 08 target: 125<br><b>Raw material cost per unit – GPS (€)**</b><br>05: 131, 06: 127, 07: 126, 08 target: 125   |
|   | Stock waste/total stock*  | This metric is calculated on an hourly basis per shift as waste is collected in the refuse skips  | <b>Stock waste/total stock (%)</b><br>05: 1.60, 06: 1.60, 07: 1.60, 08 target: 1.55  |
|   | Employee retention*   | Calculated using the formula: (# staff leaving/average headcount)*100   | <b>Employee retention (%)</b><br>05: 25, 06: 25, 07: 25, 08 target: 25   |

\* Report this information for GPS in 2008. \*\* We have presented trend data for GPS for 2008.

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**Strategy progress statement**

To implement our strategy successfully, we need to be able to measure our progress. Responsibility for developing and implementing each of our two strategic priorities has been assigned to a specific management director whose remuneration is linked to achieving operational objectives. The table below summarises the key performance indicators for each strategic priority, with a measure of our performance to date. We also indicate potential challenges to success and the action we are taking to overcome them.

| Strategic priority  | Key performance indicators  | Definition/source   | Performance  | Potential challenges/ response  |
|---|---|---|--|---|
| <b>1 Market competitiveness</b><br>Accountable director: Richard Black<br>See pages 26 and 34.<br><b>Making the expectations of our customers</b> | Market share – AWB, GPS   | Based on our share of European and North American sales by volume, as reported by the Shipping Alliance Market Review   | <b>Market share – AWB (%)</b><br>05: 22, 06: 22, 07: 22, 08 target: 22<br><b>Market share – GPS (%)**</b><br>05: 2, 06: 3, 07: 4, 08 target: 4   | <b>Disappointing product performance</b><br>Poor forecast and capacity programme focus on quality, TQ2 focus on performance<br><b>Client dependency</b><br>Loss of technical staff<br>Loss of technological advantage<br>Increased client spend<br><b>Production problems</b><br>Poor production<br>See page 30.<br><b>Loss of skilled operations staff</b><br>Dependence on key suppliers<br>Increasing cost of external support<br>See page 30. |
|   | Customer retention*   | The percentage of active customer accounts retained (active customer = one that has made a purchase within the preceding 12 months)                               | <b>Customer retention (%)</b><br>05: 94, 06: 95, 07: 95, 08 target: 94<br><b>Number of new boat lines – AWB, GPS</b><br>05: 5, 06: 4, 07: 4, 08 target: 4<br><b>Number of new boat lines – GPS (%)**</b><br>05: 2, 06: 4, 07: 4, 08 target: 13 |   |
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|   | Raw material cost per unit – AWB, GPS                                   | This represents the average material cost per unit  | <b>Raw material cost per unit – AWB (€)</b><br>05: 131, 06: 127, 07: 126, 08 target: 125<br><b>Raw material cost per unit – GPS (€)**</b><br>05: 131, 06: 127, 07: 126, 08 target: 125   |   |
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|   | Employee retention*   | Calculated using the formula: (# staff leaving/average headcount)*100   | <b>Employee retention (%)</b><br>05: 25, 06: 25, 07: 25, 08 target: 25   |   |

\* Report this information for GPS in 2008. \*\* We have presented trend data for GPS for 2008.

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# RETHINKING THE FINANCIALS

## REVENUE AND COSTS

### The problem

A high level of aggregation is necessary to present the summary information required in financial statements. However, investors require sufficient disaggregation to be able to fully understand and interpret the summary information provided.

In particular, investors want to understand the components of revenue growth. How much is down to organic growth vs. acquisitions? Is the organic growth a result of realising price increases or volume increases due to price cutting?

Likewise, allocating costs into big buckets impedes investors' insight into the company's cost structure.

### What investors want

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An understanding of revenue growth by price vs volume, organic vs acquired.

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Analysis of costs by function (eg 'Cost of goods sold') in the profit and loss statements.

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Analysis of costs by nature (eg 'Raw materials', 'Labour costs') in the notes – and greater granularity in this analysis.

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Limited use of bucket categories such as 'Other'.

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Non-recurring or 'lumpy' costs split out, with adequate disclosure of their nature.

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Providing sufficient granularity of revenue and costs is essential if investors are to understand and interpret the underlying economics.



## What we've done to make it work

Outlined the key drivers of revenue growth during the year.

Analysed the nature of both 'Cost of goods sold' and 'Administration and distribution expenses' in the notes.

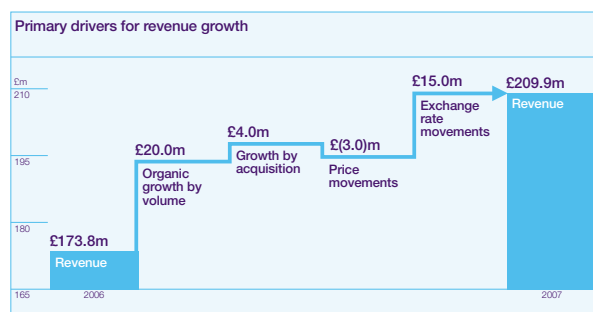
Provided cross-references to further disclosure of the components of these costs arising from movements on provisions. In our example, bad debts expense and cost of warranties are reconciled to movements in these provisions.

Ensured, as a rule of thumb, that 'Other' doesn't constitute more than 10% of the total expense category, and does not contain any single item larger than the smallest item disclosed separately.

Highlighted non-recurring expenses and indicated the likelihood of such expenses recurring in the future.

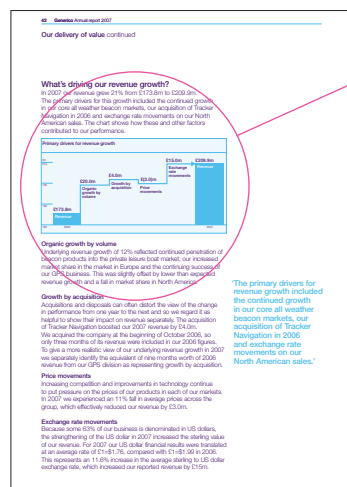
### What's driving our revenue growth?

Our revenue grew 21% from £173.8m to £209.9m. The primary drivers for this growth included the continued growth in our core all weather beacon markets, our acquisition of Tracker Navigation in 2006 and exchange rate movements on our North American sales. The chart shows how these and other factors contributed to our performance.



### Organic growth by volume

Underlying revenue growth of 12% reflected continued penetration of our beacon products into the private leisure boat market, our increased market share in the market in Europe and the continuing success of our business. This was slightly offset by lower than expected growth in our business. This was slightly offset by lower than expected growth in our business. This was slightly offset by lower than expected growth in our business.



This screenshot displays the '2 Segment information continued' section, showing a detailed breakdown of revenue and costs by segment (Europe, North America, and Group total) for the years ended 31 December 2007 and 2006. It includes various line items such as revenue, cost of sales, and administrative expenses.

### Geographical segmentation

The segment, AWB, operates in two geographical areas. The segment, AWB, operates in two geographical areas. The segment, AWB, operates in two geographical areas.

|                | Year ended 31 December 2007 |               |             | Year ended 31 December 2006 |               |
|----------------|-----------------------------|---------------|-------------|-----------------------------|---------------|
|                | Europe                      | North America | Group total | Europe                      | North America |
| Revenue        | 78,277                      | 131,614       | 209,891     | 62,194                      | 111,648       |
| Cost of sales  | 64,670                      | 55,635        | 120,305     | 56,417                      | 48,731        |
| Net investment | 2,466                       | 4,073         | 6,539       | 2,260                       | 3,482         |

This segment information should be read in conjunction with the information set out on pages 26 to 33 relating to All Weather Beacons, and on pages 34 to 37 for Global Positioning Systems.

### 3 Costs breakdown

| Cost of sales                            | Note | 2007<br>£'000  | 2006<br>£'000 | % change   |
|--|------|----------------|---------------|------------|
| Raw materials                            |      | 90,473         | 72,712        | 24%        |
| Cost of warranties                       | 14   | 4,730          | 4,154         | 14%        |
| Inventory write-down                     |      | 421            | —             | —          |
| Wages and salaries                       |      | 9,962          | 9,120         | 9%         |
| Operating lease payments                 |      | 1,124          | 892           | 26%        |
| Post retirement benefits*                |      | 1,541          | 1,246         | 24%        |
| Depreciation and amortisation†           |      | 5,214          | 4,830         | 8%         |
| Other                                    |      | 1,968          | 1,788         | 10%        |
| <b>Total cost of sales</b>               |      | <b>115,433</b> | <b>94,742</b> | <b>22%</b> |
| Administration and distribution expenses | Note | 2007<br>£'000  | 2006<br>£'000 | change     |
| Production and storage                   |      | 41,841         | 36,347        | 15%        |
| Marketing                                |      | 3,824          | 2,998         | 26%        |
| Bad debts                                | 11   | 2,574          | 1,091         | 135%       |
| Research and development                 |      | 3,145          | 3,145         | 0%         |
| Accounting and administrative staff      |      | 5,580          | 5,580         | 0%         |
| Other                                    |      | 1,091          | 1,091         | 0%         |

# RETHINKING THE FINANCIALS

## SEGMENTAL DISCLOSURE

### The problem

A good understanding of performance by segment is fundamental for assessing which areas of a business are most productive and where value is – or isn't – being added.

Current levels of segmental disclosure are typically not sufficient to allow investors to build their models and evaluate performance appropriately.

Segmental information is provided in both the front and back sections of the annual report. However, there is not always consistency in how the segments are defined. Furthermore, in some cases managers try to simplify the picture by aggregating numerous segments whose risk and reward profiles may be very different.

As with revenue and costs, the devil is in the detail. Greater granularity will add force to a strong story and highlight the flaws in a weak one.

### What investors want

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Consistent definition of each segment and, accordingly, the information provided in both the front and back sections of the annual report.

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Presentation of a sufficient number of reportable segments to reflect the differing risk and reward profiles.

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For each segment more detailed information on:

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→ Performance.

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→ Assets and liabilities.

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→ R&D by division.

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→ Return on capital employed.

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→ Free cash flow.

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Current levels of disclosure are typically not enough to let investors evaluate performance appropriately.

## What we've done to make it work

Established consistency in the definition of the segments throughout the report.

Provided context for understanding the strategy and performance by segment in the front section of the annual report.

Presented as many segments as possible within the primary segmental analysis.

Split out head office costs, rather than allocating them across the other segments.

Provided greater segmental data to facilitate investors' modelling of an entity's cash flows and sum-of-parts valuations.

...to address the following questions:  
 - What are we doing to deliver our strategy in each division?  
 - How will we increase sales volumes, keep pricing competitive, grow margins and develop the next-generation of products?

### Key points

Delivering value through:

#### Market competitiveness

**AWB** – competing aggressively on price, quality and delivery

**GPS** – growing sales, market share, new features

#### Operational excellence

**AWB** – halting decline in margins

**GPS** – growing operating margins

|  |               |               |                |                |                |
|--|---------------|---------------|----------------|----------------|----------------|
|  | 3,900         | –             | 3,900          | 336            |                |
| Other segment assets                             | 54,158        | 55,635        | 109,793        | 3,659          | 11             |
| <b>Total segment assets</b>                      | <b>58,058</b> | <b>55,635</b> | <b>113,693</b> | <b>3,989</b>   | <b>117,682</b> |
| Head office assets                               |               |               |                | 2,623          |                |
| <b>Total assets</b>                              |               |               |                | <b>120,305</b> |                |
| <b>Total segment liabilities</b>                 | <b>22,928</b> | <b>8,377</b>  | <b>31,305</b>  | <b>2,529</b>   | <b>33,834</b>  |
| Head office liabilities and tax                  |               |               |                | 38,795         |                |
| <b>Total liabilities</b>                         |               |               |                | <b>72,629</b>  |                |
| <b>Depreciation and amortisation</b>             | <b>2,952</b>  | <b>3,062</b>  | <b>6,014</b>   | <b>74</b>      | <b>6,088</b>   |
| <b>Capital investment</b>                        | <b>2,381</b>  | <b>4,073</b>  | <b>6,454</b>   | <b>85</b>      | <b>6,539</b>   |
| <b>Acquisition of subsidiary</b>                 | <b>4,000</b>  | <b>–</b>      | <b>4,000</b>   | <b>–</b>       | <b>4,000</b>   |
| <b>Return on net assets employed, before tax</b> | <b>25.4%</b>  | <b>35.1%</b>  | <b>34.7%</b>   | <b>53.8%</b>   | <b>26.6%</b>   |
| <b>Free cash flow by segment</b>                 | <b>8,543</b>  | <b>15,991</b> | <b>24,534</b>  | <b>889</b>     | <b>25,423</b>  |
| Head office, financing and tax cash flows        |               |               |                | (10,778)       |                |
| <b>Total free cash flow*</b>                     |               |               |                | <b>14,645</b>  |                |

\* Free cash flow is a **NON-GAAP** measure, see Note 21 for a reconciliation to GAAP

### 2 Segment information

#### (a) Primary segment – by business unit

The group determines its reportable segments based on the structure of the internal financial reports that are used by senior management for decision-making purposes. As at 31 December 2007, the group is organised into two main business segments:  
 (i) Manufacture and sale of all-weather balloons (AWB) in Europe and North America.  
 AWB devices form a local location to rescue services.  
 (ii) Manufacture and sale of global positioning systems (GPS) in Europe. GPS devices enable users to identify their location and navigate easily and accurately.

|   | AWB           |               | GPS            |              | Total          |              |
|---|---------------|---------------|----------------|--------------|----------------|--------------|
|   | Revenue       | Profit        | Revenue        | Profit       | Revenue        | Profit       |
| Revenue                                   | 45,486        | 101,884       | 208,710        | 6,776        | 254,196        | 108,660      |
| Cost of goods sold                        | (26,476)      | (26,486)      | (108,725)      | (5,766)      | (135,201)      | (32,252)     |
| Gross profit                              | 19,010        | 75,398        | 100,000        | 1,010        | 119,010        | 76,408       |
| Operating profit                          | 19,010        | 75,398        | 100,000        | 1,010        | 119,010        | 76,408       |
| Profit before tax                         | 19,010        | 75,398        | 100,000        | 1,010        | 119,010        | 76,408       |
| Profit after tax                          | 14,258        | 56,548        | 75,000         | 750          | 89,258         | 57,298       |
| Other segment assets                      | 54,158        | 55,635        | 109,793        | 3,659        | 117,682        | 3,659        |
| Head office assets                        |               |               |                |              | 2,623          |              |
| <b>Total assets</b>                       | <b>58,058</b> | <b>55,635</b> | <b>113,693</b> | <b>3,989</b> | <b>117,682</b> | <b>3,659</b> |
| Other segment liabilities                 | 22,928        | 8,377         | 31,305         | 2,529        | 33,834         | 2,529        |
| Head office liabilities and tax           |               |               |                |              | 38,795         |              |
| <b>Total liabilities</b>                  | <b>22,928</b> | <b>8,377</b>  | <b>31,305</b>  | <b>2,529</b> | <b>72,629</b>  | <b>2,529</b> |
| Depreciation and amortisation             | 2,952         | 3,062         | 6,014          | 74           | 6,088          | 74           |
| Capital investment                        | 2,381         | 4,073         | 6,454          | 85           | 6,539          | 85           |
| Acquisition of subsidiary                 | 4,000         | –             | 4,000          | –            | 4,000          | –            |
| Return on net assets employed, before tax | 25.4%         | 35.1%         | 34.7%          | 53.8%        | 26.6%          | 17.8%        |
| Free cash flow by segment                 | 8,543         | 15,991        | 24,534         | 889          | 25,423         | 6,600        |
| Head office, financing and tax cash flows |               |               |                |              | (10,778)       |              |
| <b>Total free cash flow*</b>              |               |               |                |              | <b>14,645</b>  |              |

\* Free cash flow is a **NON-GAAP** measure, see Note 21 for a reconciliation to GAAP

### Our strategy in action

We're encouraged by our AWB division's revenue growth, but to build market share we need to improve both competitiveness and operational effectiveness.

The GPS division's share and margins are growing well, in a fast-expanding market, and we aim to keep both growing strongly.

In this section we address the following questions:

- What are we doing to deliver our strategy in each division?
- How will we increase sales volumes, keep pricing competitive, grow margins and develop the next-generation of products?

#### Key points

Delivering value through:

#### Market competitiveness

**AWB** – competing aggressively on price, quality and delivery

**GPS** – growing sales, market share, new features

#### Operational excellence

**AWB** – halting decline in margins

**GPS** – growing operating margins

# RETHINKING THE FINANCIALS

## PENSIONS

### The problem

Defined benefit pensions and other post-employment costs are a significant liability for most companies. Understanding these liabilities is essential for investors.

Falling bond yields and increasing life expectancy are driving these liabilities higher, but too often the disclosures in relation to pension liabilities are not enough to allow investors and analysts to assess the impact of changes of these, and other, factors. For example, without information about longevity assumptions it is difficult to truly understand the risks inherent in the scheme, and the chances of increased cash contributions or other action being needed in the future.

Some companies use the 'corridor' approach in their balance sheets – only recognising actuarial gains or losses that exceed 10% of the scheme's assets or liabilities. Others use the 'SORIE' approach whereby the full actuarial deficit is recognised in the balance sheet. Investors prefer the latter, which saves hunting around in the notes to find the full pension deficit.

The emergence of major pension deficits in recent years has greatly sharpened investors' appetite for detail on this previously rather neglected subject. Calculating pension liabilities is a complex and highly technical business, and it is generally in companies' own interest to help investors understand.

### What investors want

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Sufficient information about the principal assumptions to allow an understanding of the inherent uncertainties affecting the calculation of the scheme's assets and liabilities.

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Sensitivity analysis for the principal assumptions used to measure the scheme's liabilities.

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Information that enables an understanding of the funding obligations going forward.

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Investors want to appraise the chances of increased cash contributions or other action being needed in the future.

## What we've done to make it work

Provided alternative views of the pension deficit in the front section of the annual report.

Graphically presented the volatility of aggregate UK pension deficits over a three year period as context for understanding the volatility of the group's own pension deficits.

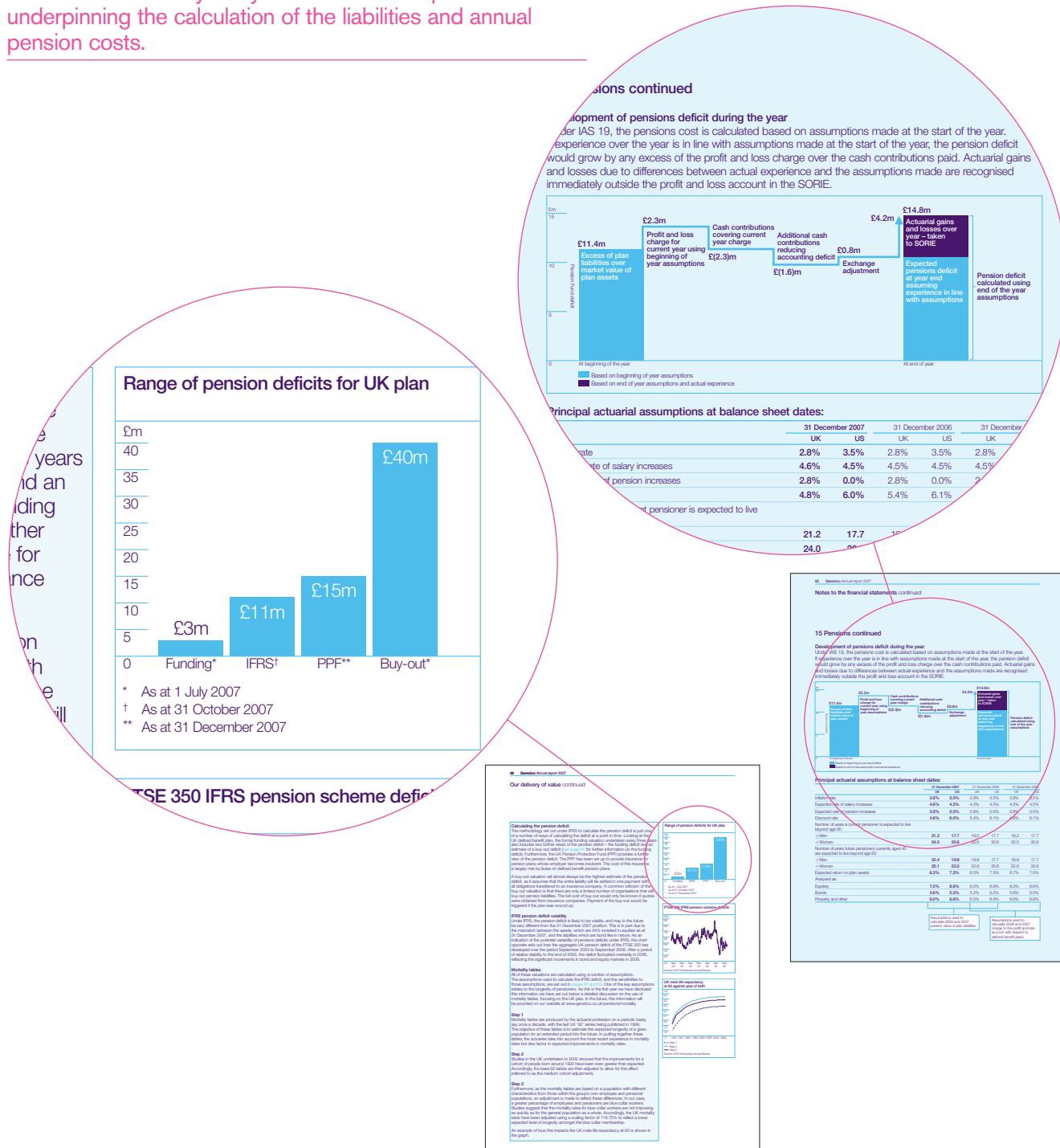
Explained the mortality tables in more accessible, less technical language.

Supported the accounting policy note for pensions and other post-retirement benefits with explanations of key terms in plain English.

Provided alternative presentation of information, eg both graphics and tables.

Located all the assumptions in one table.

Provided a sensitivity analysis of main assumptions underpinning the calculation of the liabilities and annual pension costs.



# RETHINKING THE FINANCIALS

## ANALYSIS OF NET DEBT

### The problem

Investors want a clear picture of a company's debt position in order to understand management's plans for servicing it and any risks associated with it.

Companies do give information about how they are funded in their annual reports. But it tends to be scattered throughout the financial statements and is frequently presented without details of individual liabilities. In addition, some of the critical information relating to debt isn't provided in the annual report at all – investors get the information outside the regulatory model.

The problem of determining a company's credit risk profile is even greater if it has a number of subsidiaries. In this case, investors need a clear debt profile of the group and its individual business units, as well as an understanding of any restrictions on the transfer of funds between business units.

Investors' view of debt does not stop at financial instruments. They want to know about other debt-like liabilities. These could include revenues paid in advance by customers, operating leases, pensions, or other liabilities such as decommissioning costs that could trigger major cash outflows in the future.

So we've created a new analysis of net debt that incorporates financial debt, operating debt in off balance sheet leases, and other debt-like liabilities. Investors believe all instruments that the company views as debt should be incorporated in this statement – including instruments that IFRS classifies as equity. By the same token, instruments that IFRS classifies as debt but the company sees as equity should be excluded. Some might argue that this analysis should become an additional primary statement – something for the standard setters to ponder . . .

### What investors want

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A comprehensive net debt analysis incorporating net debt from financing, operations and other debt-like liabilities.

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A comprehensive maturity table for all components of debt, showing both the contractual maturity of each debt and when management expects it to be repaid.

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Analysis of debt by currency and by subsidiary.

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Details of collateral and any restrictions over debt.

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A net debt reconciliation.

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Investors want to be able to understand and reconcile net debt movements year on year.

## What we've done to make it work

Brought all debts together into a single analysis.

Included management's non-GAAP definition of net debt.

Reconciled the cash flow statement to movements in each type of net debt.

Analysed net debt into its various components – financing, operating and other debt-like liabilities.

Reconciled annual movements for each type of debt.

Explained how the debts will unwind.

Provided a comprehensive analysis of borrowings including information about both contractual and expected maturity dates.

Disclosed more details of borrowings such as currency, source and a breakdown by business unit.

