GROUP CHIEF EXECUTIVE'S REVIEW OF OPERATIONS

This financial year has been a difficult period for the Group, which was affected by a number of operational issues, as well as a sudden and severe downturn in the world market for machine tools.

At the time of my appointment in August 2008, it was clear that both the cost infrastructure of the Group and the machine tools' supply chain were in need of urgent attention. Some cost reduction initiatives had started in the early part of the year. However, as I mentioned at the time of our Interim Management Statement in February 2009, considerable action has been taken and continues to be required to effect transformational change within the Group's operations, whilst concurrently taking additional defensive actions in light of depressed market conditions.

Sales revenue reduced by 2% in the year as a whole but showed a greater decline in the second half of the year with a particularly disappointing final quarter. The Group generated a loss from operations before restructuring costs, costs in relation to closed operations and impairment of intangible assets of £2.2 million in the year, much of this in the second half. Exceptional costs and other non cash costs relate to the cost of restructuring and discontinued products. Additionally, other charges have been made as a result of moving to a simpler business model and the need to account for costs associated with operating units, historically managed as independent entities.

The restructuring costs incurred in the year were internally financed from working capital improvements and the Group's global banking facilities.

My immediate priority is to deliver an effective turnaround of the Group's operations. This will fully occupy our management teams during the first half of the current financial year. We hope that economic conditions will improve to provide an environment in which we can drive the organic development of the business. In the absence of any encouraging indicators, however, we will consider acquiring other businesses, subject to the availability of finance, which could enhance earnings and sit comfortably within the framework we are creating.

Markets

Machine Tools

The world market for machine tools experienced a sharp downturn during the second half of the year. The initial impact was in the area of CNC machines, where demand for higher specification products reduced sharply. Automotive manufacturing is a major driver in this area and has a strong influence on second tier component suppliers with whom we conduct much of our higher end CNC business. The demand for conventional, non CNC machines, whilst reduced, has been less adversely affected and we continue to receive orders in most of our territories from distributors servicing the education sector in particular. The demand for high precision bearings held up during the year, although there is currently some evidence of customers rescheduling their future requirements. The market for workholding products was reasonable for much of the year but deteriorated during the final quarter.

As previously reported, the Group outsourced a large part of its production and supply from China, which was a significant feature of the original strategy for 2008. Regrettably, quality standards we had originally envisaged were not achieved, despite a major effort by our own engineering and quality teams to support this initiative. This resulted in machines being shipped to customers which, in many cases, led to an unacceptable level of warranty claims. These costs are fully accounted for in the year under review. Stocks of machines have been returned to the supplier in question and, under these circumstances, it was not possible to proceed with the previously announced joint venture agreement for Europe.

Supply has been switched to alternative sources which have, in the past, produced machines to a high standard for the Group. Whilst the manufacturing costs are somewhat greater, this is the optimum solution for the Group after the total cost of quality is taken into account. These changes to the supply chain began during the fourth quarter of the last financial year and the full effects will feed through during the second quarter of the current financial year.

The product strategy of the Group is also being developed in line with the move to a simpler business model. Product sourcing is now under the control of a single product management team, working on behalf of the entire Group. Most of our sales and marketing effort will be directed towards our own brands, although we will continue to sell a limited number of other products, where these are complementary to our core ranges.

Geographically, our target markets continue to be Europe and North America, supported by our activities in Australia, Africa, the Middle East and the Indian subcontinent.

Bearings and workholding continue to form a valuable part of our overall product offering and now sit within the Machine Tools Division together with spares and service.

Laser Marking

During the course of the year, the business did not experience the same level of downturn as that experienced by machine tools. The mix of customers is not dependent upon any one sector and ranges from general industrial through to pharmaceutical. Some notable projects were won in the year, both in the UK and the US. Germany is also becoming an increasingly important market.

The Raptor range, based on our in house laser technology, has continued to make progress in sales volume terms. Since passing through the initial industrialisation phase, further value engineering has taken place to reduce the material cost and improve margins. Our objective for the laser marking business is to sell an increasing share of standard products whilst still retaining the capability to supply a range of other lasers for specialist applications. Following the success of the 10W Raptor, a 20W version is now under active development.

Review of operations

United Kingdom

Overheads were reduced in all the UK businesses during the second half of the year as it became clear that order intake was slowing. Following a period of strategic review, a new structure was designed for the UK machine tools businesses. From a market point of view, the sales and product management teams are now focused on areas of the business where we have the greatest likelihood of success in the short to medium term.

Operationally, we had too much space on three sites which was not being fully utilised. We therefore took the decision to close 600 Centre in Shepshed, Leicestershire, and transfer the showroom and back office functions to our principal site in Heckmondwike, West Yorkshire. The 600 Centre building is in a good location close to the M1 and will be sold or leased when market conditions permit.

The Dalian office in China, which was a cost centre of the UK machine tools business, was closed as the new supply chain arrangements were put in place.

The Pratt Burnerd factory in Halifax is 12 miles from the site in Heckmondwike. Operations from Halifax are in the process of being transferred to Heckmondwike. This will result in the elimination of establishment costs and, combined with the existing, but underutilised, machining facilities in Heckmondwike, will provide us with a first class machining facility where labour can be more effectively utilised in one large plant. Some additional investments are being made in order that previously outsourced product can, in future, be produced within the new unit.

Employee numbers were unfortunately reduced, partly as a result of these measures, but also in response to deteriorating demand. Short time working and a reduction in the hourly rate of pay were also agreed with employee representatives, as short term measures, in order to reduce payroll costs during this downturn.

Investments are being made at Gamet to support the expansion of production in the Colchester plant for high precision bearings. This will enable the business to reduce lead times and compete more effectively in the future.

At Electrox, the small office in Singapore was closed. Whilst some overheads were reduced in the UK, most work has been put into maintaining sales volume and increasing margins by reducing material costs for standard products. The challenge for Electrox is to improve its time to market for current developments and there are a number of initiatives in the pipeline.

Germany

Germany was affected by quality issues on China sourced machines which resulted in high warranty costs during the year. Further, in advance of the proposed joint venture agreement being formally signed with DMTG, an additional building with warehouse was leased in Ditzingen, near Stuttgart. As the joint venture could no longer proceed, the existing Parat operation was transferred into the new Ditzingen facility and staff recruited, specifically to sell Dalian branded machines, were made redundant.

Germany, as an economy, is heavily orientated to the automotive and engineering industries and is currently going through a very difficult period. Nevertheless, demand for the Parat tool holder product, along with Colchester Harrison machines and spares, performed for most of the year in line with expectations.

North America

In line with other world markets, the demand for CNC machines fell away sharply. The economic mood in the US is very subdued and this is not helped by the constant stream of bad news from the automotive sector which is still a major driver for our machine tools business. There was some optimism from within the oil production sector with an increase in demand for large swing lathes and large chucks. This side of the business is heavily dependent upon the price of oil remaining at a level to justify domestic production.

Sales of Clausing conventional products generally held up well during the year, although the business was affected by supply chain shortages. Warranty and other associated costs of quality had an adverse impact on operating profit and absorbed too much management time during the year.

Clausing has an extensive installed base of machines in the US which is serviced from our spares operation in Indiana. Work continued throughout the year on the development of a web based ordering system and, subject to satisfactory experience in the US, our intention is to roll out this initiative elsewhere in the Group.

Pratt Burnerd America had an excellent start to the year, but was subsequently caught in the downturn within its traditional markets, in addition to oil price related project deferral with regard to larger chucks.

The operation that remained in Canada following the disposal of the core part of the Canadian operation in 2008 was focused on the marketing of high precision Japanese machines to component manufacturers servicing automotive and aerospace. This business could not generate enough revenue to cover its costs and was loss making for most of the year. A review of prospects for the next two years held out little hope of improvement. Rather than continue to carry the overhead, sales and working capital risk, the business was closed in February 2009. A sales operation, focused on Group products and managed from our Michigan operation, has now been established.

The Electrox infrastructure in the US was excessive for a business of this size and this structure was reduced along with associated showrooms in a number of locations. Back office functions have been transferred to Michigan. Despite the very difficult market in the US and a lack of confidence in many areas, there continue to be some good sales prospects which we expect to convert during the first half of the current financial year.

Australia

Steps were taken in the early part of the year to reduce costs. The economy seems slightly less affected by the downturn than elsewhere in the world, although the local automotive industry is struggling. Opportunities continue to exist principally for conventional machines destined for the educational sector.

South Africa

The major part of our activity relates to mechanical handling and, in sales volume terms, the business performed in line with our expectations. There was a swing in the year from private construction work to requirements driven by the development of infrastructure. State utilities, such as ESCOM also continue to drive demand. As a distribution business with a workshop facility, the Company will be able to respond quite quickly to changes within individual market segments. Currency fluctuation against the Euro and Sterling continues to be a negative feature of trading in the region.

PLC Costs

We have continued to make significant reductions in central costs during the year. The Leeds head office was vacated in October 2008 and is now up for sale or lease. All PLC activities are now managed from the site in Heckmondwike, which also enables the executive team to be much closer to the operations.

Corporate Social Responsibility

The Group takes its responsibilities seriously towards all its stakeholders, including its employees, the community and the environment. This is more applicable than ever as we steer the Company through this economic downturn. Employees on a number of sites have worked hard during some difficult periods of consultation to ensure that ultimately we have a profitable and growing business. Many sacrifices have been made and, sadly, a number of employees have left the Group during the year.

Following the outcome of the risk survey, which was commissioned in the early part of the current financial year, a full time health and safety manager has been appointed and action plans are being developed for all sites within the Group.

Outlook

The machine tools market is large and diverse and we cannot hope to compete in every sector. We will therefore continue to play to our strengths, which remain in the mid priced CNC and conventional machine sectors along with components and spares.

The laser marking business will improve its time to market and the business will be positioned to capitalise on opportunities as confidence starts to return.

The transformational work which we started in the second half of the year has continued into the current fiscal year. I envisage that a large part of the actions required under the current phase will be completed by the half year, although some subsequent business process integration issues may take a little longer to bed down. I am confident that the actions already implemented, along with the current phase, will allow the Group to trade profitably if current sales levels do not deteriorate further. This will provide a good platform for further development of the Group, exploiting its organic potential, together with any other opportunities which may arise in the future.

David Norman
Group Chief Executive
23 June 2009