



# **WH Smith PLC**

## **Interim Results**

22 April 2004



## WH Smith PLC Interim Results 2003/2004

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1. Performance Review 2003/04 H1 John Warren
  
2. Review of WHSmith Group Kate Swann
  - Hodder Headline
  - WHSmith News
  - UK Travel Retail
  
3. UK High Street Retail Kate Swann
  - Why it has under-performed
  - Areas of focus:
    1. Operating agenda
    2. Culture and structure
    3. Strategic challenges



## Group Financial Summary

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	<u>6 mths to Feb 2004 £m</u>	<u>6 mths to Feb 2003 £m</u>	<u>Growth %</u>
<b>Sales:</b>			
total	1,580	1,564	1%
continuing	1,531	1,474	4%
<b>Pre-tax profit / (loss):</b>			
before exceptional items & goodwill	65	91	-29%
after exceptional items & goodwill	(72)	54	-
<b>Earnings (loss) per share:</b>			
before exceptional items & goodwill	18.0p	26.1p	-31%
after exceptional items & goodwill	(34.4p)	11.0p	-
<b>Interim dividend per share:</b>	4.0p	6.0p	-33%



## Group Sales Performance

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	6 mths to Feb 2004 £m	6 mths to Feb 2003 £m	LFL Growth %
UK Retailing	834	833	-
Aspac	97	81	2%
Publishing	81	77	5%
News Distribution *	587	550	4%
<b>Sales - continuing</b>	<b>1,599</b>	<b>1,541</b>	<b>2%</b>
Internal Sales	(68)	(67)	1%
<b>External Sales</b>	<b>1,531</b>	<b>1,474</b>	<b>2%</b>
US Travel	49	90	
<b>Total Sales</b>	<b>1,580</b>	<b>1,564</b>	

\* LFL adjusted for "red top" discounting In the prior period



## Group Profit Bridge

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	Continuing £m	US Travel £m	Total £m
<b>Profit before tax* – 28 Feb 2003</b>	<b>100</b>	<b>(9)</b>	<b>91</b>
High Street	(33)	-	(33)
UK Travel	1	-	1
Aspac	2	-	2
Publishing	-	-	-
News Distribution	2	-	2
FRS 17 Pensions cost	(1)	-	(1)
Support costs	(1)	-	(1)
US Travel	-	4	4
<b>Profit before tax* – 29 Feb 2004</b>	<b>70</b>	<b>(5)</b>	<b>65</b>
<i>Growth</i>	<i>-30%</i>		<i>-29%</i>

\* PBT stated before exceptional items and goodwill amortisation



## News Distribution Summary

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	2004 £m	2003 £m	Growth %
<b>Sales</b>	<b>587</b>	<b>550</b>	<b>7%</b>
Gross Contribution	65	61	
House costs	(31)	(30)	
Other	(17)	(16)	
<b>PBIT*</b>	<b>17</b>	<b>15</b>	<b>13%</b>
<i>Gross Margin</i>	11.1%	11.1%	-
<i>Net Margin</i>	2.9%	2.7%	+0.2%pts

\* PBIT excluding goodwill amortisation



## ASPAC Retail Summary

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	2004 £m	2003 £m	Growth %
<b>Sales</b>	<b>97</b>	<b>81</b>	<b>20%</b>
Gross Contribution	41	34	
Costs - rent	(12)	(10)	
- store	(15)	(13)	
- other	(7)	(6)	
<b>PBIT</b>	<b>7</b>	<b>5</b>	<b>40%</b>
<i>Gross Margin</i>	42.3%	41.8%	+0.5%pts
<i>Net Margin</i>	7.2%	6.2%	+1.0%pts
Stores	202	199	



## Publishing Summary

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	2004 £m	2003 £m	Growth %
<b>Sales</b>	<b>81</b>	<b>77</b>	<b>5%</b>
COS	(37)	(36)	
Provisions	(5)	(3)	
Gross Contribution	39	38	
Costs - staff	(14)	(13)	
- other	(14)	(14)	
<b>PBIT</b>	<b>11</b>	<b>11</b>	<b>- %</b>
<i>Gross Margin</i>	48.8%	49.5%	-0.7%pts
<i>Net Margin</i>	13.4%	14.7%	-1.3%pts



## UK Retailing Summary

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	2004 £m	2003 £m	Growth %
<b>Sales</b>	<b>834</b>	<b>833</b>	<b>-%</b>
Gross Contribution	315	331	
Costs - rent	(85)	(81)	
- store	(112)	(109)	
- other	(67)	(58)	
<b>PBIT</b>	<b>51</b>	<b>83</b>	<b>-39%</b>
<i>Gross Margin</i>	<i>37.8%</i>	<i>39.8%</i>	<i>-2.0%pts</i>
<i>Net Margin</i>	<i>6.1%</i>	<i>10.0%</i>	<i>-3.9%pts</i>
Stores	678	685	



## UK Retailing Gross Contribution Analysis

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	LFL Sales 6 mths to 28 Feb 2004 %	YoY Gross Margin % pts
Books	-	- 2%
Stationery	2%	- 1%
News and Express	2%	-
Entertainment	- 4%	- 4%
	<u>-</u>	<u>- 2%</u>



## Group Exceptional Items

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	<u>2004</u> £m	<u>2003</u> £m
Operating exceptionals	(75)	(35)
Non-operating (FRS3) exceptionals *	<u>(61)</u>	<u>-</u>
<b>Total exceptionals</b>	<b>(136)</b>	<b>(35)</b>
Goodwill	(1)	(2)
<b>Total exceptionals and goodwill</b>	<b><u>(137)</u></b>	<b><u>(37)</u></b>

\* The current period includes US goodwill £39m previously written off to reserves



## Group Operating Exceptionals

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	<u>£m</u>	<u>Cash £m</u>
UKR stock write down	(45)	(4)
UKR fixed asset impairment	(17)	-
UKR reorganisation & other	(4)	(3)
Publishing author advances provision	(9)	-
	<u>(75)</u>	<u>(7)</u>
Tax relief	<u>9</u>	
<b>Net cost</b>	<u><u>(66)</u></u>	



## USA Non-Operating Exceptionals

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	<u>\$m</u>	<u>£m</u>
Proceeds	70	39
Net assets	(56)	(32)
Costs - Transaction	(11)	(6)
- Closure	(11)	(6)
- Liability liquidation	(31)	(17)
	<u>(39)</u>	<u>(22)</u>
Goodwill previously written off		<u>(39)</u>
<b>Loss on sale (FRS3)</b>		<u><b>(61)</b></u>



## Group Free Cashflow

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	2004 £m	2003 £m
Profit before tax, goodwill and exceptionals	65	91
Depreciation	24	27
Working capital	(50)	(57)
Capital expenditure	(24)	(19)
Tax	(17)	(15)
Provisions spend	-	(1)
Disposal of fixed assets	-	2
<b>Free cash flow</b>	<b>(2)</b>	<b>28</b>



## Group Balance Sheet

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	Feb 2004 £m	Feb 2003 £m	Aug 2003 £m
Goodwill	220	228	228
Fixed assets	250	294	273
Working capital	70	141	94
Tax	(35)	(52)	(39)
Dividends	(10)	(15)	(32)
Provisions	(26)	(25)	(27)
<b>Operating Assets Employed</b>	<b>469</b>	<b>571</b>	<b>497</b>
Net cash	28	31	68
<b>Total Net Assets (excl. Pensions)</b>	<b>497</b>	<b>602</b>	<b>565</b>
Pension liability	(138)	(138)	(156)
<b>Total Net Assets</b>	<b>359</b>	<b>464</b>	<b>409</b>



## Current Trading

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	<u>LFL sales 6 months to 29 Feb 2004</u>	<u>LFL sales 7 wks to 17 April 2004</u>
UK Retailing	-	-1%
Aspac	+2%	+3%
Publishing	+5%	-1%
News Distribution	+4%	+6%



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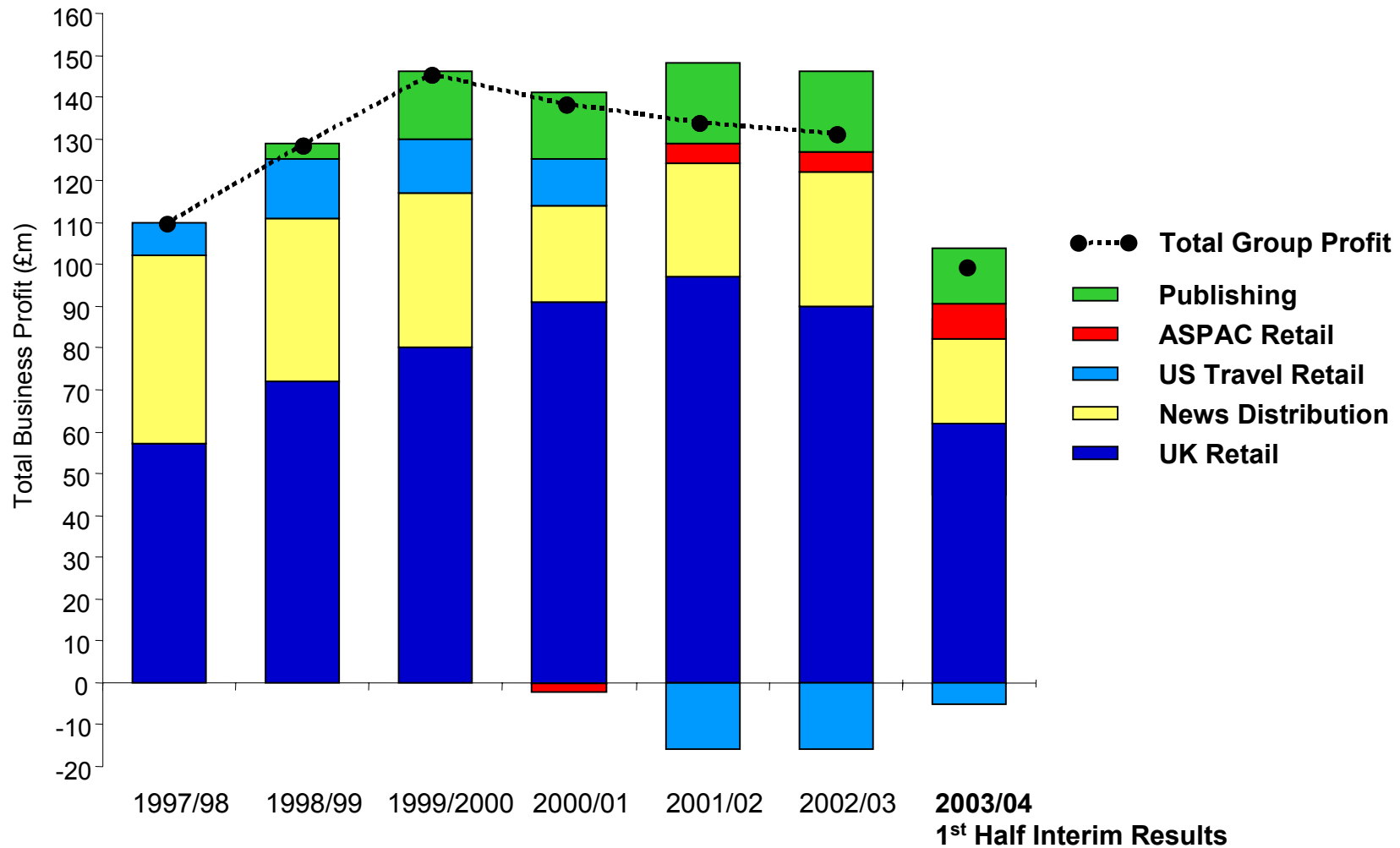
## Group Priorities

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- Simplify the Group – USA and Aspac disposals
- Three key divisions – to deliver profitable, long-term organic growth
- News Industry review
- Assess problems in UK High Street Retail – take appropriate actions
- Develop immediate operating agenda for High Street
- Begin to address strategic challenges of the High Street



## Increasingly complex Group – inconsistent performance





## Review of Publishing

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- Hodder Headline acquired during 'dot com' era
- Sales and profit growth over time
- Small, bolt-on acquisitions delivered well
- Strong market share positions in fiction and high-margin areas of education
  - No 2 in fiction and secondary education
  - No 1 in consumer education and further education
- Responding to challenging market conditions by:
  - Diversifying education portfolio
  - Improving productivity of author advances
  - Reducing high-risk projects
  - Improving targeting of promotional spend
  - Tightening financial controls
- On target performance



## Review of News Distribution

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- Market leading business – market share, systems and customer service
- Improved performance through cost control, increased efficiencies and improved service
- Contract renewal discussions progressing well; Frontline contract agreed
- Working closely with partners and OFT/DTI on news industry review
- Strong 1<sup>st</sup> half performance



## Review of UK Travel Retail

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- Clear position in the UK travel market
- Offer tailored to meet unique demands of travelling customer
- Resilient sales and profit growth
- Separate operating structure with team focused on:
  - Operational efficiency
  - Developing partnerships with landlords
  - Space and range productivity
  - Increased sales through better customer conversion
  - Improving service proposition
- Strong 1st half performance



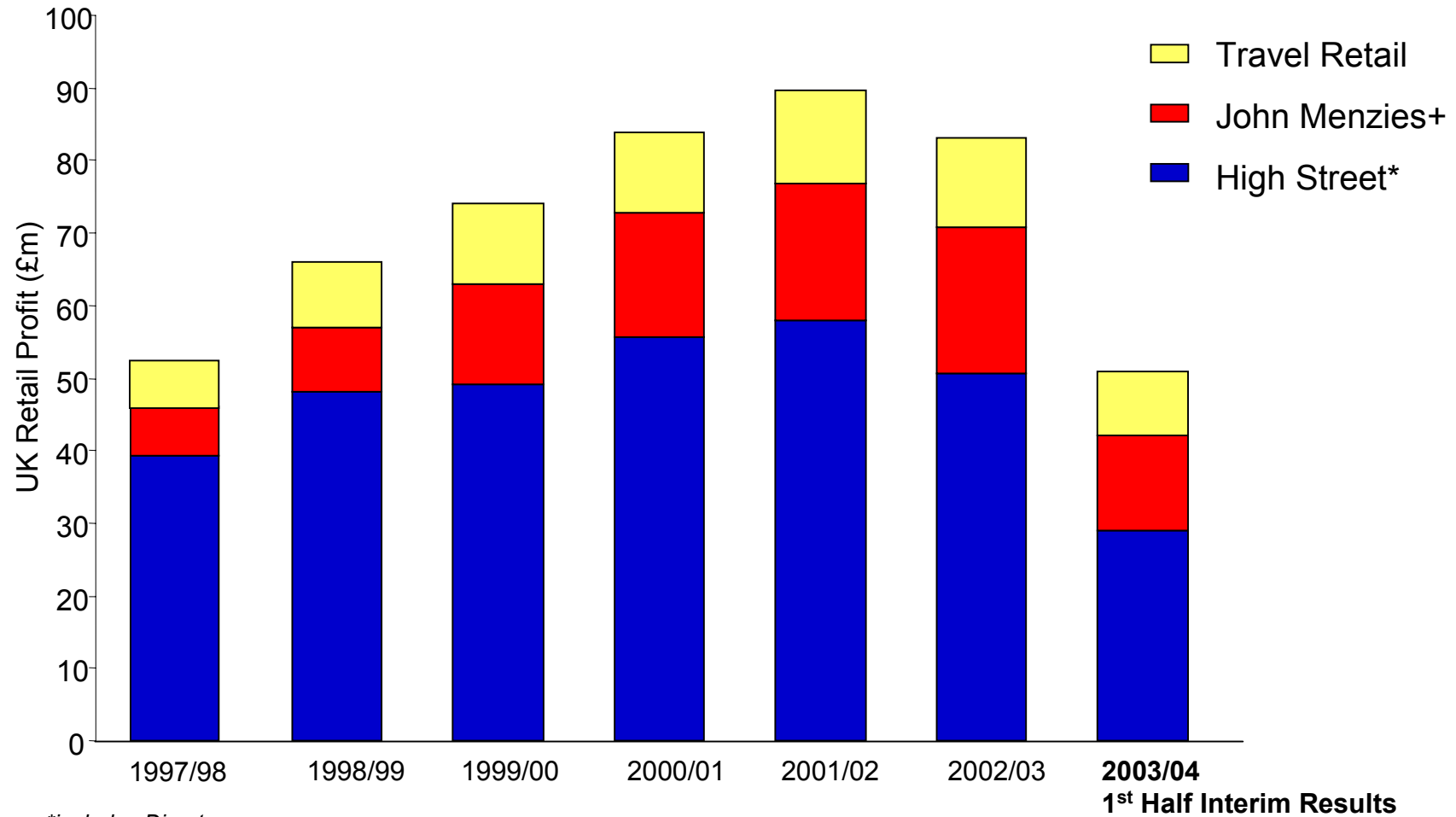
## Review of UK High Street Retail

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1. Underlying business performance weak for several years
2. Strategically challenged and operationally poor performance
3. Three areas of focus
  1. Operating agenda – stabilisation in short and medium term
  2. Culture and structure – creation of simpler, less bureaucratic organisation
  3. Strategic challenge – growth in the longer term - analysis and trials underway
4. Addressing issues will take time



## UK RETAIL - Underlying profit performance poor



\*includes Direct

+Contribution only



## Why the UK Retail High Street business has under-performed

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- Pressure on sales and margin from evolving competitive environment and changing customer behaviour
- Strategic response inadequate, reduced authority on the high street
- Customers confused by changing value proposition
- Compounded by poor operating performance and rising costs
- Complexity, lack of clarity and bureaucracy have led to changing priorities



## AREAS OF FOCUS

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1. Operating agenda
2. Culture and structure
3. Strategic challenge



## **IMMEDIATE OPERATING AGENDA – 5 Key Priorities**

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1. Re-base our costs over time, starting with the central office
2. Address stock availability
3. Improve the offer in store
4. Strengthen controls and processes
5. Address product ranging



## 1. COST BASE

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### **Review**

- Costs rising faster than sales in all key areas
- Central office costs high and uncompetitive with other retailers

### **Actions**

- Organisational review underway
- Process and structure changes
- 270 roles removed from central offices giving annualised savings of £8.5m
- Reviewing other addressable costs



## 2. AVAILABILITY

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### Review

- Availability weak
- Retek issues
- Inadequate measurements
- Warehouse availability poor and in-store availability worse

### Actions

- Systems
  - New IS Director
  - Resolve Retek issues
- Central
  - Processes mapped, accountabilities clear
  - Inventory function integrated
- Stores
  - New in-store disciplines
  - Clear, robust measures



## 3. INSTORE OFFER

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### **Review**

- Store standards and customer conversion levels variable
- Service basics often missing
- Initiatives poorly executed
- Customer communication confused

### **Actions**

- Appointed new Stores Director
- Restructured regions and areas
- Implementing basic store standards and service programme
- Instigated customer communication review



## 4. CONTROLS AND PROCESSES

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### Review

- Controls not integral
- Stock targets inappropriate
- Aged stock management
- Forecasting has been inaccurate
- Investment decision-making

### Actions

- Introduced greater discipline in key areas
- More regular and thorough store stock audits
- Open to buy process and cost of catalogue
- New forecasting process
- Investment focused on existing estate and value creation
- Continuous improvement



## 5. RANGE PLANNING

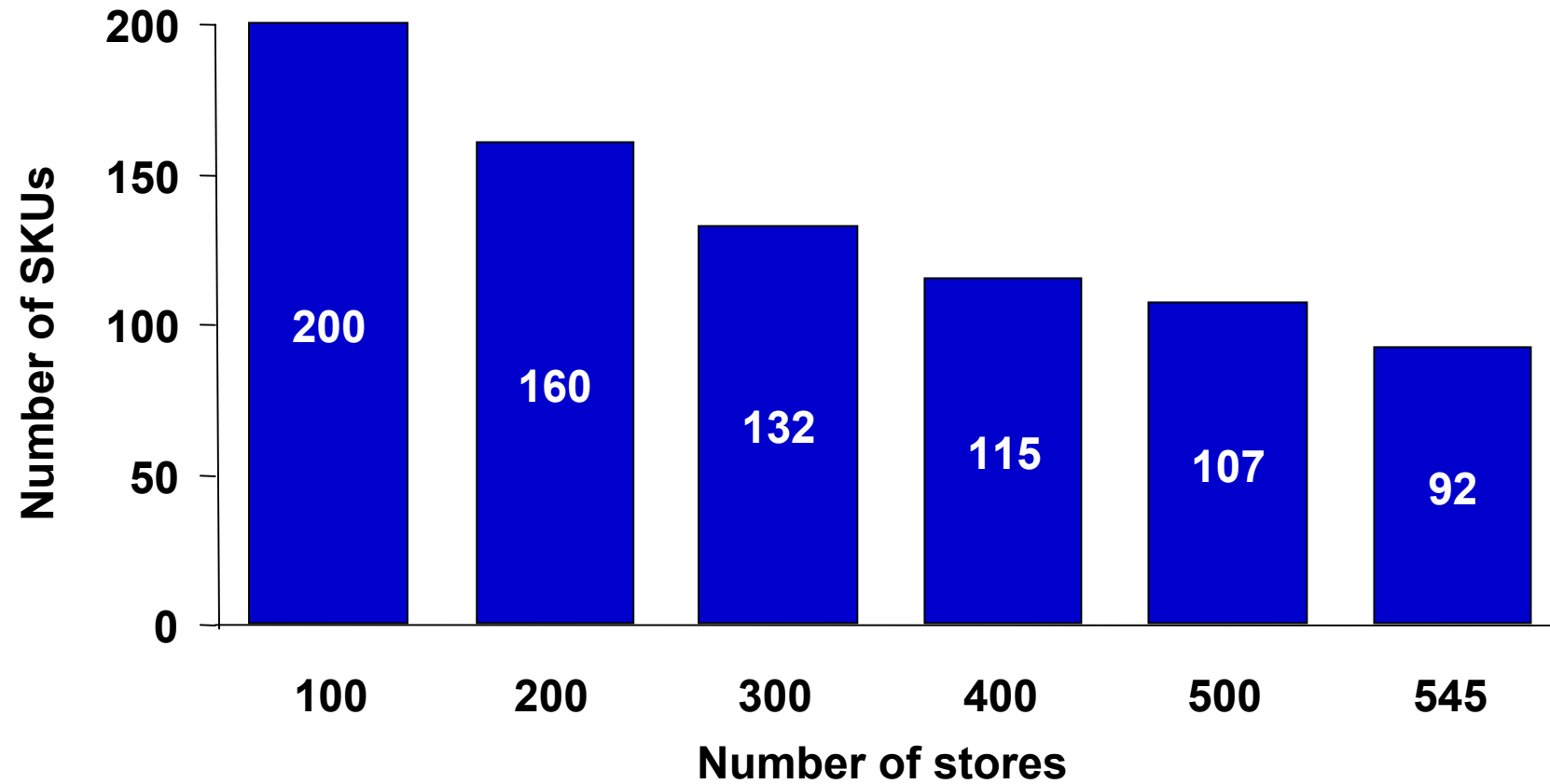
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### Review

- Range planning not implemented
- Range structures out of date
- Range architecture now lacking



## Top 200 Stationery SKUs\*



\*Contribution per store



## 5. RANGE PLANNING

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### Review

- Range planning not implemented
- Range structures out of date
- Range architecture now lacking

### Actions

- Range reviews 12-18 months
- Focus new product development on core ranges
- Best sellers in all stores for Christmas



## **OPERATING AGENDA – SUMMARY**

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- 5 key priorities for balance of year
- Actions to address underway
- Complex issues but solvable
- Important to address now
- Leads naturally to addressing strategic challenges



## **CULTURE AND STRUCTURE**

### **– What I found**

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- Enthusiastic and committed staff
- Desire to do well, lack of clarity around performance
- Complicated structures and processes
- Bureaucratic with priorities constantly changed
- Not enough focus centrally on the customer and stores



## **CULTURE AND STRUCTURE**

### **– reducing bureaucracy**

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- Simpler, clearer leadership structure
- Strengthening team – 4 new directors appointed
- Organisational review clarifies and simplifies accountabilities and processes
- Greater central emphasis on serving customers and stores
- High level of focus on performance
- Much more progress to make



## THE STRATEGIC CHALLENGE – some important positives

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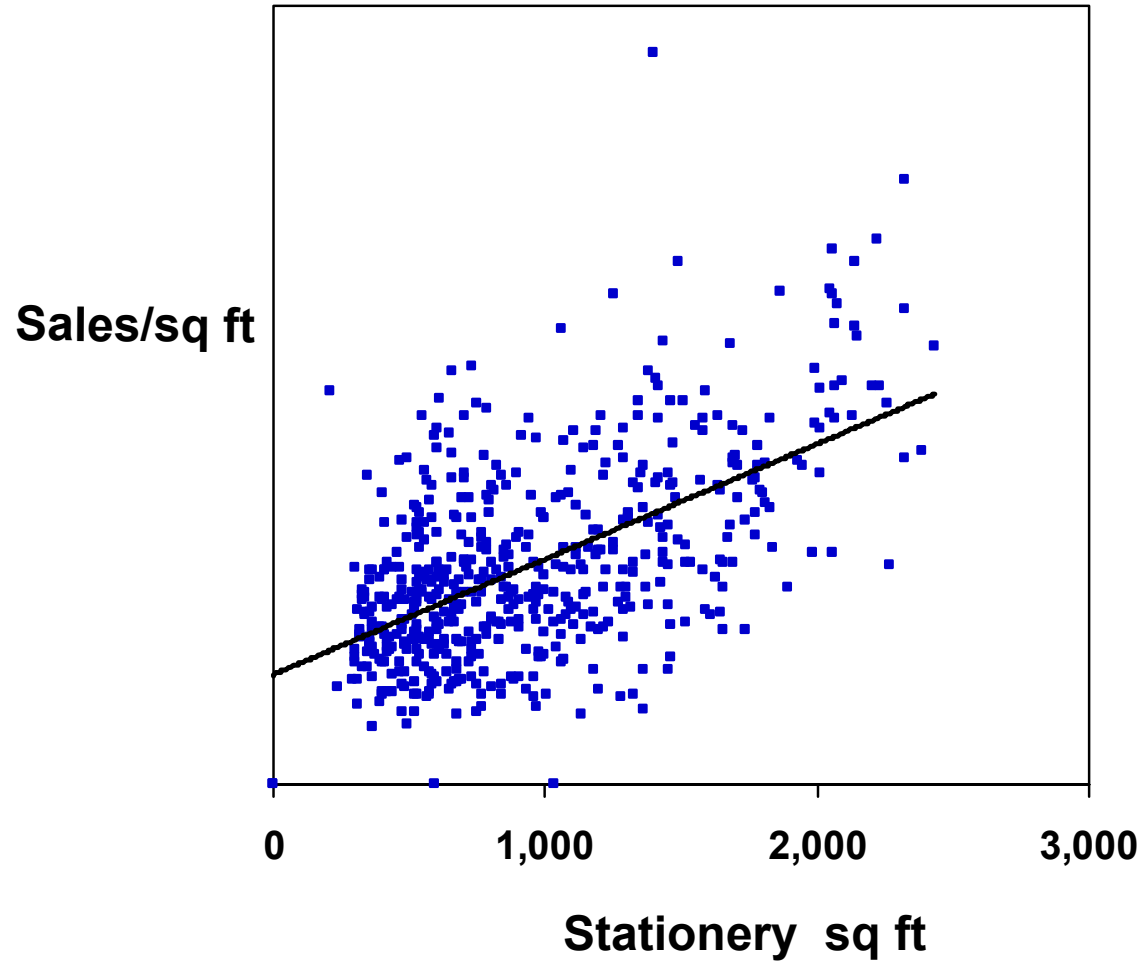
- WHSmith has strong assets on which to build
  - high penetration
  - valuable brand
  - great store locations
- WHSmith has strong category positions
  - 25% market share in books\*
  - 17% share in magazines†
- Consumers shop our categories rather than our stores, therefore compelling offer needs to be constructed by category

Source: \*Bookscan MAT , † WHSN and Surridge Dawson)



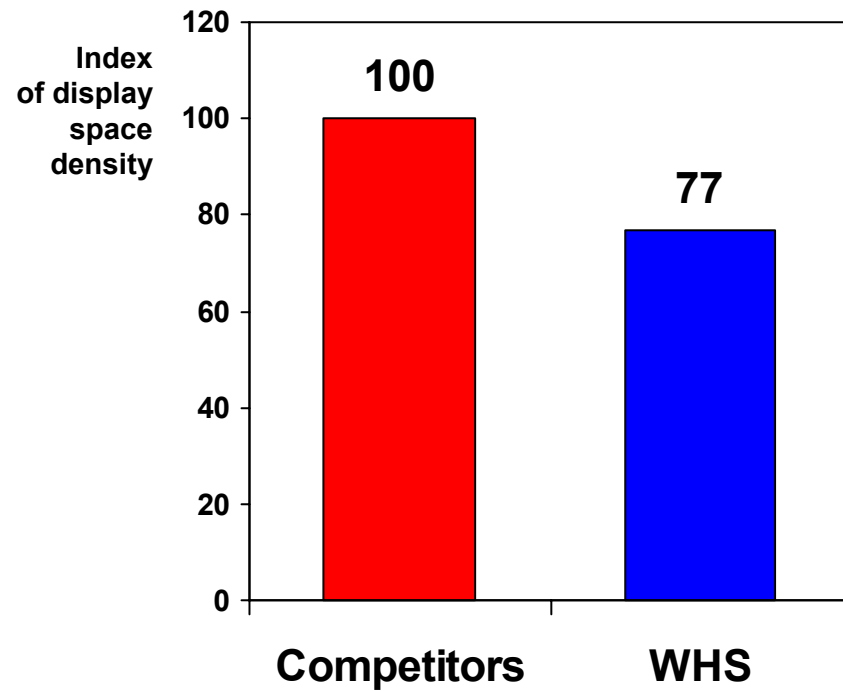
# Stationery

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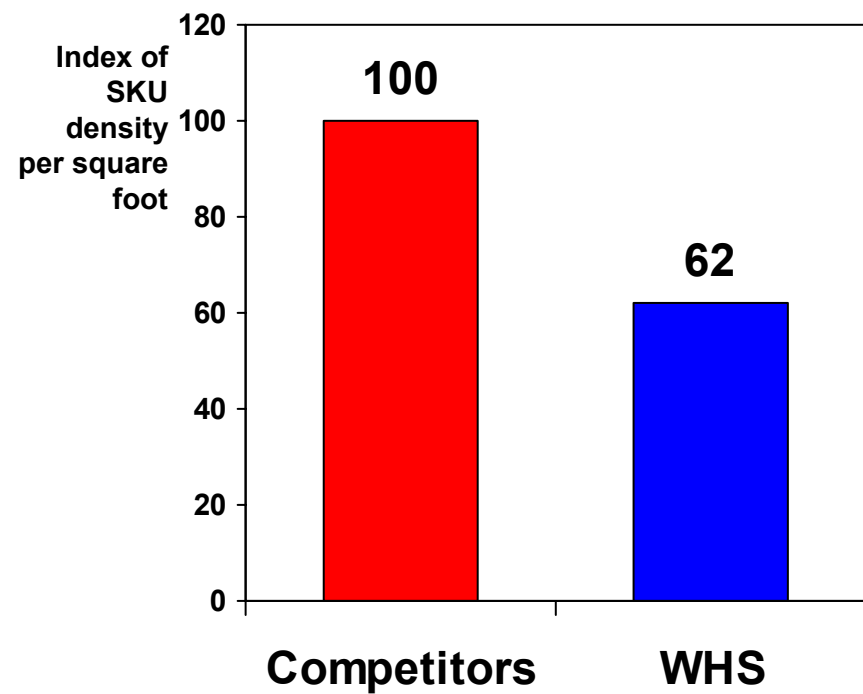




**WHS footprint: display space ratio below competitors**



**WHS SKU density per square foot below competitors**





## THE STRATEGIC CHALLENGE

### – some important positives

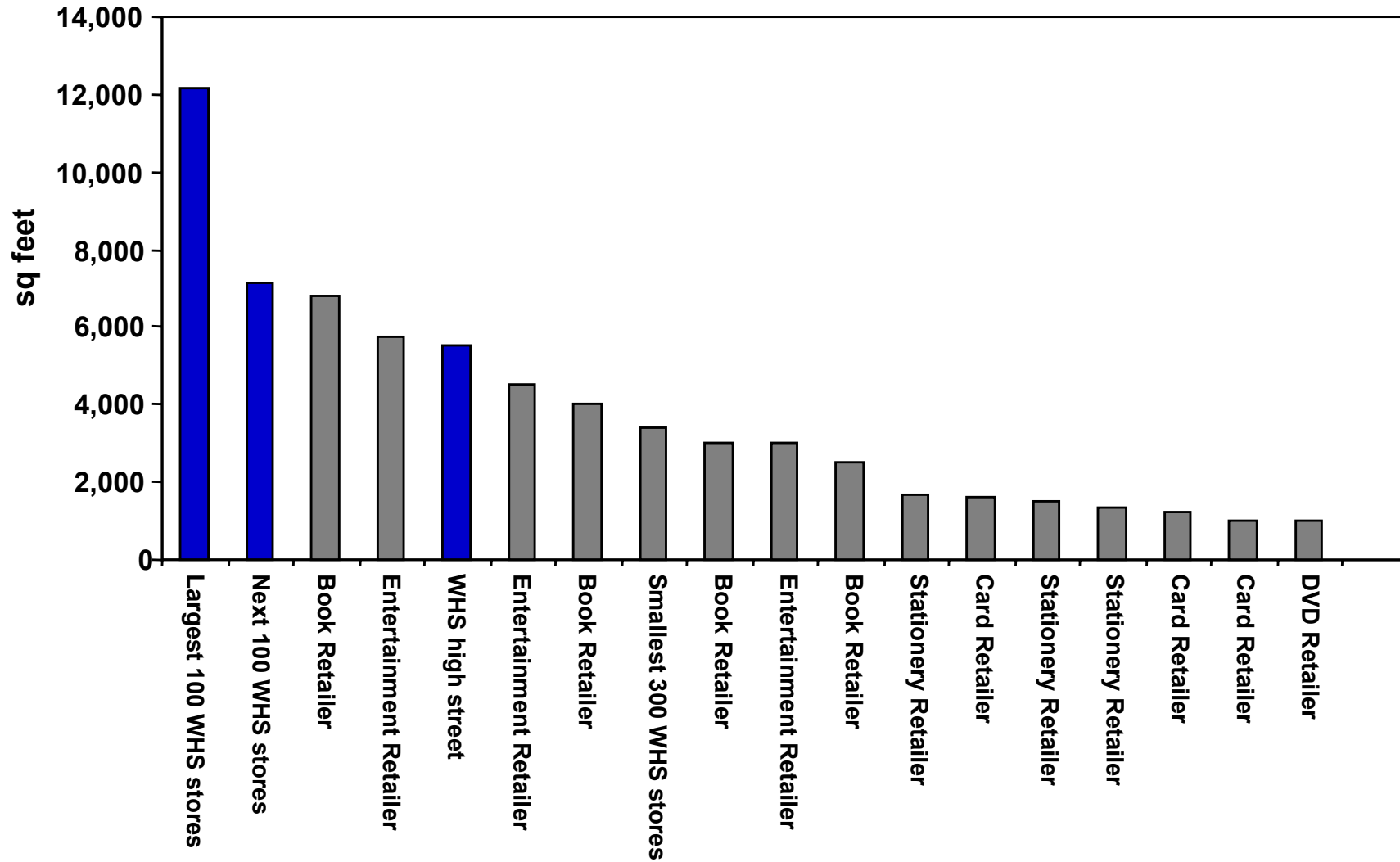
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- WHSmith has strong assets on which to build
  - high penetration
  - valuable brand
  - great store locations
- WHSmith has strong category positions
  - 25% market share in books\*
  - 17% share in magazines†
- Consumers shop our categories rather than our stores, therefore compelling offer needs to be constructed by category
- Advantage needed in key cost areas; good buying scale in books and stationery
- Where we have competitively advantaged economics, we get above-average profitability, however average profitability varies widely by category

Source: \*Bookscan MAT , † WHSN and Surridge Dawson)



## Average store sizes of various competitors on the high street





## THE STRATEGIC CHALLENGE

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- We operate in high consumer interest markets
- Customer behaviour by category and subcategory varies substantially
- Increased competition from supermarkets, internet, specialists is variable by category and catchment
  - e.g. internet has high share of entertainment products but low share in cards
  - e.g. supermarkets compete mainly in front-list products, not back-list
- In many of our categories some high street specialists are succeeding



## MEETING THE STRATEGIC CHALLENGES

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- Develop clear understanding of the current situation
- Determine where and how we want to compete
  - Compelling to consumer
  - Economically advantaged
- Data gathering, analysis and trials underway
- Controlled capital allocation
- Strategic picture is richer than usually portrayed
- Addressable over time



## SUMMARY

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1. Simplified Group structure: three key divisions – valuable assets
2. Good performances from Publishing, News and Travel Retail
3. UK High Street Retail underperformance
4. Implementing change in High Street Retail with clear operating agenda and new executive team
5. Focus on operational execution whilst developing and testing ways to meet strategic challenges