WH SMITH PLC
PRELIMINARY RESULTS ANNOUNCEMENT
FOR THE TWELVE MONTHS ENDED 31 AUGUST 2004

KEY POINTS

Profit before tax, exceptional items and goodwill amortisation in line with market expectations at £67m (2003: £102m).

Exceptional charge before tax of £200m and goodwill amortisation of £2m.

Loss before tax of £135m (2003: profit of £52m).

Total sales of continuing operations up 2% at £2.5bn:
- UK Retail lfl sales down 1%
- News Distribution lfl sales up 4%

Earnings per share before exceptional items and goodwill amortisation down to 18.0p (2003: 29.1p).

Loss per share of 60.7p (2003: earnings per share of 9.4p).

Final dividend of 8p (2003: 13p) making 12p for the full year (2003: 19p).

Group now simplified and focused on its UK Retail and News Distribution businesses.

£207m cash will be returned to shareholders on 29 October 2004.

GROUP CHIEF EXECUTIVE'S COMMENTS:

Commenting on the results, Kate Swann, Group Chief Executive said:

"This has been a poor year for the Group. The High Street Retail business delivered an unacceptable performance following weak Christmas trading, which highlighted the operational shortcomings and underlying strategic challenges to the business. We have strengthened management, reduced the cost base and taken action to reinstate sound retailing disciplines. While we still face considerable challenges, we have begun to position the High Street Retail business to meet these more effectively.

"This has also been a year of substantial change. We have sold our USA Travel Retail, Aspac Retail and Publishing businesses. The Group is now considerably simplified and focused on its core retail and news distribution businesses in the UK.

"Travel Retail has had a strong year of profit growth benefiting from sound retail disciplines and a stable international travel environment.

"News Distribution has delivered another year of steady profit growth through continued focus on improving customer service and making further cost efficiencies.

"Current trading is in line with expectations. Although we are making progress in improving the business, much remains to be done and we expect to face tough competition in our core markets this Christmas."

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CURRENT TRADING

In the 6 weeks to 9 October 2004, High Street Retail's lfl sales are down 2% but gross margin has improved, in line with expectations. Travel Retail's lfl sales are up 4% and News Distribution's lfl sales are up 3%.

FINANCIAL REVIEW

OVERVIEW

While our News Distribution, Publishing, Travel Retail and Aspac Retail businesses delivered good performances during the year, the Group's overall results were poor, driven by underperformance from the High Street Retail business.

In September 2003, we announced the sale of the airport and hotel divisions of the USA Travel Retail business. We successfully completed the sale of these operations in the first half of the year.

In April 2004, we agreed to sell our Aspac Retail business, consisting of businesses in Australia (Angus & Robertson), New Zealand (Whitcoulls) and Hong Kong. This sale was completed at the end of May and our Singapore business was subsequently sold at the end of June 2004.

In August 2004, we reached agreement to dispose of our publishing business, Hodder Headline, to Hachette Livre S.A. and announced our intention to return to shareholders up to £207m of cash, equivalent to 85p per ordinary share. Shareholders approved the disposal and return of cash at an Extraordinary General Meeting on 23 September 2004 and the disposal completed on 25 September 2004.

The Group also announced that following the disposal of Hodder Headline, it would make a cash contribution of £120m to the WHSmith Pension Trust, which will be financed from the Group's own resources and new banking facilities. Annual cash contributions to the WHSmith Pension Trust will be reduced to approximately £21m in the coming year (2004: £42m), which will be the first year of a planned nine-year repayment period.

The Group generated a profit before tax, exceptional items and goodwill amortisation of £67m (2003: £102m). Loss before tax, after exceptional items and goodwill amortisation, was £135m (2003: profit of £52m).

The loss per share was 60.7p (2003: earnings per share of 9.4p) whilst adjusted earnings per share before exceptional items and goodwill amortisation were 18.0p (2003: 29.1p).

Cash generation of the Group was weaker than in previous years, driven by lower cash generation in our UK Retail business. Overall, the Group generated free cash flow[1] of £12m (2003: £61m) and the year-end balance sheet held net cash of £45m (2003: £68m).

Trading results

NB: All divisional profit and loss figures in this and subsequent sections are stated before pension service costs, exceptional items and goodwill amortisation, interest and taxation.

The trading results can be summarised as follows:

£m	2004	2003 Restated[2]	*Growth %*	*LFL Sales Growth %*
Sales				
UK Retail	**1,453**	1,463	*(1%)*	*(1%)[3]*
WHSmith News Distribution	**1,182**	1,115	*6%*	*4%[4]*
Less Internal sales	**(115)**	(109)	*6%*	*4%[4]*
Total Continuing sales	**2,520**	2,469	*2%*	*2%*
USA Travel Retail	**49**	181		
Aspac Retail	**132**	149		
Publishing	**155**	143	*8%*	
Less Internal sales	**(22)**	(22)	*(2%)*	
Total Discontinued sales	**314**	451	*(30%)*	
Total sales	**2,834**	2,920	*(3%)*	

[1] As defined in 'Free cash flow and cash balances' section below
[2] Restatement arising from adoption of Application Note G "Revenue recognition" to Financial Reporting Standard 5 "Substance of Transactions"
[3] UK Retail's sales growth has been adjusted for the impact of new space
[4] News Distribution's sales growth has been adjusted for impact of tabloid newspaper price discounting in the prior period

£m	2004	2003 Restated	*Profit Growth %*
Operating profit			
UK Retail	**44**	90	*(51%)*
WHSmith News Distribution	**35**	32	*9%*
Divisional profit – continuing	**79**	122	*(35%)*
Support functions	**(15)**	(14)	
Internal rents	**1**	3	
Pension service costs	**(14)**	(12)	
Operating profit pre exceptional items and goodwill amortisation - continuing	**51**	99	*(48%)*
USA Travel Retail	**(5)**	(16)	
Aspac Retail	**7**	5	
Publishing	**20**	19	
Pension service costs – Publishing	**(1)**	(1)	
Operating profit pre exceptional items and goodwill amortisation	**72**	106	*(32%)*
Exceptional items – continuing	**(92)**	(18)	
Exceptional items – discontinued	**(9)**	(35)	
Goodwill amortisation - continuing	**(1)**	(2)	
Goodwill amortisation - discontinued	**(1)**	(2)	
Total operating (loss)/profit	**(31)**	49	-

UK RETAIL

The results for the UK Retail business comprise:

£m	2004	2003 Restated	*Growth %*	*LfL Sales Growth %*
Sales				
High Street Retail	**1,145**	1,164	*(2%)*	*(2%)*
Travel Retail	**301**	291	*3%*	*3%*
WHSmith Online	**7**	8		
Total sales	**1,453**	1,463	*(1%)*	*(1%)*
Divisional profit				
High Street Retail	**25**	73	*(66%)*	
Travel Retail	**21**	19	*11%*	
WHSmith Online	**(2)**	(2)	-	
Total divisional profit	**44**	90	*(51%)*	

UK Retail sales fell by 1% to £1,453m (2003: £1,463m). In the High Street Retail business, sales fell by 2% to £1,145m. Sales in Travel Retail grew by 3% to £301m. Divisional profit fell 51% to £44m (2003: £90m).

Book sales fell by 2%, with second half sales down 6% after a flat first half. The key drivers of the sales decline were the release of *Harry Potter and the Order of the Phoenix* last year and our decision not to repeat promotions that had been unprofitable. Stationery sales were up 2% in the year with sales of our core stationery ranges of ‘fashion, lifestyle and essentials’ trading well. News and Express sales were up 2% on last year, driven by new weekly men’s magazine titles, newspaper price discounting in the prior period and improvements in our snacking offer. Excluding the decline in sales of phonecards, sales grew 4%. Entertainment sales fell by 7%, with the continued decline in music, VHS and multimedia sales only partially offset by another strong year for DVDs, up 20%.

Gross profit for the full year decreased by £19m to £554m with the decline in sales being exacerbated by increased pressure on gross margin. Overall, the gross margin rate decreased by a full percentage point compared to last year.

Costs grew ahead of inflation, reflecting, for the first time, the £5m depreciation impact of our investment in the integrated Retek stock management and merchandising system. In addition, Christmas marketing spend increased by £3m on the previous year. These cost increases were offset to a small degree by initial cost savings from the Organisation Review towards the end of the year. Overall, costs grew as a percentage of sales by 2.1 percentage points. Consequently, overall net margin for the UK Retail business decreased by 3.1 percentage points to 3.0%.

The UK Retail business now operates from 673 stores, which occupy 3.3 million square feet. Ten new stores were opened in the year, including seven edge of town stores, in line with plan. Fourteen stores were also closed in the year, the majority of which were small loss-makers.

News Distribution

Total sales increased by 6% to £1,182m (2003: £1,115m). Magazine sales increased by 2%, driven by celebrity titles and a number of new launches, including *Star, Total TV Guide, Nuts* and *Zoo*. Newspapers sales were up 8% buoyed by price increases and book promotions in the first half of the year. Excluding the impact of tabloid price discounting in the prior year, like for like newspaper sales were up 5%.

Partworks were one of the key drivers of growth, with annual sales increasing by 39%. This market strengthened in 2004 as it moved from a seasonal (post-Christmas) market to a year-round industry. Key titles included *Radio Controlled, Make It Groovy* and the *Carry On* series DVDs. Sales of one-shot titles were up by 23%, driven by strong Euro 2004 merchandise sales.

Gross profit increased by £5m to £132m, driven by increased sales volumes and improved product mix. Overall costs grew by 2%, including the closure costs of the Croydon warehouse, but reduced as a percentage of sales by 0.3 percentage points as a result of tight cost control in the news warehouses and at head office. As a result, net margin improved slightly to 3.0% (2003: 2.9%) as divisional profit grew to £35m (2003: £32m).

Other profit items

Centrally controlled support costs increased to £15m (2003: £14m). Internal rents on freehold property owned by the Group, which are charged to the businesses, were £1m, a £2m decrease on last year, due to the sale of freehold property in the last two years.

USA Travel Retail

USA Travel Retail incurred divisional trading losses of £5m (2003: loss of £16m) prior to the exit from both the Hotel and Airport Retailing businesses.

Aspac Retail

Prior to the completion of the sale at the end of May, the Aspac Retail business continued to trade well with like for like sales for the nine-month trading period up 3%. Divisional profit increased to £7m (2003: £5m).

Publishing

Total Publishing sales increased by 8% to £155m (2003: £143m), driven by a particularly strong release programme in the first half of the year. Notable releases included Martin Johnson's and Paul Gascoigne's autobiographies, Pamela Stephenson's 'Bravemouth' and the latest Martina Cole title, 'The Know'.

Gross profit increased by £4m. Gross margin fell 1.4 percentage points on the prior year, as the additional contribution generated by the strong sales growth was offset by an increase in the level of provisioning for unearned authors' advances. Divisional profit, excluding this charge, grew faster than sales.

Operating costs increased by £3m but reduced by 1.0 percentage point as a percentage of sales. With this tight cost management significantly offsetting the fall in gross margin, the overall net margin only fell by 0.4 percentage points to 12.9% (2003: 13.3%) and divisional profit increased to £20m (2003: £19m).

Exceptional items

The Group has booked pre-tax exceptional charges in the year of £200m. Of these, £101m are classified as operating exceptional items, charged against operating profit, but treated as exceptional due to their size and non-recurring nature.

Operating exceptional items totalling £75m were booked in the first half of the year, following a full operational and financial review of our UK businesses. The largest item related to the write down of the carrying value of stock in UK Retail (£45m). In UK Retail, we also wrote down certain fixed assets by £17m, booked £1m of reorganisation costs and £3m of other exceptional charges. In respect of Publishing, we provided £9m to ensure that the balance sheet reflected an up-to date view on the backlist sales prospects of titles published in previous years.

In the second half, we incurred further operating exceptional charges of £26m. We announced at the interim stage the results of an Organisation Review at our Swindon and London head offices. The total costs related to this review in the second half amounted to £10m and a further £2m has been provided which relates to the integration of WHSmith Online's operations into the High Street business. The net savings from the Organisation Review are anticipated to be £8.5m in the next financial year (2004/05) and £10m per annum by 31 August 2006. We have also taken a further impairment charge against fixed assets in the UK Retail business of £3m. Costs incurred responding to Permira's approach, implementing the changes to the Group's structure and the return of capital to shareholders amounted to £11m.

The majority of the operating exceptional charges are non-cash asset write-offs. The total cash costs will amount to £30m, against which we expect tax relief of £10m.

In addition to the operating exceptional items, we booked an exceptional charge of £61m arising from the disposal of our US operations in the first half, including £39m of goodwill previously written off to reserves. In the second half, we have increased this charge by £1m.

The disposal of our Aspac Retail businesses generated an exceptional profit on disposal of £10m.

Although the sale of Hodder Headline completed after the balance sheet date, we have recorded a provision for loss on disposal of £48m.

In addition, the Group made a £2m profit on the sale and leaseback of freehold properties in the second half of the year and charged £1m related to other Group properties.

Interest

The results include interest paid of £5m (2003: £4m), of which £4m is the net finance cost of the pension fund under FRS 17. This represents the difference between interest earned on pension scheme assets and interest charged on pension scheme liabilities.

Taxation

The tax charge for the year is £13m, including £3m of foreign tax. The effective tax rate on continuing activities, excluding exceptional items and goodwill amortisation, was 30% (2003: 30%). The effective tax rate on discontinued activities, excluding exceptional items and goodwill amortisation, was 43%, reflecting losses in the USA and a higher tax rate in Aspac Retail. As a result, the Group's effective rate, on this basis, was 34%.

Over the next year it is hoped that the Group will make progress on settling prior year corporation tax liabilities with the Inland Revenue. As a result, we expect that our effective tax rate will be lower than the continuing operations' prevailing 30% tax rate in future years.

Operating leases

The Group's stores are held mainly under operating leases, which are not regarded as debt for accounting purposes. The UK High Street leases are on standard 'institutional' lease terms, typically with a 15-year term subject to 5-year upwards-only rent reviews. The Travel Retail stores operate mainly through turnover related leases, usually with minimum rent guarantees, and generally varying in length from 5 to 10 years.

The business has an annual minimum net rental commitment of £142m (net of £9m of external rent receivable). The total future rental commitment at the balance sheet date amounted to £1.0bn with the leases having an average life of 7 years. The net present value of these commitments is approximately £0.7bn. Although large, these commitments are characteristic of the retail sector and the risks associated with them depend on their liquidity, influenced mainly by the quality and location of the sites. These are considered to be satisfactory.

Fixed charges cover

A key measure of financial strength for the businesses is fixed charges cover. The fixed charges comprise operating lease rentals, property taxes, other property costs and interest. These were covered 1.3 times by profit before fixed charges (excluding exceptional items and goodwill amortisation) (2003: 1.4 times). For the continuing businesses, fixed charges cover is 1.2 times (2003: 1.5 times).

Loss/Earnings per share

After the substantial exceptional charges in the year, the Group generated a loss per share of 60.7p (2003: earnings per share of 9.4p) whilst adjusted earnings per share before exceptional items and goodwill amortisation were 18.0p (2003: 29.1p).

Dividends

In view of the substantial reduction in the Group's profitability, the Board is proposing a final dividend of 8 pence (2003: 13 pence). The final dividend will be paid on 28 January 2005 to shareholders registered at the close of business on 31 December 2004. This will give a dividend for the full year of 12 pence. The total cost of the dividend will be £24m. Excluding exceptional items and goodwill amortisation, the proposed dividend is covered 1.5 times by earnings.

Free cash flow and cash balances

The operating free cash flow (before acquisitions and financing items) amounted to £12m compared with £61m in the previous year.

£m	2004	2003
Profit before tax, exceptional items and goodwill	**67**	102
Depreciation	**46**	49
Cash Profit	**113**	151
Working capital	**(27)**	(8)
Capital expenditure	**(49)**	(47)
Disposal of assets	**-**	1
Tax paid[5]	**(21)**	(32)
Net provision movement	**(4)**	(4)
Free Cash Flow	**12**	**61**

The movement in working capital is £19m worse than the previous year, largely due to investment in increasing stock density in the UK Retail business towards the end of the financial year. The movement in creditors relates predominantly to discontinued operations:

£m	2004	2003
Stock	**(17)**	3
Debtors	**(1)**	(17)
Creditors	**(9)**	6
Working Capital Movement	**(27)**	**(8)**

We have continued to invest in the physical and systems infrastructure of the business as this analysis of capital expenditure shows:

£m	2004	2003
New stores	11	6
Refurbished stores	16	19
Systems	15	20
Other	7	2
Total	**49**	**47**

The movement in the net cash position is as follows:

	£m
Opening Net Cash	**68**
Free cash flow	12
Dividends	(42)
Pension deficit funding	(25)
Proceeds from sale and leaseback	5
Net proceeds on disposal of businesses	42
Cashflow relating to exceptional items (net of tax)	(2)
Cash in subsidiaries disposed	(11)
Currency translation differences	(2)
Closing Net Cash	**45**

[5] Before receipt of tax refund relating to exceptional items.

The amount shown for pension deficit funding of £25m represents the difference between the cash contributions to the defined benefit pension schemes of £44m and the associated profit and loss charge, which comprised £15m for operating costs and £4m for financing.

With the planned recovery in the profitability of the High Street Retail business, the reduction in on-going contributions to the Pension Trust, the lower on-going dividend payments, tighter control of working capital and the elimination of exceptional one-off cash charges, we anticipate that the Group will be cash generative in future years.

Balance Sheet

The net assets comprise:

	£m	£m
Tangible assets		237
Goodwill		164
		401
Stock	184	
Creditors less debtors	(143)	
Working capital		41
Provisions		(38)
Dividends		(14)
Corporation Tax		(30)
Operating assets		**360**
Net Cash		45
Net Assets excluding pension liabilities		**405**
Pension liabilities		(149)
Total Net Assets		**256**

The Group's net assets declined substantially over the year from £409m at the end of 2003 to £256m this year. The decline is accounted for by the exceptional charges taken in the year as shown below:

	£m	£m
Opening Net Assets		**409**
Pre-tax profit before exceptional items and goodwill	67	
Tax on above	(23)	
		44
Dividends		(24)
Actuarial loss on pension schemes		(11)
Currency translation differences		(7)
Other movements		(2)
Net Assets before exceptional items		**409**
Operating exceptional items	(101)	
Tax relief on the above	10	
		(91)
Net loss on sale of discontinued operations	(101)	
Goodwill previously written off	39	
		(62)
Closing Net Assets		**256**

The Group's balance sheet structure and net assets will be substantially altered by the disposal of our publishing operations, the return of cash to shareholders and the payment to the pension fund. On a pro-forma basis, the impact is as follows:

	As at 31 Aug 2004 £m	Sale of Hodder Headline Group £m	Return to shareholders £m	Pension contribution £m	Continuing Group £m
Tangible assets	237	(7)	-	-	230
Goodwill	164	(149)	-	-	15
	401	(156)		-	245
Working Capital	41	(65)	-	-	(24)
Provisions	(38)	-	-	15	(23)
Dividends	(14)	-	-	-	(14)
Corporation Tax	(30)	-	-	21	(9)
Operating Assets	360	(221)	-	36	175
Net cash	45	207	207	(120)	(75)
Net assets excluding pension liabilities	**405**	**(14)**	**(207)**	**(84)**	**100**
Pension liabilities	(149)	14	-	84	(51)
Total Net Assets	**256**	**-**	**(207)**	**-**	**49**

<u>Return on Capital Employed</u>

Total capital employed and returns thereon were as follows:

	Operating Capital Employed £m	ROCE %	ROCE % with operating leases capitalised
High Street Retail	189	13%	10%
Travel Retail	25	83%	24%
WHSmith Online	(2)	-	-
UK Retail	**212**	**21%**	**12%**
WHSmith News Distribution	(18)	-	-
Central items and property	(55)	-	-
Total Continuing Operations	**139**	**37%**	**14%**
International Retail	11		
Publishing	210		
Total Discontinued Operations	**221**		
Total	**360**		

In the prior year, comparable returns for the continuing operations were 55% (20% with operating leases capitalised).

Pensions

The financial position of the Group is sensitive to the financial position of its two main defined benefit schemes (WHSmith Pension Trust and Hodder Headline Staff Retirement Benefits Plan) which, together with retained liabilities under the USA scheme, had a gross deficit of £205m as at 31 August 2004 and a net deficit of £144m, after deducting the related deferred tax asset. An additional net £5m liability relates to retirement medical benefits for certain pensioners.

The pension scheme assets are held in separate trustee-administered funds to meet long-term pension liabilities to past and some present employees. The Group has undertaken to meet any shortfalls against the liabilities in the WHSmith Pension Trust scheme should they arise. The Group closed its main defined benefit scheme to new members in 1995 but continues to fund the benefits accruing in respect of the remaining 3,542 active members. Employees who have joined the Group since 1995 are able to benefit from a defined contribution pension arrangement.

Following the disposal of Hodder Headline, the Group will make a contribution of £120m to the WHSmith Pension Trust, which will be financed from the Group's own resources and new banking facilities.

The Group expects a reduction in pension service costs going forward. This is as a result of contributions being made by our employees for the first time; a prospective reduction in some of the scheme benefits such as early retirement terms; and an overall reduction in pensionable salaries following the Organisation Review.

Financing

A three year £270m facility agreement was signed on 26 July 2004 between the Group, Lloyds TSB Bank plc, HSBC Bank plc and The Royal Bank of Scotland plc under which up to £120m is available by way of a term loan facility, of which amounts repaid may not be reborrowed, and £150m is available by way of a multicurrency revolving credit facility. Lloyds TSB Bank plc, HSBC Bank plc and The Royal Bank of Scotland plc are joint mandated lead arrangers under this facility agreement. The agreement contains provisions, obligations and certain financial covenants, which are customary in such an agreement. The Group intends to draw down £90m of the term loan facility.

Currency

Approximately 7 per cent of the Group's turnover was earned in foreign currencies. The effect of fluctuations in exchange rates was to decrease total sales by £1m, with an increase in operating profit before exceptional items and goodwill amortisation of £2m.

Currency exposures mainly relate to the translation of foreign income and the supply of products from outside the UK. On a continuing basis, the exposure to foreign income will be reduced to an immaterial level.

Accounting for goodwill

The goodwill of the publishing operations has been impaired by £45m following the announcement of the sale of the business to Hachette Livre. Following the disposal of Publishing, the remaining goodwill will be £15m, which relates to the acquisitions of the John Menzies Retail chain in 1998 and eight stores from TM Retail in 2002, both of which are being amortised over 20 years.