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WH Smith PLC

Separation of WH Smith Retail and News Distribution businesses via a Demerger

On 12 April 2006 the Board of WH Smith PLC announced its intention to separate the WH Smith Retail and News Distribution businesses via a Demerger, resulting in the creation of two separately listed companies. Today, the Board is providing investors with further information on the proposed Demerger and outlining the reasons why the Board believes that the Demerger is in the best interests of WH Smith PLC and its Shareholders.

Key Highlights

- Demerger of WH Smith Retail business into a separately listed company, New WH Smith PLC, which will be renamed WH Smith PLC
- News Distribution business will be renamed Smiths News PLC
- Existing WH Smith Shareholders will receive one share in New WH Smith and one share in Smiths News for each WH Smith share
- Kate Swann and Alan Stewart to be Group Chief Executive and Group Finance Director, respectively, of New WH Smith. All other members of the existing WH Smith Board become non-executive directors of New WH Smith
- Mark Cashmore and Alan Humphrey to be appointed Chief Executive and Finance Director, respectively, of Smiths News
- Brendan Fitzmaurice to be appointed non-executive Chairman, Dennis Millard to be appointed non-executive Deputy Chairman and Anthony Cann to be appointed non-executive director of Smiths News. WH Smith is seeking, as soon as is practicable, a further non-executive director to join the board of Smiths News
- New WH Smith and Smiths News intend to recommend dividends at the time of their preliminary results announcements for the period ended 31 August 2006 of 6.2p and 4.0p, respectively
- There will be no change to employees' pension benefits as a result of the proposed Demerger. Upon Demerger, the WH Smith Pension Trust will be divided into two sections with each successor entity bearing its own share of the existing WH Smith Group pension obligation
- As part of the ongoing programme for reducing the pension deficit, WH Smith has agreed with the Trustees of the WH Smith Pension Trust that a £50m payment be made into the WH Smith Pension Trust to be funded from £70m of new borrowings of Smiths News
- The Management Investment Plan will continue for existing participants and Executive Directors of WH Smith (Kate Swann and Alan Stewart) are required to retain Investment Shares in both New WH Smith and Smiths News. Separate

EPS targets will be set for each business based on the original plan. The TSR of the combined companies will be added together so that the aggregate is comparable with the original targets

- The proposed Demerger is subject to Shareholder approval. Shareholder documentation is expected to be posted to Shareholders on or around 7 July 2006 with Shareholder meetings anticipated in early August and the Demerger expected to become effective on 31 August 2006

Commenting on the announcement, Kate Swann, Chief Executive of WH Smith, said:

"With a strong team in place to run Smiths News and the existing management team remaining to run Retail as an independent company, both businesses will benefit from increased focus on their respective strategies."

Mark Cashmore, Chief Executive of Smiths News, said:

"The Demerger is an exciting step for Smiths News. The team is looking forward to working as an independent company focused on building value for shareholders by providing value-added customer service to both publishers and retailers."

Current Trading

Since the announcement of its Interim Results on 12 April 2006, WH Smith Group's businesses have continued to trade satisfactorily and market conditions have not changed. High Street Retail has made further progress in its recovery plan with the focus on increasing profitability and improving cost control. Travel Retail has continued to build on its good first half trading results. In a challenging market, News Distribution has delivered a solid performance. Overall the Board continues to be cautious about the outlook for consumer spending. Nevertheless, current trading is in line with management expectations and the Board remains confident in the outcome for the full year.

Background To And Benefits Of The Demerger

Since 2003 WH Smith has undertaken a restructuring of the WH Smith Group by selling non-core assets including its Asia Pacific retail operations, the US hotels and airports businesses and Hodder Headline Limited. As a result, WH Smith now has two businesses: WH Smith Retail and News Distribution. Although these businesses have operated within the WH Smith Group for a long time, there are limited operational synergies and the Board believes that there is no continuing strategic logic for them to remain part of the same group.

Accordingly, the Board believes that it is now appropriate to separate the two distinct businesses into independently listed entities. This will allow both businesses to benefit from greater management focus on their respective strategies as independent businesses.

As a separate company, the News Distribution business will be more responsive to publisher needs and be capable of investing further in its services to publishers. Without the link to the WH Smith Retail business, the News Distribution business will also be able to work more effectively with other retailers who have previously viewed the News Distribution business as being part of a competitor's group. Furthermore, the Board believes that the News Distribution business will be better placed to maximise its technological investments, win new business and develop new revenue streams.

The OFT is currently reviewing the system of exclusive territory contracts awarded by the publishers/distributors to wholesalers, following changes to competition law from which newspaper and magazine wholesalers were previously exempt. The OFT issued a draft opinion for consultation on 19 May 2005. Following wide-ranging responses in the consultation process and an internal review requested by senior management of the OFT, the OFT announced on 13 March 2006 that it would issue a new draft opinion on the compatibility of newspaper and magazine distribution agreements with UK competition laws. The new draft opinion was issued on 31 May 2006 and provides a framework for self-assessment by wholesalers and publishers.

The newspaper and magazine distribution industry is becoming increasingly customer focused and, irrespective of the terms of the OFT's final opinion, this trend is likely to continue. News Distribution remains focused on continuing to deliver excellent customer service. News Distribution is the UK's leading wholesaler of newspapers and magazines. It benefits from economies of scale and has invested heavily in IT systems to enable it to provide high levels of customer service both to publishers and retailers. Consequently, the Board believes the business is well placed to adapt to any changes in the market and it will be playing an active part in the upcoming consultation process with the OFT.

As an independent listed UK retailer, the Board believes the WH Smith Retail business will also benefit from greater focus, enabling the High Street Retail business to continue the delivery of its recovery plan and the Travel Retail business to continue with its growth path.

Summary And Effect Of The Proposals

The Proposals involve the Demerger of the WH Smith Retail business from the existing WH Smith Group, creating two new holding companies, Smiths News PLC (which will be the holding company of the News Distribution business) and New WH Smith PLC (which will be the holding company of the WH Smith Retail business). WH Smith Shareholders will receive one Smiths News Share and one New WH Smith Share for each WH Smith Share. Shareholders will hold the same proportion of shares in Smiths News and New WH Smith after the Demerger as they held in WH Smith before the implementation of the Proposals. Upon the Demerger, New WH Smith PLC will be renamed "WH Smith PLC".

The steps required to implement the Proposals include the insertion of a new holding company, Smiths News, between WH Smith and its shareholders via a scheme of arrangement, a reduction of share capital of Smiths News, the Demerger of the WH Smith Retail business by a dividend *in specie* of WH Smith, the issue to Smiths News's shareholders (the former WH Smith Shareholders) of shares in New WH Smith and a subsequent reduction of capital of New WH Smith. The aggregate costs of the Proposals are not expected to exceed £12m.

Shareholder approval is needed to implement the Proposals and is being sought at two Shareholder meetings, a Court Meeting and an Extraordinary General Meeting (EGM). Notices convening these meetings will be set out in the Shareholder circular, which is to be posted on or around 7 July 2006. The Smiths News Prospectus and New WH Smith Prospectus, which contain prescribed information relating to Smiths News and New WH Smith respectively, will be published at www.whsmithplc.co.uk on or around 7 July 2006.

Boards Of New WH Smith And Smiths News

The board of New WH Smith will remain unchanged from that of WH Smith and will comprise the following members:

Robert Walker	<i>Non-executive Chairman</i>
Kate Swann	<i>Group Chief Executive</i>
Alan Stewart	<i>Group Finance Director</i>
John Barton	<i>Non-executive Director, Senior Independent Director</i>
Mike Ellis	<i>Non-executive Director</i>
Luke Mayhew	<i>Non-executive Director</i>
MT Rainey	<i>Non-executive Director</i>

The board of Smiths News will, with effect from the Demerger, comprise the following members:

Brendan Fitzmaurice	<i>Non-executive Chairman</i>
Dennis Millard	<i>Non-executive Deputy Chairman, Senior Independent Director</i>
Mark Cashmore	<i>Chief Executive</i>
Alan Humphrey	<i>Finance Director</i>
Anthony Cann	<i>Non-executive Director</i>

WH Smith is seeking, as soon as is practicable, a further non-executive director to join the board of Smiths News.

Dividend Policies

The directors of Smiths News and New WH Smith intend to recommend a dividend of 4.0p per share and 6.2p per share, respectively, at the time of their preliminary results announcements in October 2006. The timetable for the declarations and payments of these dividends is expected to be in line with WH Smith's historic practice. The aggregate value of these Smiths News and New WH Smith dividends will equal the final dividend, which the Board currently would expect to recommend in respect of the financial year ending 31 August 2006 if the Demerger does not proceed. Taken together with the interim dividend of WH Smith of 5.1p declared on 12 April 2006, the aggregate of these intended dividends and the interim dividend equates to 15.3p per share.

Thereafter, the boards of Smiths News and New WH Smith intend to adopt progressive dividend policies. New WH Smith's dividend policy will aim to deliver real growth, taking into account the long-term development of the business. The New WH Smith directors intend to target a dividend that would, over time, be broadly covered twice by earnings. Smiths News's dividend policy will reflect the highly cash generative nature of the business and the proposed Smiths News directors intend, over time, to target a dividend that would be broadly covered twice by earnings.

Going forward it is intended that the Smiths News and New WH Smith interim dividends will be paid in June and final dividends will be paid in February, in the approximate proportions of one-third and two-thirds, respectively, of the total annual dividend.

Capital Structure And Effective Tax Rate

As part of the Demerger, approximately £70m of new borrowings will be drawn down by Smiths News under new facilities (outlined below), principally to fund the £50m payment to be made following the Demerger to the WH Smith Pension Trust (Pension Trust) by the News Distribution business and the WH Smith Retail business. Smiths News has entered into an agreement that will provide a £50m term loan facility and a £50m revolving credit facility. Additionally, New WH Smith has entered into a £90m credit facility agreement that will be available for working capital and general corporate purposes. These facilities essentially replace WH Smith's existing credit facility agreement. No new equity capital is being raised by either New WH Smith or Smiths News. In addition, the existing WH Smith B and C shares and 5.125% loan stock will be repaid and redeemed, respectively.

Since the 2005 financial year and following its withdrawal from international activities through the disposal of a number of businesses, WH Smith has had an effective tax rate below the UK standard tax rate. Following the Demerger, it is expected that New WH Smith and Smiths News will continue to have an effective tax rate below the UK standard tax rate over the medium term. The exact tax rate achieved will depend on the underlying profitability of each business and the closing off of outstanding tax assessments. Over time, the tax rate in New WH Smith and Smiths News is expected to revert to the UK standard tax rate. In the current financial year, an effective tax rate of approximately 20% is expected.

Pensions

WH Smith currently operates two pension schemes, the defined benefit scheme, WH Smith Pension Trust, and the defined contribution scheme, WH Smith Pensionbuilder. No members have been admitted to the Pension Trust since 1 April 1996.

On an IAS 19 basis, at 31 March 2006, the gross defined benefit pension deficit was £104m (£73m net of deferred taxation) for the Pension Trust, up from £87m at 28 February 2006 due to market conditions and revised assumptions. On an ongoing basis, the gross defined benefit pension deficit was £159m (£111m net of deferred taxation) for the Pension Trust. The ongoing deficit is greater than the IAS 19 deficit due to different assumptions and calculation methodologies.

As a result of the Demerger, it is intended to divide the Pension Trust into two sections: one for the News Distribution business and one for the WH Smith Retail business. This will involve segregating the assets and liabilities of the Pension Trust, by way of a "sectionalisation" to reflect the membership of the two businesses. These proportions will be approximately 35:65 for the News Distribution business and the WH Smith Retail business, respectively. Assets apportioned to one section of the Pension Trust will not be able to be used for the purposes of the other section. There will be no cross-subsidy or cross-guarantee between the sections of the Pension Trust, so that an employer in the News Distribution business section will not be responsible for the liabilities of an employer in the WH Smith Retail business section and vice versa. However, for administrative and investment purposes the Pension Trust will operate generally on a unified basis except that the principal employer will be replaced with a sponsor for each of the sections of the Pension Trust. The Pensionbuilder scheme will also be divided into two sections.

As part of the ongoing programme for reducing the pension deficit, the WH Smith Group will make a further one-off payment to the Pension Trust of £50m. In the period from 31 August 2004 to 31 March 2006 WH Smith has reduced the net pension deficit by £71m as calculated under UK GAAP (from £144m to £73m). The

one-off payment would have effectively reduced the IAS 19 pension deficit to £38m net of related deferred tax as at 31 March 2006. Upon sectionalisation and after taking account of the £50m one-off payment:

- The News Distribution business's net pension deficit as at 31 March 2006 would have been £14m and £27m on a IAS 19 basis and an ongoing basis, respectively, net of related deferred tax; and
- The WH Smith Retail business's net pension deficit as at 31 March 2006 would have been £24m and £49m on an IAS 19 basis and an ongoing basis, respectively, net of related deferred tax.

The combined WH Smith Retail business and News Distribution business have also agreed with the Pension Trust Trustees to make ongoing pension deficit payments of £15m in total each year, commencing 1 September 2006, over the next five years to reduce the Pension Trust deficit. The £15m annual payment will be divided between the News Distribution business and WH Smith Retail business in the estimated proportions 35:65, amounting to approximately £5m and £10m, respectively. The aggregate future annual pension deficit payments of the two businesses will be less than the current agreed annual pension deficit payments of WH Smith, reflecting the reduced pension deficit following the one-off contribution.

WH Smith has applied for and been granted clearance by the Pensions Regulator in respect of the above pension arrangements.

WH Smith Share Plans

The Remuneration Committee of the WH Smith Group Board has reviewed all WH Smith Share Plans.

Under the L-TIP, which covers circa 20 executives, existing awards will be replaced with awards of options over shares in the post-Demerger employing company with the same intrinsic value. Other terms and conditions remain unchanged.

Unapproved options will be replaced with options over the post-Demerger employing company with the same intrinsic value. Other terms and conditions remain unchanged.

Approved options and the Sharesave scheme options become exercisable just prior to Demerger as HMRC will not allow for the approved options or Sharesave scheme options to be adjusted appropriately.

Under the rules of the Management Investment Plan (MIP) consent is required by 75% of participants in the MIP as measured by value to amend the rules of the scheme in order that the Demerger is not considered an event that would trigger the right to exercise Matching Awards. The Company has received the participants' consent to amend the rules of the scheme. Following the Demerger, participation in the MIP will continue for existing participants in both New WH Smith and Smiths News. For every current Investment Share, participants will receive one share in WH Smith Retail and one share in Smiths News. Kate Swann and Alan Stewart, as Executive Directors, will be required to continue to hold both the New WH Smith Shares and Smiths News Shares they receive as a result of their holding of Investment Shares in order for their Matching Awards to vest.

All other participants will be required either to continue to hold shares of both companies or sell the shares of the company which does not employ them, in which case they will be required to purchase the equivalent value of shares in their post demerger employing company net of tax and dealing costs, by 30 November 2006.

Matching Awards will be paid in both New WH Smith Shares and Smiths News Shares, to the value earned under the MIP regardless of the decision made under personal investment.

For the TSR performance condition, the market capitalisation at the end of the performance period of the two new companies plus reinvested dividends paid over the whole of the three-year period, will be added together to determine the percentage of Matching Awards vesting. The performance targets will continue to be measured relative to the General Retailers Sector of the FTSE All Share Index.

Separate EPS targets will be set for each business. The allocation of the original WH Smith EPS target between the two businesses is in proportion to the contribution that each business was originally planned to contribute to WH Smith EPS at the time that the MIP was established. The targets are not being adjusted for the on-going PLC costs relating to the Demerger (including the Smiths News Credit Facility) so that the underlying profits required to achieve the targets are effectively being increased. Consequently, it is estimated that, based on an assumed level of RPI for the performance period of 3% per annum, the threshold EPS for New WH Smith will be 23.0p and the maximum EPS will be 29.0p. Similarly, it is estimated that the threshold EPS for Smiths News will be 11.4p and maximum EPS will be 14.5p. In aggregate these estimated targets equate to 34.3p for threshold performance and 43.5p for maximum performance, equal to the current targets with the same assumptions for inflation.

Pursuant to resolutions to be proposed at the EGM, the directors of Smiths News and New WH Smith will be authorised to introduce the new L-TIP, executive share option scheme and employee Sharesave scheme after the Demerger.

Indicative Timetable

	<u>2006</u>
Posting of circular and publication of prospectuses	7 July
Extraordinary General Meeting	2 August
Scheme becomes effective and Smiths News becomes the ultimate holding company of WH Smith	30 August
Smiths News Shares admitted to the Official List and trading in Smiths News Shares commences on the London Stock Exchange	30 August
New WH Smith Shares admitted to the Official List and trading in New WH Smith Shares commences on the London Stock Exchange	1 September

Investors should note that on 30 and 31 August 2006, it is expected that Smiths News PLC will trade as the new holding company for the WH Smith Group and will hold both the WH Smith Retail and the News Distribution businesses prior to the Demerger becoming effective, which is expected on 31 August 2006.

Information On New WH Smith And Smiths News

Information on New WH Smith and Smiths News is set out in the annex to this announcement.

ENDS

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Greenhill & Co. International LLP, which is regulated in the UK by the Financial Services Authority, is acting for WH Smith as financial adviser and sponsor for Smiths News and New WH Smith as sponsor in connection with the Proposals and for no one else and will not be responsible to any other person for providing the protections afforded to its clients, or for providing advice in relation to the Proposals.

This announcement does not comprise a prospectus relating to Smiths News or New WH Smith. It does not constitute or form part of any offer of securities, or constitute solicitation of any offer of securities. You should not purchase or subscribe for securities referred to in this announcement except on the basis of information in the prospectuses to be issued in due course in relation to Smiths News and New WH Smith (and any supplement or amendment thereto).

This announcement does not constitute a recommendation concerning the Proposals, and should not be construed as legal, business, tax or investment advice. The value of shares can go down as well as up. Past performance is not a guide to future performance. Shareholders of WH Smith should consult a professional adviser as to the suitability of the Proposals for the individual concerned.

Shares in Smiths News and/or New WH Smith have not been and will not be registered under the United States Securities Act of 1933 (as amended) and will be issued in transactions that are exempt from or not subject to the registration requirements of such Act. In addition, shares in Smiths News and/or New WH Smith have not been and will not be registered under the securities laws of any state of the United States, and will be issued in reliance on available exemptions from such state law registration requirements.

This announcement contains certain forward-looking statements. Such forward-looking statements involve risks and uncertainties that could significantly affect expected results and are based on certain key assumptions. Many factors could cause actual results to differ materially from those projected or implied in any forward-looking statements. Due to such uncertainties and risks, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date hereof. WH Smith, Smiths News and New WH Smith disclaim any obligation to update any forward-looking statements contained herein, except where it would be required to do so under applicable law.

The financial information concerning WH Smith, Smiths News and New WH Smith contained in this announcement does not amount to statutory accounts within the meaning of section 240 of the Companies Act 1985.

Annex

Information On The WH Smith Retail Business

WH Smith Retail is one of the best-recognised UK retail brands and has an extensive store portfolio spanning 543 high street and 128 travel stores. It is present in 85 per cent. of the top 500 UK retailing locations and 95 per cent. of its stores are in prime locations with high customer traffic. On average, just over 1.2 million people visit a High Street Retail store every day and approximately 125 million travellers pass WH Smith Retail's busiest travel store at London's Victoria Station each year.

WH Smith Retail has market-leading positions in three product categories, with market shares of approximately 15 per cent. in books, 18 per cent. in magazines and 13 per cent. in stationery. It has a reputation as one of the UK's most popular stationers, booksellers and newsagents. Its outlets are frequently a first choice for customers on the high street and it is a trusted convenience retailer for customers at its travel locations.

In the year to 31 August 2005, WH Smith Retail had operating profits before exceptional items of £47m on revenues of £1,423m and gross assets of £542m.

Information On The Smiths News Business

1. Business overview

News is the UK's leading wholesaler of newspapers and magazines by share by value, serving approximately 22,000 retailers in England and Wales daily. News handles over 59 million copies of newspapers and magazines every week serving retail outlets ranging from small newsagents and convenience stores to supermarkets and garage forecourts. It receives newspapers and magazines in bulk from publishers and distributors and then re-packs and distributes them to retailers in one of the most time sensitive and fast-moving daily logistics operations in any supply chain. As products are sold predominantly on a "sale or return" basis, News also handles the return of newspapers and magazines unsold by retailers. News provides a number of other services to publishers/distributors and retailers including copy management, information provision and merchandising. News currently has an approximate 39 per cent. share by value of the magazine wholesaling sector and an approximate 36 per cent. share by value of the newspaper wholesaling sector in the UK.

News is positioned between publishers/distributors and retailers and provides services to both:

- For publishers/distributors, News distributes their titles and manages copy allocation to increase sales and availability and to reduce returns. News also undertakes sales development activities and provides the publishers/distributors with sales data and support to help them achieve growth in sales; and
- For retailers, News supplies newspapers and magazines aiming to maximise sales and availability and handles returns. News also offers a number of services to help retailers increase sales and maximise business opportunities, including: sales development activities, marketing support, sales information, range and space advice, shop refitting and merchandising.

Publishers of newspapers and distributors of magazines normally enter into long-term supply contracts (on average around five years) with the wholesalers. These contracts currently provide for exclusivity in pre-determined geographic territories. The geographic territories are broadly similar for the magazine and newspaper sectors. The territories of publishers/distributors and wholesalers have evolved to a level where the efficiency of distribution is high, with publishers/distributors effectively sharing the cost with wholesalers to market in a way that is difficult for any individual industry participant to match economically.

Recent contract awards with publishers/distributors have progressed well and News has now, in line with the current industry structure, contracted approximately 81 per cent. of its revenue. The contracts have an average of four years remaining on each contract.

News operates 45 warehouses throughout England and Wales. News has approximately 4,200 employees and uses around 1,400 contractors. The News business operates 24 hours a day, 364 days a year.

The News business generated operating profit of £33m on revenues of £1,187m in the financial year ended 31 August 2005 on an unaudited pro forma basis. In the current financial year to date, News continues to deliver a solid trading performance through service improvements and tight cost control, recording sales of £587m and generating operating profit of £17m for the 26 weeks ended 28 February 2006 on an unaudited pro forma basis, despite slower consumer spending and rising costs.

2. Market overview

2.1. UK industry background

The UK newspaper and magazine industry is a developed and diverse market with high numbers of newspapers and magazines produced per capita. Magazines and newspapers are sold to consumers through approximately 53,700 retail outlets, reaching all parts of the UK.

The national newspaper sector in the UK is dominated by five major publishing groups. The retail sales value of national newspapers sold in the UK in 2005 was estimated to be £2.27bn and has grown in value at a compound annual growth rate of 2.6 per cent. since 2000.

The magazine sector is divided into weekly and monthly titles as well as one-shots (one-off publications which cover particular events, for example the football World Cup) and partworks (publications produced as a series to form a collection). The number of consumer magazines published in the UK is currently approximately 3,300 titles. Approximately 42 million consumer magazines are delivered to retailers every

week. The retail sales value of consumer magazines sold in the UK in 2005 reached £2.03bn and has grown in value at a compound annual growth rate of 3.1 per cent. since 2000.

The magazine and newspaper supply chain operates on a sale or return basis. Publishers of newspapers and distributors of magazines generally award long-term supply contracts (on average around five years) to wholesalers. These contracts currently provide for exclusivity in pre-determined geographic territories with the relevant wholesaler being appointed as the exclusive supplier of that newspaper publisher or magazine distributor's titles in the territory and being granted with absolute territorial protection (see below). The geographic territories for the magazine and newspaper sectors are broadly similar. The territories of publishers/distributors and wholesalers have evolved to a level where the efficiency of distribution is high, with publishers/distributors effectively sharing with wholesalers the cost to market in a way that is difficult for any individual industry participant to match economically.

2.1.1. Overview of absolute territorial protection

In a newspaper or magazine distribution agreement, News is usually awarded an exclusive territory in which to distribute the particular publisher's/distributor's titles to retailers. The agreement usually grants News absolute territorial protection as a result of a ban on both active and passive sales. A ban on active sales means that News is prevented from actively marketing its titles to retailers located outside of its exclusive territory (i.e. into another wholesaler's exclusive territory). A ban on passive sales mean that News is also prevented from responding to a request for supplies from retailers located outside of its exclusive territory, even if that request is unsolicited, and vice versa for other wholesalers in News's territory. The majority of newspaper and magazine distribution agreements appoint wholesalers on this basis. The Code of Practice also contains a restriction on passive sales as it requires that a wholesaler does not accept an application for the supply of newspapers from an applicant located outside its operation as defined by the relevant newspaper publisher.

In the absence of absolute territorial protection, News would still have the exclusive right to market the publisher's/distributor's titles actively to retailers in a particular territory. It would continue to be prevented from actively selling to retailers located outside of its exclusive territory. However, News would be able to respond to a "passive" (unsolicited) request for supplies from a retailer located outside of its exclusive territory (i.e. in a competing wholesaler's territory) and supply that retailer from its own exclusive territory. Likewise, other wholesalers would be able to supply retailers located in News's exclusive territory in response to an unsolicited request for supplies, from their exclusive territories.

2.2. Newspaper publishing

The tables below set out the estimated current shares by value of each of the publishers, wholesalers and retailers in the supply of national newspapers.

2.2.1. National newspaper sector share

<i>Publisher</i>		<i>Wholesaler</i>		<i>Retailer</i>	
News International	31%	Smiths News	36%	Independent	62%
Associated News	22%	Menzies Distribution	28%	Newsagents	
Mirror Group	16%	Dawson News	22%	Tesco	6%
Telegraph	10%	Independents	14%	TM Retail	5%
Express	9%			WH Smith Retail	3%
Guardian	5%			Sainsbury	3%
Independents	3%			Morrison	2%
Financial Times	2%			T&S	1%
Sport	1%			Star News	1%
Other	1%			ASDA	1%
				Other	16%

Source: News data, based on contract awards and net sales

The five principal newspaper publishers currently account for 88 per cent. of the market. The retail channel is more fragmented with small independent newsagents still accounting for the majority of retailer outlets.

News's geographic areas cover some of the more populated areas of the UK, compared to its competitors.

2.2.2. Industry trends and key drivers

The national daily UK newspaper sector has experienced declining circulation volumes since the late 1980s due to changing consumer lifestyles and the increased availability of news through television and the internet. Newspaper publishers have increased cover prices with the average newspaper cover price increasing by an average 4.3 per cent. per annum since 2000. This has driven circulation revenue growth of 2.6 per cent. per annum over the same period as the cover price increases offset circulation declines. The growth in circulation revenue is an important trend for wholesalers as they are generally remunerated on the basis of cover prices (70 per cent. of News's newspaper revenues derive from contracts based on the value of sales, and 30 per cent. based on volume of sales).

2.3. Magazine publishing

2.3.1. Structure and size

The UK magazine sector has different characteristics from the newspaper sector, as there is a broader range of titles. The magazine publishing market is more fragmented than the newspaper publishing market with a large number of small publishers. Many publishers lack the scale to arrange their own distribution, necessitating an intermediary in the magazine value chain, the distributors, which in most cases are owned by the larger magazine publishers.

The tables below set out the estimated current shares by value of each of the publishers, distributors, wholesalers and retailers in the supply of magazines.

2.3.2. Magazine sector shares

<i>Publisher</i>		<i>Distributor</i>		<i>Wholesaler</i>		<i>Retailer</i>	
IPC Media	18%	Frontline	29%	Smiths News	39%	WH Smith Retail	18%
Emap	13%	Marketforce	27%	Menzies	34%	Tesco	13%
Bauer	7%	Comag	21%	Dawson News	24%	Sainsbury	6%
BBC	6%	Seymour	7%	Independent		TM Retail	4%
Future	5%	Northern &		wholesalers	3%	Morrisons	4%
Northern &		Shell	4%			ASDA	4%
Shell	3%	Magazine Marketing				Somerfield	2%
Haymarket	2%	Company (MMC)	2%			One Stop	1%
National		Associated News	2%			Independent	
Magazine	2%	Other	9%			newsagents	34%
Trader Media	2%					Other	14%
Dennis	2%						
Hello	2%						
Puzzler Media	2%						
DC Thomson	2%						
Conde Nast	1%						
Other	33%						

Source: News data, based on contract awards and net sales.

The UK magazine industry currently comprises over 3,300 consumer titles with an estimated retail sales value of £2.03bn. As with newspapers, the magazine industry has two core revenue streams: circulation (retail sales) and advertising.

2.3.3. Industry Trends and Key Drivers

In the early 2000s the magazine sector was characterised by the emergence of weekly magazine titles, which took market share from monthly magazines. Since 2000, UK magazine circulation has grown at a 0.9 per cent. compound annual growth rate to 1.37 billion copies. This has been driven by 2.3 per cent. annual growth in weeklies over the period while monthlies circulation has declined by 1.1 per cent. as the traditional weekly TV listings and popular women's titles have been complemented by more high profile weekly magazines focusing on celebrities, popular leisure and fashion interests. Cover prices have grown at a compound annual growth rate of 2.3 per cent. since 2000 with weeklies up 3.2 per cent. and monthlies up 2.7 per cent. annually.

3. Competitive strengths

The News business is well placed to deliver strong profit growth and cash generation through:

- UK's leading wholesaler

News is the UK's leading newspaper and magazine wholesaler in the sector with an approximate 39 per cent. share by value of the magazine wholesaling sector and an approximate 36 per cent, share by value of the newspaper wholesaling sector in the UK.

Newspaper and magazine wholesaling is an industry that favours scale and high local market share. There are high fixed costs associated with packing and delivery, therefore, within any given locality, the wholesaler with the most contracts awarded by publishers/distributors will have the lowest unit operating cost. As the UK's largest industry participant in the newspaper and magazine wholesaling distribution industry, News benefits from economies of scale.

- **Long-term contracts with predictable revenues and gross margins**

The long-term contracts that News has been awarded by the major newspaper publishers and magazine distributors give some certainty over future revenues and gross margins. Following recent contract awards, News has now, in line with the current industry structure, contracted approximately 81 per cent. of its revenues. The contracts have an average of approximately four years remaining on each contract. News's profits are relatively predictable due to certainty of distribution contracts, stable cost structure and the inflation indexation in its carriage service charges to retailers.

- **Highly cash generative**

The combination of strong operating cash flow and low capital expenditure requirements make the News business highly cash generative.

- **Organisational adaptability and innovation**

News's organisational adaptability makes it readily able to react to changing needs in the marketplace. News uses its technology to provide innovative tailored services to individual retailers. An example of this is News's sales-based replenishment system, which reduces the stock levels that need to be held by retailers.

- **Technological investment**

News currently operates market leading SAP technology, enabling it to provide better customer service and more efficient business operations than its competitors. The News business has spent £5m on sophisticated picking and sorting equipment and £22m to date on implementing SAP technology to improve its efficiency at handling both physical product and information flows. This technology is regularly improved to ensure that the News business is at the forefront of industry technology.

- **High level of customer service**

With the latest technology, News believes that it provides both publishers/distributors and retailers with superior customer service through the provision of rapid, detailed information on sales, returns and circulation. Independently conducted surveys consistently benchmark News as a market leader for customer service in the industry. The increasing technological sophistication of these services ensures that News's relationships with publishers/distributors and retailers are strengthened, thereby enhancing News's competitive position.

Management's strategy is to invest further in services that improve the profitability of newspapers and magazines for key retailers, thereby building the commercial relationship between the major retailers and News, as it becomes further involved in retailers' processes and work practices.

- **Extensive distribution network**

The distribution network of the News business covers the more highly populated regions of the UK, providing a highly time-sensitive logistics service for its suppliers and creating opportunities for share and product range expansion.

- **Opportunities to develop new revenue streams**

News is planning to capitalise on revenue growth opportunities such as expanding merchandising and promotional services to publishers/distributors, providing revenue-generating on-line information services to distributors, publishers and retailers, and using its warehouse and delivery fleet infrastructure to handle other products for retailers and other customers. News has recently established a new business called "The Returns Company" with a view to entering the returns logistics market. The separation of News and WH Smith Retail is expected to enhance News's ability to develop this new business. News also plans to use its existing technology investments to offer IT consultancy through a new operation called "Newsworks."

- **Proven track record of reducing costs**

Since 2001, News has been successful at reducing operating costs by over £10m. The advanced technology systems of the News business have made a large contribution towards these improvements and the framework that is now in place allows for continued cost reduction.

- **Experienced senior management team**

The management team at News has over 57 years of combined experience in the industry and has successfully tendered for publisher/distributor contracts and reduced costs since 2001. Management has developed a strategy to ensure that News is best placed in the current market environment, having reduced the number of warehouses it operates from and increased the efficiency of the business over the last five years. Management has also led industry initiatives seeking to improve the industry supply chain through the introduction of Tote and Track, key performance indicators (KPIs), magazine scan, returns processing and Sales Based Replenishment.

4. Strategy

As a consequence of the changes in the newspaper and magazine wholesale industry in the late 1980s, News's strategy in the early 1990s focused on developing its position within the industry structure of exclusive publisher area contracts. News rationalised its network to improve effectiveness and reduce infrastructure costs. The primary focus of the News business at this time was to meet the needs of publishers through the retail network.

Since 2000, News has focused on investing in the quality of its service to publishers/distributors and retailers in order to gain market share in a competitive environment and to use the improved data management capability of its SAP technology. At the same time News embarked on a significant cost reduction programme to improve profitability. These initiatives were facilitated by the automation introduced through the SAP system (£22m investment to date) and the

TWI pick and pack system technology, which have enabled a reduction in waste and improved process effectiveness.

The News business has a track record of investment in market leading innovations, which enable it to provide a high quality service to both publishers/distributors and retailers while enhancing the profitability of News by refining the business's cost structure, as well as generating new revenue initiatives.

During 2005, transparent key performance indicators (KPIs) were introduced by News and disclosed to publishers/distributors and retailers. These allow visibility of News's logistics performance for publishers/distributors and retailers. The KPIs are agreed in conjunction with publishers, distributors and retailers and have generated a step change in service performance. Performance is now measured across core logistics areas such as timely delivery, accuracy of supplies and returns and product tracking to and from stores. The provision of this information is only possible due to the substantial systems investment undertaken by the News business. Performance improvement has been delivered through the introduction of new measurement tools, a dedicated support team plus clear accountability and responsibilities amongst the staff. The benefits of introducing this service are cost savings and reduced wastage, as well as building better customer relations across the supply chain.

The market leading, enterprise-wide technology investment made by News gives it a competitive advantage and provides opportunities for new revenue streams such as additional information services and returns logistics. News is developing services to generate improved profits for retailers and publishers/distributors and to build relationships. These include:

- Sales Based Replenishment (SBR): a form of "just in time" delivery for retailers that helps them to improve availability and reduce waste by replenishing stock more frequently based on the retailers' sales data. SBR is currently available in all but two of the magazine warehouses of News across the top 300 magazine titles; and
- Vendor Managed Inventory (VMI): management of stock and other retailer processes. This is under trial at the moment; and
- Electronic Data Interchange (EDI): paperless management of the supply chain, reducing waste for all parties. News is currently in discussion with several industry participants about EDI

These services help to increase the attractiveness of News's offering and enhance its relationship with the retailers.

News has established a new business called "The Returns Company" to focus on the returns logistics sector. This is a relatively new sector to the UK, but is set to expand as retailers seek to outsource the processing of returns to specialist third parties. News has the skills and infrastructure to make rapid progress into this sector. "The Returns Company's" current focus is on books, though the service could be used by many types of retailers that need to manage returns. The separation of News and WH Smith Retail is expected to allow News to develop this product with other retailers more rapidly.

News has also developed an IT consultancy service named "Newsworks" to provide systems solutions to publishers, distributors and European wholesalers by adapting News' information systems. News is able to use its existing technology know-how to provide systems solutions in the newspaper and magazine industry.

The new revenue opportunities from “The Returns Company” and “Newsworks” are expected to contribute less than 10% of profits over the medium term. There are also opportunities to increase market share in its national newspaper and magazine business, as well as seeking to increase its current limited presence in the regional newspaper distribution market.

5. Operations

News has three sources of revenues:

- **Publisher/distributor revenues**

Magazines revenues are calculated as a percentage of the cover price of the products sold, based on volume net of returns. Approximately 70 per cent. of News's newspaper revenues are based on a percentage of the cover price, with the remainder based on fixed price per copy contracts (generally indexed to inflation), regardless of cover price.

- **Carriage service charges (CSC)**

These charges are paid to News by the retailer. News has a standard template of CSC bands, which specify the charges payable by the retailer. This template is applied on a national basis and is reviewed annually by the News business. The template ensures that the charges are indexed for inflation in labour and fuel costs.

- **Other activities revenues**

Paid to News by publishers/distributors and retailers for the additional products and services it provides, such as: vouchers, handling of supplements, information provision, merchandising and returns management.

In the 2005 financial year News generated approximately 52% of revenue from newspapers, 44% from magazines and 4% from carriage service charges and other activities.

6. Capital Expenditure

Capital expenditure was approximately £6.3m for the 2005 financial year and consisted primarily of ongoing maintenance expenditures. The News business does not require significant capital expenditure to maintain its warehouses and the cost is usually below the depreciation charge in the annual accounts. Ongoing expenditure is expected to focus primarily on maintaining and refurbishing the existing IT systems. The Returns Company and “Newsworks” may require limited additional future investment.

7. Pro forma financial information

7.1. Income statement

	Year ending 31 August 2005 IFRS	6 months ended 28 February 2006 IFRS
<i>£million</i>		
Continuing operations		
Revenue	1,187	587
Operating profit	33	17
Finance costs	(4)	(2)
Profit/(loss) before tax	29	15

7.2. Balance sheet

	As at 28 February 2006 IFRS
<i>£ million</i>	
Non-current assets	34
Net current liabilities	(55)
Of which: Cash and cash equivalents	---
: Obligations under finance leases	(1)
: Bank overdrafts and other borrowings	(16)
Non-current liabilities	
Bank loans and other borrowings	(50)
Retirement benefit obligation	(14)
Deferred tax liabilities	(4)
Long-term provisions	(1)
Obligations under finance leases	(2)
Other non-current liabilities	---
Total net liabilities	(92)

8. Executive Directors And Senior Management

Details of the Executive Directors and Senior Managers of New WH Smith are set out below:

Kate Swann (41), Group Chief Executive

Alan Stewart (46), Group Finance Director

Stephen Clarke (38), Commercial and Marketing Director

Tanith Dodge (45), Group Human Resources Director

Simon Marinker (47), Stores Director and Managing Director of Travel Retail

Neil Monnery (44), Group Strategy Director

Robert Moorhead (41), Finance, Property, IT and Direct Director

Details of the proposed Executive Directors and Senior Managers of Smiths News are set out below:

Mark Cashmore (45), Chief Executive Officer

Alan Humphrey (52), Finance Director

Jonathan Bunting (34), Commercial Director

Graeme Underhill (46), Operations Director

Glenn Leech (31) Human Resources Director

Richard Webb (41), Information Systems Director

Mark Charlton (44), Business Planning Director

9. Definitions

Code of Practice	The industry code of practice for the supply of newspapers to retailers
Demerger	The proposed demerger of the WH Smith Retail business to create the WH Smith Retail Group and the Smiths News Group
Demerger Effective Date	The date on which the Demerger becomes effective, expected to be 31 August 2006
EPS	Earnings per share
High Street Retail	The part of the WH Smith Retail business which operates from primarily high street locations, rather than travel locations, comprising the sale of a wide range of newspapers, magazines, stationery, books and entertainment products
New WH Smith	New WH Smith PLC (to be renamed WH Smith PLC)
New WH Smith Share	The ordinary shares in New WH Smith to be allotted and issued pursuant to the Demerger

News Distribution business or the News business or News	The business carried on by the WH Smith Group prior to the Demerger, of wholesaling and distributing newspapers and magazines to retailers and supplying other services to publishers and retailers
OFT	The Office of Fair Trading
Proposals	Collectively the proposed Scheme and Demerger and the subsequent New WH Smith Reduction of Capital
Scheme	The proposed scheme of arrangement
Shareholder	A registered holder of WH Smith Shares including any person entitled by transmission
Smiths News	Smiths News PLC
Smiths News Credit Facility	The £50m revolving credit facility and £50m term loan entered into by Smiths News
Smiths News Group	Smiths News and those entities which will be its subsidiaries and subsidiary undertakings as from the Demerger Effective Date and where the context requires, its associated undertakings, which will own and operate the News Distribution business following the Demerger
Smiths News Share	The ordinary shares in Smiths News to be allotted and issued pursuant to the Scheme
Travel Retail	The part of the WH Smith Retail business comprising the sale of a tailored range of newspapers, magazines, books and confectionery products from outlets primarily based in airports and railway stations
WH Smith	WH Smith PLC
WH Smith Board or the Board	The directors of WH Smith as at the date of this announcement
WH Smith Group	Before the Demerger, WH Smith and its subsidiaries and subsidiary undertakings and, where the context requires, its associated undertakings
WH Smith Retail	The business carried on by WH Smith Group prior to the Demerger of retailing through High Street Retail and Travel Retail
WH Smith Retail Group	The entities which carry on the WH Smith Retail business
WH Smith Share	The ordinary shares of 2 13/81p each in the capital of WH Smith
WH Smith Shareholders	Holders of WH Smith Shares

