

12 October 2006

WH Smith PLC
Preliminary Results Announcement
For the twelve months ended 31 August 2006

-STRONG PROFIT PERFORMANCE FOR THE GROUP-

KEY POINTS

- Profit before tax and exceptional items on continuing operations, up 31% to £51m (2005: £39m). Profits from trading operations are:
 - High Street profit up 14% to £42m⁽¹⁾ (2005: £37m)
 - Travel profit up 24% to £31m⁽¹⁾ (2005: £25m)
- Total Group profit before tax⁽²⁾ up 42% to £44m (2005: £31m)
- Strong free cash flow of £68m (2005: £44m)
- As anticipated, sales of £1.3bn, down 4% like-for-like (LFL), reflecting our strategy to focus on profitable sales in our core categories and the continued tough trading environment
 - High Street LFL sales down 7%
 - Travel LFL sales up 3%
- Gross margin has improved by 270 basis points year on year
- Cost savings delivered faster than planned; further incremental cost savings of £15m over next 3 years identified
- Successful separation of the Retail and Smiths News businesses
- Headline earnings per share⁽³⁾ up 43% to 25.0p (2005: 17.5p per share)
- Basic earnings per share up 50% to 18.6p (2005: 12.4p per share)
- Pension deficit of £41m⁽⁴⁾, reduced from £152m in 2003
- Dividend of 6.2p proposed; combined with dividend proposed by Smiths News PLC, giving a full year proforma dividend up 12% to 15.3p (2005:13.7p)

⁽¹⁾ High Street and Travel profit is stated after directly attributable defined benefit pension service costs, share based payment costs and before central costs, exceptional items, interest and taxation

⁽²⁾ Continuing and discontinued operations

⁽³⁾ Profit before tax, exceptional items and IAS 19 pension interest - undiluted

⁽⁴⁾ On a gross IFRS basis, post the one-off payment of £25m on 1 September 2006

⁽⁵⁾ Profit before tax and exceptional items on continuing operations

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

“The Group has delivered a strong performance, with a 31% improvement in full year profit ⁽⁵⁾ and strong free cash flow of £68m.

“Travel has had another good year with a 24% increase in profitability⁽¹⁾. Despite tough trading conditions on the UK high street, High Street has improved its profitability⁽¹⁾ by 14% and we continue to make progress in improving our customer offer and rebuilding our authority in our core categories. These results reflect the successful implementation of our plan so far.

“Spending in our categories remains subdued and we expect the Christmas season to be competitive; we have planned accordingly.”

- Ends -

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CURRENT TRADING

In the 5 weeks to 7 October 2006, Retail LFL sales were down 3% and gross margin was up on last year.

DEMERGER

On 31 August 2006, the Retail and News business were separated via a demerger allowing both businesses to benefit from greater focus on their respective strategies as independent businesses.

GROUP INCOME STATEMENT

Revenue

Group revenue decreased from £1,423m to £1,340m over the year, as we have focused on profitable sales, in a tough trading environment. The LFL sales decline over the period was 4%.

£m	2006	2005	Growth %	LFL Sales Growth %
High Street	1,021	1,112	(8%)	(7%)
Travel	319	311	3%	3%
Total	1,340	1,423	(6%)	(4%)

High Street sales were down 8% and on a LFL basis down 7%. Travel sales growth of 3% (3% on a LFL basis) has been driven by the airports business, up 6% on a LFL basis and 2 percentage points ahead of passenger growth, primarily through product range improvements and more efficient use of space.

Books LFL sales were down 5% with gross margin up year on year as we continued to focus on rebuilding our authority as a popular specialist and maximising profitability. Excluding Harry Potter, Books LFL sales were down 3%. At Christmas we created a very competitive offer via promotions and saw some excellent shares on top titles such as Sharon Osbourne's *Extreme*, Jamie Oliver's *Jamie's Italy* and John Peel's *Margrave of the Marshes*. Over the year, we also achieved our third consecutive period of market share stabilisation versus the general high street and we increased our ranges by expanding our space to books in 70 stores. We will increase the space devoted to books in more stores during the course of this financial year. We also implemented significant changes to our books supply chain so we can carry more stock at no additional stock holding cost. With a stronger supply infrastructure in place, we have begun to carry out in-depth analysis at a sub-category level to improve our performance and authority further. In Travel we also increased our range of airport exclusive books from 100 to 200 lines. These books offer great value, a degree of exclusivity and this year we are moving into non-fiction airport exclusives.

Stationery LFL sales were down 4% with lower consumer spending in this market impacting sales. As planned, we focused on our core categories and removed unprofitable categories like electronics. This had a negative impact on sales but a positive impact on profit. Gross margin was up strongly driven by intra category mix and sourcing benefits from low cost countries. In the second half of the year we began thorough reviews across all stationery categories. We also tested extended ranges of wrap, art and crafts and core stationery in a small number of large stores as well as testing new ranges such as scrap-booking, card-making and educational toys. We have now added all these ranges into 70 stores and we will be making further changes as a result of these reviews during this financial year. The stationery trial store in Barnet has performed well and provided us again with some useful findings, which we are incorporating into our standard stores. In the second half of the year, we opened three further standalone stationery-only stores in Orpington, Bangor and Tonbridge to gather more data.

News and Impulse LFL sales were up 3% year on year with an improvement in gross margin. We held share in news and magazines, supported by strong promotions, despite challenging market conditions with sales declines particularly in monthly magazines and part works. In both High Street and Travel, we continued to grow our confectionery and snacking ranges by making better use of our space, putting in new ranges and equipment. In Travel, we also extended our food range to 20 more stores and increased choice with more desserts, yoghurts and breakfast options as well as extending our ranges of healthy snacks – fruit, nuts, fresh juices including introducing branded healthier options such as Innocent Smoothies and granary bars. In July, drinks in Travel benefited from the hot weather.

Entertainment LFL sales were down 19% in an extremely competitive market with a weaker release schedule than in 2004/05 and continuing price deflation. We focused on maximising profit and delivered profitable sales. We anticipated declines in entertainment sales as we rebalanced elements of our entertainment space to other core categories. We tightly controlled stock to reflect sales patterns while maintaining availability levels in line with the previous year.

Profit before exceptional items and taxation

£m	2006	2005	Profit Growth %
High Street ¹	42	37	14%
Travel ¹	31	25	24%
Trading operations profit ¹	73	62	18%
Central costs	(14)	(16)	
Internal rents	1	1	
Operating profit ²	60	47	28%
Net finance charges	(9)	(8)	
Profit before taxation ²	51	39	31%

¹ Trading operations profit stated after directly attributable share based payment and pension service charges

² Stated before exceptional items

The Group generated a profit before tax and exceptional items of £51m (2005: £39m), an increase of 31%. Operating profit² increased by 28% from £47m to £60m with the main driver being strong improvements in trading operations.

High Street

High Street delivered a profit¹ increase of 14% to £42m (2004: £37m) as we focused on rebuilding authority in our core categories, optimising margins, tight cost control and delivering the retail basics.

Gross margin improved during the year with the continued benefits of category mix management, lower cost of goods from improving our buying terms further and increasing our Far East sourcing, improved promotion management, reduced shrinkage and better markdown management.

High Street delivered £22m of cost savings during the year, which is £4m ahead of our expectations of £18m, set in April this year. Cost savings were delivered from a number of areas of the business including logistics, information systems, stores and marketing communications. We have identified a further £15m of cost savings over the next three years from areas including logistics, information systems and stores.

As a result of these initiatives and the costs savings delivered in the year, net margin for High Street has increased by 80 basis points to 4.1%. This is before non-allocated central costs.

The High Street business now operates from 543 stores, which occupy 3.0m square feet (2005: 3.0m square feet). We opened 7 new stores in the year and closed 6 stores.

Travel

Travel delivered a strong performance with profit¹ increasing by 24% to £31m (2005: £25m). This was delivered from increased sales, boosted by the hot weather in July 2006, combined with mix and space changes, range improvements and tight cost control.

Gross margin has increased during the year through buying improvements and mix changes, resulting in more sales in higher margin categories such as snacking. We have

improved average transaction value by focusing on mix changes and improved promotional activity.

The Travel business now operates from 129 stores. During the year we made good progress on contracts in airports and rail. In airports we renewed 4 contracts - for the bookstore and CTN* store at Glasgow airport and for CTN stores at Heathrow Terminal 4 and Southampton airports. In airports we also opened 5 new units during the year - a bookstore at Bristol airport and CTN stores at Blackpool, Glasgow, Southampton, and Manchester airports.

In rail we renewed successfully 10 contracts, including a key contract with ScotRail that represents 12 sites across Scotland. We also opened 3 new units in rail - a bookstore at London Liverpool Street and two standalone stationery stores at London Charing Cross and London Bridge stations.

* CTN – confectionery, tobacconist, newsagent

Central costs and internal rents

Central support costs were £14m, down £2m from the prior year. Internal rents on freehold property owned by the Group remained at the prior year level of £1m.

Net finance charges

Net finance charges have increased by £1m in the year with lower debt interest from the repayment of the term loan facility during the year being offset by higher IAS 19 pension interest of £3m (2005: £1m). Pension interest has increased due to the impact of the change in investment policy to a Liability Driven Investment ('LDI') policy.

Exceptional Items

The Group has taken a £12m exceptional charge in relation to costs associated with the demerger. A £5m exceptional gain was also recognised in the year as a result of the settlement of post retirement medical benefit liabilities.

Taxation

The tax charge for the year before tax on exceptional items was £10m (2005: £9m). The effective tax rate on continuing activities, excluding exceptional items was 20% (2005: 23%). We expect the effective tax rate to remain below the UK standard rate over the medium term. The exact tax rate achieved will depend on the underlying profitability of the Group and continued progress in closing off outstanding tax assessments.

Earnings per share

The Group generated basic earnings per share of 18.6p (2005: 12.4p) while headline basic earnings per share from continuing operations was 25.0p (2005: 17.5p). The growth has been generated by both improving profitability and a more favourable effective tax rate.

Dividends

The Board is proposing a dividend of 6.2p per ordinary share. Subject to shareholder approval the dividend will be paid on 6 February 2007 to shareholders registered at the close of business on 5 January 2007. The Board intends to have a progressive dividend policy, which over time would be broadly covered twice by earnings.

Fixed charges cover

Fixed charges, comprising property operating lease rentals and net finance charges, were covered 1.3 times by profit before fixed charges (2005: 1.3 times cover).

CASH FLOW

The operating free cash flow amounted to £68m compared with £44m in the previous year.

£m	2006	2005
Operating profit ¹	60	47
Non cash items	1	4
Depreciation & amounts written off tangible fixed assets	37	41
Cash profit	98	92
Working capital	9	(8)
Capital expenditure	(29)	(30)
Tax	(2)	(2)
Net interest paid	(5)	(2)
Net provisions	(3)	(6)
Free cash flow	68	44

¹ Stated before exceptional items

Cash generation has strengthened due to the improved trading performance in the businesses and good working capital control.

Non-cash items relate to share based payment charges of £6m (2005: £4m) and profits on disposal of fixed assets of £5m (2005: £nil). There have also been impairment charges of £3m (2005: £nil) in the year.

The movement in working capital for continuing businesses was £17m favourable to the previous year, principally as a result of the strong focus on stock levels and improved control of receivables.

This can be further analysed as follows:

£m	2006	2005
Inventories	6	5
Receivables	7	(12)
Payables	(4)	(1)
Working capital movement	9	(8)

Capital expenditure

£m	2006	2005
New stores and store development	11	11
Refurbished stores	7	7
Systems	7	7
Other	4	5
Total	29	30

We have continued to invest in maintaining our retail properties.

Net Funds

The movement in the net funds position is as follows:

	£m
Opening net debt	(58)
Free cash flow	68
Equity dividends paid	(15)
Net purchase of own shares	(6)
Pension deficit funding	(12)
Corporate advisory and financing costs	(6)
Sale & leaseback and fixed asset disposal proceeds	9
Net disposals of subsidiaries	8
Other items	(3)
Settlement of intercompany account on demerger	57
Closing net funds¹	42

¹ Stated before £25m cash contribution to pension liability on 1 September 2006

The amount shown for pension deficit funding of £12m represents £10m of additional pension deficit funding in line with our agreement with the Trustees and £2m in relation to the post retirement medical benefit liability settlement.

The net disposals of subsidiaries of £8m includes deferred consideration of £11m received in early settlement of loan notes received on the disposal of the USA Travel Airports business to Hudson Group in 2004.

Corporate advisory and financing costs of £6m includes fees paid in relation to the demerger.

After the year end an additional £25m cash was contributed to the defined benefit pension scheme as part of the demerger agreement with the WHSmith Pension Trust Trustees.

GROUP BALANCE SHEET

	£m	£m
Goodwill and other intangible assets		30
Property plant and equipment		184
		<u>214</u>
Inventories	143	
Payables less receivables	<u>(149)</u>	
Working capital		(6)
Net Deferred tax asset		16
Current tax liability		(20)
Provisions		(12)
Operating assets employed		192
Net funds ¹		42
Net assets excluding pension liabilities		234
Pension liability ¹		(66)
Total net assets		168

¹ Stated before £25m cash contribution to pension liability on 1 September 2006

The movement of net assets over the year is as follows:

	£m	£m
Opening net assets		105
Profit before tax and exceptional items	51	
Tax on above	(10)	
		41
Share based payments and employee share schemes		6
Dividends paid		(15)
Tax effected movement in pension scheme deficit		(16)
Movement of intercompany account on demerger		66
Purchase and issue of own shares		(6)
Other items		(4)
Net assets before exceptional items		177
Exceptional items (net of associated tax)		(9)
Closing net assets		168

The Group's net assets have increased from £105m at the end of 2005 to £168m this year.

Return on Capital Employed

Total capital employed and ROCE were as follows:

	Operating Capital Employed £m	ROCE %	ROCE% with operating leases capitalised
High Street	180	23%	13%
Travel	21	148%	47%
Retail	201	36%	18%
Central items and property	(33)	-	-
Operating assets employed	168	35%	17%

For the prior year, comparable average returns were 23 per cent (12 per cent - after capitalised operating leases)

Pensions

At 31 August 2006, the gross defined benefit pension deficit is £66m (2005: £60m). The pension deficit has increased mainly due to actuarial adjustments in relation to the lengthening of mortality rates. The results include net finance costs of £3m (2005: £1m).

In September 2005, the Company and the Trustees of the WHSmith Pension Trust (the "Pension Trust") agreed that they would adopt a new investment policy in order to substantially reduce the volatility in the underlying investment performance and the risk of a significant increase in the deficit in the defined benefit fund. The assets in the investment fund were restructured in order to adopt this policy. This involved the assets being invested such that they are expected to alter in value in line with changes in the pension liability caused by changes in interest and inflation ("a Liability Driven Investment 'LDI' policy").

The key features of this fund restructuring are as follows:

- 94% of the fund's assets are invested in an LDI structure with a leading international institutional fund manager
- 6% of the fund's assets are invested in a portfolio of long-dated equity call options. These represent a notional exposure to underlying equities of some £350m.

The impact of this change in investment policy is to substantially reduce the volatility in the fund and the resultant risk of a significant increase in the overall deficit whilst enabling the fund to continue to benefit from any potential higher returns in the equity markets.

On the date of demerger, 31 August 2006, the assets and liabilities of the Pension Trust and the WH Smith Retirement Savings Plan (a defined contribution plan) were split between the News business and the Retail business by way of a "sectionalisation". Each section only contains the accounts of members who are or were employed by the relevant business. There will be no cross subsidy or cross guarantees between the sections of the Pension Trust.

The assets and liabilities of the defined benefit scheme were allocated to the News business section and the WH Smith Retail business section in proportions that reflected the related liabilities of active, deferred, pensioner and orphan members belonging to the respective News and Retail businesses.

On 1 September 2006, the Group made a £25m one-off cash contribution to the Pension Trust. The Group has agreed with the Pension Trust Trustees to make aggregate ongoing pension deficit funding payments of approximately £10m each year for the next five years.

Financing and capital structure

The Group is financed through a mixture of debt, comprising overdrafts and credit facilities, finance leases, loan notes and equity (ordinary and preference shares).

The Group signed a five-year multi-currency £90m revolving credit facility agreement on 26 June 2006. The agreement contains provisions, obligations and certain financial covenants, which are customary under such an agreement.

In order to facilitate the demerger the Company issued 182,919,970 ordinary shares to the shareholders of Smiths News PLC on a 1:1 basis. On 7 September 2006, a capital reduction was undertaken with the nominal value of ordinary shares reduced from 195p to 20p each, which created £320m of distributable reserves.

Operating leases

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

The business has an annual minimum net rental commitment of £124m (net of £8m of external rent receivable). The total future rental commitment at the balance sheet date amounted to £832m with the leases having an average life of seven years. The net present value of these commitments is approximately £558m. This is considered to be a satisfactory situation for, 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.

The Group has contingent liabilities relating to reversionary property leases. Pursuant to the terms of the Demerger Agreement, any such contingent liability will be apportioned between the Group and Smiths News PLC in the ratio 65:35 (provided that the Smiths News PLC liability is limited to £5m in any 12 month period). We have estimated the Group's 65% share of the future cumulative rental commitment at approximately £102m (2005: £118m).

Basis of preparation and accounting policy changes

In accordance with IFRS 3 'Business Combinations' the financial statements of WH Smith PLC have been prepared as if the continuing operations of the Retail business were in existence for the whole of the period from 1 September 2004 through to 31 August 2006. Central costs of the pre demerger group have been mainly allocated to WH Smith PLC.

The Group adopted IAS 32 "Financial Instruments: Presentation and Disclosure" and IAS 39 "Financial Instruments: Recognition and Measurement" at 1 September 2005.