

## Operational review continued

### Homebase

Homebase is being repositioned as the UK's leading home enhancement retailer. Its strategic priorities are to:

- improve the existing core business;
- enhance and extend its home furnishings offer; and
- deliver synergies by leveraging the scale and expertise of ARG.

During the year under review, Homebase has made substantial progress in executing this strategy.

Homebase has started to improve the in-store experience, by better stock availability, less cluttered stores, enhanced retail standards and a major step forward in customer service, with over 17,000 staff completing the culture change programme. Customers are recognising these enhancements, which are directly contributing to the improvement in sales performance.

Homebase will accelerate its new store opening programme. From its current base of 278 stores, Homebase plans to open an additional 10 stores in financial year 2005 and a further 15 to 20 stores each year from 2006 to 2008. Following the successful trial in 2004, roughly half of these will be smaller stores. This format is 30-35,000 square feet of trading space including the mezzanine and external garden area. It offers edited ranges in markets where a larger store would not be viable or available. The current performance of new stores, particularly small stores, is substantially above the investment hurdle rate.

Homebase continues to roll out the mezzanine format. The performance of stores with mezzanines remains strong, generating an average sales uplift of 15% across the total store. The additional space is used to showcase kitchens, bathrooms and home furnishings, without reducing space for core DIY products. Homebase plans to add mezzanine floors to a further 35 stores in 2005, at a capital cost of about £1m each. In addition, most new stores will be built with a mezzanine.

Home furnishing ranges and the mezzanine offer continue to be improved. The 'Mezzanine II' format has been trialled in 12 stores during 2004. These changes to mezzanine ranges, lighting, display and merchandising techniques, combined with more profitable space allocation, will be used in all new mezzanines. The miHome range, which offers contemporary, quality products at competitive prices, has been tested in ten stores since September 2003. These new ranges will be extended across the chain over time, whenever range reviews are undertaken, resulting in a significant offer of miHome product in all stores by Easter 2005.

Homebase is starting to deliver the benefits of being part of ARG. In 2004, this has enabled the rapid launch of a new Homebase store card, use of the ARG Hong Kong and Shanghai buying offices and improvements to the big ticket home delivery offer. 2005 will see further benefits from the acceleration of direct importing and lower media buying costs.

Supply chain gains are accelerating at Homebase. A thorough review of sourcing at Homebase and the areas of product overlap with Argos has been undertaken. The opportunities to drive down costs and to improve the Homebase product offer are significant, giving ARG confidence that savings at least equal to those envisaged at the time of acquisition will be achieved. The bulk of these gains will, as previously indicated, be re-invested in the business and in reducing prices further for consumers.

### Homebase

	2004	2003
	£m	£m
12 months to 28 February		
Sales	<b>1,483</b>	246
Total growth	<b>5%</b>	-
Like-for-like growth	<b>3%</b>	-
Operating profit	<b>102.2</b>	2.2
Operating margin	<b>6.9%</b>	-
At 28 February		
Number of stores	<b>278</b>	273
Of which: number with mezzanine floor	<b>67</b>	36

In the twelve month period to 28 February 2003, Homebase had sales of £1,416m and operating profit of £101.6m, an operating margin of 7.2%.

**ARG Financial Services**

12 months to 31 March	2004 £m	2003 £m
Sales	<b>60</b>	34
Profit before funding costs	<b>6.8</b>	(6.4)
Interest charge	<b>(12.3)</b>	(6.7)
Operating (loss)	<b>(5.5)</b>	(13.1)
At 31 March		
Gross loan book	<b>374</b>	192
Number of active store card holders (000s)	<b>765</b>	634

**Financial review**

Sales in the 12 months to 28 February 2004 increased by 5%, 3% on a like-for-like basis. The Home-related categories performed particularly strongly, especially in kitchens and bathrooms. In the second half, all major product areas showed year-on-year growth.

Gross margin was in line with last year, with supply chain benefits exceeding £5m, mainly through terms harmonisation between Argos and Homebase. These gains funded lower prices and higher sales of lower margin kitchens, bathrooms and furniture.

Operating profit in the year was £102.2m, a similar level to last year. This is after significant investment in the store portfolio, with higher depreciation and rates on the roll-out of mezzanine floors. The investment in costs of change was approximately £6m in the full year, covering mainly staff training and the one-off costs associated with improving the home delivery offer.

**ARG Financial Services**

ARG Financial Services (ARG FS) works in conjunction with Argos and Homebase to provide their customers with the most appropriate credit offers to drive product sales. This currently includes store cards, personal and product loans and insurance products. As well as driving merchandise sales in the stores, ARG FS is expected to move into profit after funding costs for the first time in 2005 and to generate significant profits over time.

In 2004, ARG FS grew strongly, almost doubling its total loan book. The Argos store card has maintained its good performance during the year, now funding 9% of sales at Argos. The store card outstanding receivables have grown by nearly 50% in the year. Argos loans also continued to grow well, with the number of loans issued and the gross loan book more than doubling in the year.

Following the acquisition of Homebase in December 2002, ARG FS utilised its existing infrastructure to launch quickly to Homebase customers both a range of personal and product loans (in April 2003) and a new store card (in October 2003).

ARG FS expects to invest about a further £150m in its loan book during 2005 to fund additional lending to both Argos and Homebase customers.

**Financial review**

In 2004, ARG FS earned a profit of £6.8m before funding costs which are charged against operating profit. The loan book at ARG FS is funded on the GUS balance sheet, with an assumption of 10% equity and 90% debt. The interest cost of the debt (£12.3m in 2004) is charged against ARG FS operating profit, with the Group interest charge being reduced by the same amount.

Reported operating losses after funding costs reduced to £5.5m in 2004, reflecting the maturity of the Argos store card loan book, which was in profit for the first time in 2004 since its launch in 2001. This was offset somewhat by the start-up investment to launch the Homebase products.

**Wehkamp**

12 months to 31 March	2004 £m	2003 £m	Change at constant FX
Sales	<b>235</b>	226	(3%)
Operating profit	<b>21.4</b>	19.9	-
Operating margin	<b>9.1%</b>	8.8%	

**Wehkamp**

Sales at Wehkamp, the leading home shopping brand in Holland, were 3% lower in euros compared to last year. This reflects the difficult Dutch economy and retail market, as well as increased competition. Wehkamp has a multi-channel model and is the leading Internet retailer in Holland. In 2004, about one-third of its merchandise sales were via the website and this is expected to rise further in 2005.

The change in product mix towards higher margin fashion, together with tight control of operating costs, resulted in a slightly improved operating margin.

The £/euro exchange rate moved during the year from an average of €1.55 in the year to March 2003 to €1.44 in 2004. This increased reported sales by £16m and operating profit by £1.5m.