

## Chief Executive's statement

In a particularly difficult trading environment, we have managed our costs and cash very effectively to limit the impact on profits.

**This focus has put us in an even better position to trade through another tough year while further improving our competitive position. We will continue to develop our broad product range, benefit further from our advantaged sourcing operations and invest in our multi-channel operations in order to strengthen our position as the UK's leading home and general merchandise retailer.**

### Outlook for our markets

Total consumer spending in the £60 billion home and general merchandise market declined marginally in calendar year 2008. Within individual product categories we have typically held or gained some share; however, our greater relative exposure towards some of the weaker markets such as furniture, homewares and DIY resulted in our overall 10% share of the total market remaining unchanged.

Looking ahead, we continue to expect a difficult trading environment for the product markets in which we operate. We remain in a position of planning cautiously in respect of the outlook for consumer confidence in general and for the level of discretionary household spending.

In addition to reduced consumer demand, there are also further retail industry-specific pressures. Given the weakness of sterling, the cost of goods for the majority of home and general merchandise products will increase for virtually all UK retailers. A further area of pressure will be the likely continued cost inflation that retailers face.

Against this difficult economic backdrop, Home Retail Group, as the UK's leading home and general merchandise retailer, will continue to pursue a strategy to further its competitive advantage.

### Benefit of broad product offerings

Argos and Homebase are strong retail brands and household names that draw demand from having a wide customer appeal. Average transaction values are low at £20–30, while purchase frequency is relatively high at around five visits per customer each year. The Argos operating model typically allows it to offer the product range depth of a specialist retailer in each of the many categories in which it operates. Homebase is well positioned across the broad home enhancement market. The product ranges are also adjusted to the changing needs of customers over time.

The product offering will continue to be strengthened to maximise opportunities during the consumer slowdown, and to target further share gains in large product markets such as consumer electronics at Argos and kitchens at Homebase.

### Leadership in multi-channel convenience

Leadership in multi-channel convenience remains key to differentiating the shopping experience for customers, enabling them to shop how they want to today and in the future. Some 40% of Argos' sales are now multi-channel, i.e. internet and phone orders, or store orders for home delivery. The fastest growing channel continues to be online reservations for immediate store collection, a unique service across the entire product range and available in every store. The internet in total generated £1.1bn or 26% of Argos' sales.

Argos and Homebase will continue to develop their internet offerings as a further important growth opportunity; the potential of the internet is significantly supported by the presence of an expanding store network for additional customer convenience. It is also supported by the scale efficiencies of the shared home delivery infrastructure that delivered 12 million items in the year. The shared Financial Services platform, which provides promotional credit offers across all customer channels, adds further competitive advantage. >>



**Terry Duddy**  
Chief Executive

## Chief Executive's statement continued

### Gross margin management

The Group remains committed to delivering customer value while trading through the consumer slowdown. Our product markets will however see significant impact from the weakness of sterling, which is likely to more than offset any underlying easing in supplier manufacturing and shipping costs. Prices to consumers are therefore likely to rise in some of our product markets, but the Group will remain price competitive and the prices of thousands of lines will still be held flat or lowered.

As a market leader, the Group's scale advantage will continue to see it well positioned to stay price competitive relative to most other retailers operating in the same product markets and facing the same overall product cost pressures.

### Advantaged sourcing operations

As well as purchasing scale, the Group's skills and infrastructure in all areas of sourcing create a highly advantaged supply base that will enable it to continue to provide excellent customer value. Buying directly from overseas has grown to 33% of Group sales, with our overseas buying offices now directly sourcing around 8,300 product lines across the majority of the Group's product categories. These shared sourcing operations will continue to be the major driver of Group synergy benefits.

There is expected to be further progress on growing the proportion of products directly sourced from overseas manufacturers, as well as additional benefits from value chain projects, supplier base management, and synergies in purchasing goods or services that are not for resale.

### Managing the cost base for further efficiencies

In a likely environment of declining sales, coupled with further inflationary pressures on the operating cost base, there will be an ongoing need to deliver further cost efficiencies across all parts of the Group. To offset each 1% of underlying inflation across the operating and distribution cost base would require around £20m of cost savings to be found, whilst declining sales volumes would require even further cost reductions to be made.

Given the inherent benefits in its operating cost model, Argos has a strong track record of achieving cost efficiencies and positive cost productivity. While ongoing action on costs will still be required at Argos, there remains a more significant challenge at Homebase given it is a more highly operationally geared business. A number of organisational changes across the

Group are already being made in order to deliver annualised cost savings of approximately £50m, of which around £35m will be achieved in the new financial year.

### Focus on cash generation

The Group will maintain its focus on cash, building upon the success of the past three years over which time approximately £500m of net cash has been generated. Capital expenditure will be restricted to where it generates the highest levels of return and to that required to keep our infrastructure well maintained; excluding brand acquisitions, net capital expenditure reduced by around a third to £132m in the year being reported, and is expected to fall further in the new financial year. Working capital will also continue to be tightly managed; stock levels were reduced by around 7% year-on-year and the overall movement in working capital was broadly neutral.

The Group will still invest capital selectively in order that its businesses will emerge from the consumer downturn strongly positioned. This will include around 20 new stores at Argos and approximately five at Homebase in the new financial year.

### Overall position of strength

Home Retail Group faces the challenging backdrop from a position of operational and financial strength. The Group's broad product offerings, low average transaction values and frequent customer visits are likely to offer resilience. Our strength and leadership in multi-channel retailing will ensure the relevance of our business model by offering true customer convenience. Product cost pressures will be dealt with by appropriate trading strategies and our competitive scale advantage, skills and infrastructure in Group-wide sourcing operations. The drive for further cost efficiencies and our overall focus on cash generation will further protect our position. All of this will be delivered by our colleagues, with their commitment, effort and passion for success being a critical element of the strength of Home Retail Group.

The Group therefore expects to demonstrate further good relative performances in its markets, and to emerge well positioned from the current economic downturn.

**Terry Duddy**  
Chief Executive

£484m

of net cash has been generated over the last three years.