

First Quarter Trading Update, 21 July 2004

Analyst conference call transcript

David Tyler, Group Finance Director, GUS plc

1. Introduction

Thank you very much. I am with Fay Dodds here in London, and with Peg Smith of Experian, on the line from North America, who will join me in answering any questions. Let me start by welcoming you to the call, and summarising our performance.

First of all, we have had the very sad news today that Craig Smith, who had been the Chairman of Experian for some years, has tragically passed away after a short illness. We are extremely sad to have to give this news; we gave it to shareholders at our annual general meeting this morning and had a minute's silence. All of us express our deepest sympathy to his family, and we will miss him here at GUS and Experian very deeply, both from a professional and a personal point of view.

Having said that, business must go on, and let me now take you through what we said in our announcement this morning.

2. Argos

Sales

Sales for Argos grew by 15% in the quarter. New stores contributed 6% of that growth and like-for-like sales showed 9% growth in the quarter, which was clearly an extremely encouraging figure for our business. Building on the success of the Spring/Summer catalogue, which was launched back in January, we saw strong sales growth across the board at Argos, with particularly good performances from photographic products, white goods and seasonal leisure lines.

Delivering Value

A lot of this success came from offering customers even better value. Prices were 3% lower on re-included lines in this catalogue than in the one the year previously. We had a lot of very compelling offers in the main catalogue, and we continued our strong promotional programme with seasonal flyers in a number of areas such as outdoor toys.

Gross Margin

As a result, gross margin for the two quarters that covered the Spring/Summer catalogue this year was in line with last year, and that helped us drive the extra sales growth that we saw in this catalogue. As you can now see, this was something of a shift in emphasis in our trading stance, compared to the catalogue that was out in the months before Christmas last year.

Increased Choice

Argos continued to deliver increased customer choice. You will see further evidence of that on Saturday when we launch our Autumn/Winter catalogue, in which there are 13,200 lines – 4% more than last year. In addition to that – and probably even more significantly – Argos Extra will have 17,000 lines available in about 150 stores from this weekend, which is double the current level.

Unsurprisingly, the catalogue offers even better value than last year. Customers will benefit from the supply chain gains that we have achieved, and the effect of the weaker Dollar will also lead to lower catalogue prices in Sterling.

The Multi-Channel Offer

The convenience of our multi-channel offer continues to drive performance at Argos. Argos Direct sales grew by 30% in the last three months, and now represents 25% of our total sales, as compared with 23% a year ago. Online sales grew by 60% in the first quarter, and internet orders now account for 6% of our sales. A further 9% of sales are either reserved on the phone, the internet or by text message for collection later in the store. This is a real multi-channel offer, and that is one of the main reasons that we are driving performance.

3. Homebase

Sales

Homebase sales increased by 5% in the four months to June; of this, 3% came from like-for-like growth and 2% from our new stores. It was very pleasing to see that over this very important trading period, which included Easter, Homebase again saw positive growth in all of its four major areas: core DIY; decorative products; garden products; and home products.

As we have said before in previous quarters, kitchen and bathroom sales were very strong, and that has certainly been helped by the improved ranges and merchandising, especially on the mezzanine floors. However, we also saw good growth in our core DIY lines, such as tiling and air conditioning products.

Gross Margin

Gross margin was in line with last year, with the customer again benefiting from the supply chain gains and synergies we are achieving.

Achieving Objectives

18 months on from acquiring Homebase, we are pleased with the progress it is making around all of its key strategic objectives. Those objectives were: improving the key retail disciplines; enhancing the home enhancement offer; and delivering synergies with Argos. All of that is going very much according to plan, and as we said at the prelims, we expect that the synergy savings of £20 million mentioned at the time of the acquisition will, at the very least, be achieved at that level within the first three years after acquisition.

4. Experian North America

Sales

Experian showed double-digit sales growth in this quarter. At constant exchange rates, global sales from continuing activities increased by 15%. Please note in this figure that, as we said at the time of the prelims two months ago, these sales growth numbers exclude discontinued activities, such as the lettershops we sold in the US and the UK call centres. The difference between the 15% sales growth now and the reported 7% obviously represents the impact of the weakness of the Dollar and the Euro in the last 12 months.

Mortgage Refinancing Market

In North America, sales from continuing activities in dollars grew 12%. Of this, 7% came from corporate acquisitions and therefore 5% was underlying growth. However, that growth was achieved despite an adverse impact from the slowdown in the mortgage refinancing market, which was at its peak this time last year. That slowdown reduced our rate of growth in this quarter by 5%.

Resilience

Overall, the performance in the first quarter in Experian in North America shows that the portfolio is resilient as we move through the economic cycle in the US, with solid performance during both the downturn and the upturn.

Credit and Marketing

Our credit and marketing activities both show good underlying growth. We did well in Consumer Direct, our direct-to-consumer offers, saw double digit growth in decision solutions, especially in areas such as fraud and our Scorex business, and had some good wins in marketing, particularly with clients in the real estate, travel, retail and financial services areas. We also benefited from the affiliate acquisitions, which added around 2% to our growth in the quarter.

5. Experian International

Sales

Experian International, which accounted for 45% of worldwide revenue last year, grew sales from continuing activities by 18%, of which 7% came from the single acquisition in the last 12 months. There was underlying growth of 11%, with credit and marketing again performing well in the quarter. Highlights included the strong consumer credit information and value-added products growth that we saw in the UK and throughout Europe, especially Experian Scorex, which continues to trade particularly well.

Global Strategy

Globally, Experian continues to benefit from its clear strategy of building on the core, selling new solutions, and growing through targeted acquisitions. We acquired a number of companies in the last 24 months, and all of those are reinforcing Experian's competitive position and leveraging the assets we have.

6. Burberry

The Burberry figures came out on Monday, and sales grew by 14% at constant exchange rates, with good growth in all three channels: retail, wholesale and licensing. We remain confident in Burberry's future growth plans.

7. South African Retailing

In South Africa, the partial IPO remains on track for this year, subject to market conditions, and we will update you on current trading when appropriate as the process goes forward.

Summary

Although in GUS as a whole we are conscious of the challenges we face in some of our markets, we believe we can continue to build on the strong sales momentum in the first quarter in all of our businesses and make further progress during the course of the year.

Questions and Answers

Brad Eichler, Stephens Inc

Equifax has announced that it plans to put a surcharge in place for the FCRA FACTA exposure due to begin in October. What is your position on that?

Peg Smith, EVP, Strategic Business Development, Experian Global

Regarding the Equifax announcement, frankly that is not material to us; we will set that aside and do our own independent analysis of the cost impact to Experian of what we now know to be the final rules for operating the central source. We have said consistently that we would look to push back any significant cost to clients, and that is still our intention.

We now know the approximate size of what is expected from the FTC in terms of building the central source, and that gives us guidance around modelling the cost impact. We have no announcement at all on the mechanism for cost recovery, but it is still our intention to push cost back to the client.

Brad Eichler

Have you heard anything from the FTC on how much you could charge for a credit score?

Peg Smith

That is one of the most relevant pieces of our economic models. It has not yet been released by the FTC. They had originally said 15 October, and then said it would be at the end of the summer. What we do know is that they have ceased taking comments from anyone about guiding them in that process – they are in that deliberation now. We expect to see it within the next couple of weeks.

Brad Eichler

Finally, the North American Division is in a challenging environment and 5% looks like good growth. Can you talk in more detail about what you are seeing this past quarter on the mortgage refinancing and marketing sides of your business?

Peg Smith

Of course, we have a tough comparable this quarter versus this time last year in terms of the mortgage refinancing. As you know, in the US there were spikes of activity both in April and then again in June around mortgage refinancing, because rates had been fluctuating across the board. This time last year, mortgage refinancing represented about 10% of total revenue, and we have seen that drop to our normal position in a business year, which is closer to 5%. That is why David referenced the 5% impact of mortgage refinancing, but business is growing around that.

Brad Eichler

What is happening in marketing?

Peg Smith

We are seeing slow continued growth in low single digits on our core consumer marketing services, such as direct marketing lists. It is still early in the growth process, but where we are seeing good growth is in things like automotive information, and our recent acquisition of CheetahMail for e-mail marketing has proved to be very successful. We are seeing a good rate of growth in those kinds of businesses.

David Tyler

In terms of the numbers Peg was giving, 10% of our sales this time last year came from all our mortgage activity, not just the mortgage refinancing. The slowdown we have seen, from around 10% of our activity to 5%, was because of the slowdown of mortgage refinancing. Underlying mortgage activity, of course, continues at much the same level as the previous year.

Frederick Searby, JP Morgan

The way I interpret it is that if there is a significant cost, you would also put in a surcharge, although you are not going to make any definitive announcements until the rules are clarified more by the FTC.

What is the outlook for a pick-up in credit card marketing? The yield curve has flattened somewhat, and we have talked about the sub-prime coming back and loan loss levels coming down. What is the outlook and sense in the market? Some of your competitors have announced some fairly solid numbers. Are we finally, after a long drought, starting to see a pick-up in direct marketing activities? What is your sense there? I am looking more for a forward-looking statement with all the usual caveats than I am for a rear-view mirror comment.

Peg Smith

On the surcharge, I think we have said about as much as we can at this point until we make an announcement. It is our intention, as we have always said, to pass costs on if they prove to be significant.

On card marketing, we have seen a pick-up and it has continued. It started around December; it is not explosive growth, but the card issuers are back in the market and we are seeing solid single-digit growth in the credit marketing arena.

Frederick Searby

Is credit card marketing accelerating or decelerating now?

Peg Smith

It has levelled out from that first quarter activity. We have not seen the total number of pieces in the mail yet for the second calendar quarter.

Frederick Searby

What do you think about the second half of 2004? Do you think it will continue to level out or pick up?

Peg Smith

I think they will stay in the market at about the same level that they are right now.

Frederick Searby

There will be no pick-up?

Peg Smith

The difference is in the comparables in third and fourth calendar quarter of 03. Those were the two softest card marketing periods.

Frederick Searby

That is what I am saying: do you see a year-on-year pick-up? Are you saying that it will pick up year-on-year although it is staying at the same rate on a sequential basis?

Peg Smith

Yes.

David Tyler

Irrespective of the market as a whole, we are picking up good contracts. We are pleased about the competitiveness of our business going forward.

Frederick Searby

What about pricing and bank consolidation for the credit bureaux? Historically there have been pricing pressures driven by technological change that you then pass through that efficiency. What is the state of that? Is the kind of consolidation we have seen causing disruption and pricing pressures, particularly the mega-consolidations?

Peg Smith

Any time you see major players such as Bank of America, Fleet, Chase or Bank One combine there is pricing pressure as a result – that is not unexpected. We have seen these mergers and acquisitions heat up periodically across the US. The combination of their volumes pushes them to a better tier of pricing, and they also come back to negotiate better rates.

The good news is that when they go through those consolidations they also orientate their business for stronger growth, and the outcome is normally an increase in total spend, but it is slightly out from the actual point of merger.

Frederick Searby

Are you worried about the flattening in the yield curve? Do people typically pull back when the yield curve flattens or do they get more aggressive to try to make up for it?

Peg Smith

My experience in this industry is that they get more aggressive.

Robert Miller, Dresdner Kleinwort Wasserstein

Could you tell us what contribution to the growth rate in North America came from Consumer Direct?

David Tyler

We have not given a specific answer to that, because it is getting into too much detail, but Consumer Direct continues to grow much faster than the average in the business, and it has become quite a big part of the business as a whole. Clearly, part of the pick-up is because of that strength.

Robert Miller

Was the MetaReward acquisition an add-on to the Consumer Direct effort?

David Tyler

That is correct.

Robert Miller

Is it located in the same part of the disclosure as Consumer Direct?

David Tyler

We have separated it out, and that is within the 7% contribution that came from corporate acquisitions. It will of course be included within Consumer Direct when we announce the figures, and that is within the credit information box.

Andy Hughes, UBS

I have a couple of questions on Argos. You said in your presentation that the Autumn/Winter catalogue would be even better value. Are you implying that the price deflation will be more than 3%?

David Tyler

I am not going to give you a precise figure, but you can assume that the impact of the Dollar's fall was not fully reflected in our last catalogue, given how we hedge forward for buying the Dollar. We have been buying it at a much more attractive rate for the catalogue that is coming out today than the one six months ago. That will have an impact on prices. We will no doubt provide more information about the precise percentages in due course, but we are not ready to do that today.

Andy Hughes

Have you got an update on the performance of the Argos Extra stores? I know that the figure of 150 stores is unchanged, but is there a change in the split between what will be stocked in and what will be neighbourhood stores?

David Tyler

We have got nothing new to say on that from what we said two months ago at the prelim statement. We are seeing high single-digit growth on those where it is stocked in, as you indicate, and a low single-digit number where the items are not. All being well, our sense is that as we move towards maturity and customers get more used to it, those numbers will get better rather than the reverse.

Andy Hughes

You seem to be making good progress with Homebase, certainly on the back end of the business. What are surveys telling you in terms of what customers like and dislike about what is going on at Homebase?

David Tyler

They are showing improvement, which is encouraging. We even thought about showing something two months ago at the preliminary announcement, in terms of what our customers are saying and what general DIY customers are saying about the businesses. We are seeing improvements in customer perception, service, value for money and trust in the operation. Some of the key things are beginning to turn or have already turned in the right direction over recent quarters, but we do not pretend for a minute that we have not got a lot more to do. However, we are on track in terms of what we intended.

Ashish Pant, Farallon Capital

Regarding the call centres that are going to be sold in the UK and taken out of the continuing activities, can you give a sense of how big that revenue was last year?

David Tyler

It was around £3 million for the quarter as a whole this time last year, so it was quite modest. You will not be surprised to learn that the average profit margin in this business, like other outsourcing businesses, is lower than the average for Experian as a whole.

Fay Dodds, Director of Investor Relations, GUS plc

If you look in the back of the preliminary pack we did in May, you will see that we have restated the H1, H2 and full year numbers to strip out all discontinued activities, which is why we are reporting continuing activities only going forward.

Ashish Pant

Do you include the affiliate acquisitions in organic growth?

David Tyler

Yes, because we cannot make the number evident due to the fact that we integrate the acquisitions almost immediately after we have acquired them. However, we can give you an estimate of the figure of about 2% of sales from affiliate acquisitions in the last 12 months.

Ashish Pant

We know that MetaRewards was a part of the 7% contribution of acquisitions in North America – were there others? CheetahMail, I presume.

David Tyler

Yes, CheetahMail was the second one and MarketSwitch is the third. The latter is very much the smallest of the three, but it is a very exciting optimisation and decisions solutions business that we think will give us great growth in the future. CheetahMail is doing exceedingly well. E-mail marketing stands out for us, and following the acquisition we are delighted with the progress of that business.

Ashish Pant

You referenced Scorex growth a couple of times. Are you seeing that primarily outside the US, or are you starting to see that grow substantially in the USA?

David Tyler

It is growing faster outside the US than inside, but we are seeing ever better growth in the US with its product range, and we have talked about it again on this occasion, as you have heard.

Michael Meltz, Bear Stearns

Following up on the question about Consumer Direct growth, can I take those comments to mean that the business grew at a similar rate as in the past few quarters?

David Tyler

As the business gets bigger the rate of growth on the whole has been slowing, but it still much faster than the average in Experian North America as a whole.

Michael Meltz

Have you adjusted the marketing strategy for Consumer Direct yet in light of the FACT Act?

David Tyler

No, not yet, although clearly there will be some natural adjustments after the FACT Act comes into play.

Michael Meltz

In terms of the growth of your decisioning products, do you attribute that to general market growth or do you think you are taking some share?

Peg Smith

It is a combination of both. It is a competitive business with the solutions that are out there on the decisioning side, but we have had some nice contract wins up against our entrenched competitors in that space. It is a combination of both the expansion of the market and taking share.

Michael Meltz

Is that business growing faster than the core business?

Peg Smith

It is growing faster than the core, albeit from a smaller base.

Mal Patel, HSBC

In terms of Experian and the free credit reports, can you give us some idea whether you have incurred significant cost already, with regards to the centralised facility? If not, when do you expect the bulk of that cost to be incurred?

Peg Smith

We are already incurring costs on the central source; it needs to be up and operational by 1 December. Regardless of the fact that we did not get the final rules until the end of June, we had to be working along the path of getting that up and operational, and at the same time working on the other compliance requirements in

the FACT Act that are above and beyond a free report. It has been a busy time on the compliance activity front.

Mal Patel

Before you decide on how to mitigate that cost, can you give us an idea of when that cost will peak?

Peg Smith

That is one of the unknown factors on this issue. As you know, we are doing a geographic roll-out and it did finalise that. That is at least an effort to smooth out some of the volumes as we make this available to consumers across the US. At this point, we see maybe four peaks as they roll out each of the four regions.

Mal Patel

Does that begin in Q3?

Peg Smith

It begins on 1 December in the western states and then goes eastwards.

John Baillie, SG Securities

In terms of Consumer Direct and Experian, are the margins getting closer to the divisional average of businesses reaching maturity?

David Tyler

No, they are ahead already. They were ahead last year and they continue to grow, because of the growth of this business being faster than the rest of the business.

John Baillie

Can you give an indication of the differential and the average in Consumer Direct?

David Tyler

I am afraid not. We are going to keep some things commercially confidential, but you can go on assuming that it is an attractive business to be in. Largely, the costs of information are in place already.

Henrik Olssen, Theorema AM

Argos is growing very strongly – who do you think you are gaining market share from? Secondly, in terms of Homebase how much do you think the market will grow in the second half of the year?

David Tyler

You will not be surprised if I do not give you a very detailed answer. We are clearly growing faster than the market in nearly every product area in Argos. Therefore, you

can assume we are gaining share in most product areas. I am certainly not going to try to pick out individual businesses from whom we are gaining share.

As far as Homebase is concerned, it is difficult to say how the DIY market will grow in the remainder of the year. In general, we see consumer demand growth in the UK slowing as we get through the year with the impact of interest rates in particular. However, we continue to believe that our DIY and home enhancement business in Homebase will continue to show sales growth.

Concluding Remarks -David Tyler

Thank you again. I appreciate you all joining us. It has been a very good day for us in terms of trading, but a very tragic day in personal terms. The next trading statement, talking about the first six months for the business as a whole, will be made on 14 October. We look forward to talking to you then, if not before.