

The GUS logo is rendered in a white, serif typeface against a blue background. The letters are bold and closely spaced.

ARG – Strategic Sourcing
June 2005

Maria Thompson

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Richard Ashton
Finance Director
Argos Retail Group

Agenda

- Introduction to ARG
- Strategic sourcing
 - Theory - how we approach it
 - Practice - real world examples
- Scale of operations

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ARG – integrated business model

- Multi-brand, multi-channel
- Separate customer facing brands
- Leverage ARG infrastructure and scale
 - Sourcing and supplier management
 - Customer services (multi-channel, home delivery and contact centres)
 - Financial services
 - Shared services (property, finance, HR, IT)

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ARG – multi-brand, multi-channel



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ARG

12 months to 31 March	2005 £m	2004 £m	Growth* %
Sales	5,535	5,162	7
Operating profit#			
Argos	325.8	297.4	10
Homebase	110.1	102.2	8
Financial Services	0.2	(5.5)	na
Wehkamp	19.9	21.4	(6)
	456.0	415.5	10

* At constant exchange rates

Before one-off charges in 2005 for the OFT fine (£16.2m) and Homebase reorganisation costs (£18.3m)₆

Argos

12 months to 31 March	2005 £m	2004 £m	Growth %
Sales	3,652	3,384	8
Operating profit	325.8	297.4	10
Operating margin	8.9%	8.8%	

- Against weakening market, sales up 8% (H1 13%; H2 5%)
- New space of 5%; like-for-like sales up 3%
- Gross margin increased slightly; sixth year of improvement



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Homebase

12 months to 28 February	2005 £m	2004 £m	Growth %
Sales	1,580	1,483	6*
Operating profit	110.1	102.2	8
Operating margin	7.0%	6.9%	

- Homebase gained share with 6% sales increase
- Like-for-like growth of 3%, driven by mezzanines, new ranges and big ticket items
- Gross margin slightly ahead, helped by ARG supply chain



* Growth excludes 29 February 2004

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Argos – delivering sustainable growth

Improve choice	<ul style="list-style-type: none">▪ Argos Extra▪ Range expansion
Improve value	<ul style="list-style-type: none">▪ Supply chain▪ Cost productivity/efficiency
Improve convenience	<ul style="list-style-type: none">▪ Argos Direct▪ New stores▪ Speed of service▪ Serviceability



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Homebase – delivering sustainable growth

Improve customer offer	<ul style="list-style-type: none">▪ Homebase Way▪ Range reviews▪ New ad campaign▪ Improve service and standards▪ Improve stock availability
Increase new space	<ul style="list-style-type: none">▪ New stores▪ Mezzanine rollout
Leverage ARG scale	<ul style="list-style-type: none">▪ Joint sourcing▪ Transactional website▪ Direct catalogues▪ Financial Services



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ARG – difficult market background

- Consumer spending slowed sharply in recent months
 - Expect decline in like-for-like sales in non-food, non-clothing market in current year
 - Retailers facing higher cost inflation
- Argos and Homebase not immune, but
 - Robust cost control and productivity drive
 - Ongoing initiatives to deliver sustainable growth

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The logo for GUS, consisting of the letters 'GUS' in a white, serif font, set against a blue background with a grid of squares.

Strategic Sourcing
Theory - how we approach it

Maria Thompson
Commercial Director
Argos Retail Group

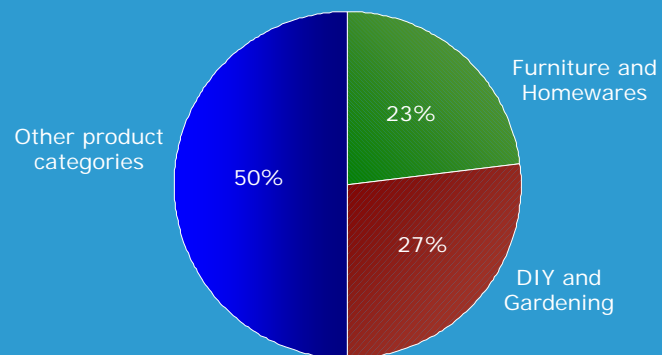
ARG - supply chain

- Why did Argos embark on a Supply Chain programme in 2001?
 - To enable growth
 - To offer great value
 - To retain retail leadership
- Equally relevant to Argos and Homebase today



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Scale opportunity is huge



Argos and Homebase
combined sales
£5.2bn

Year to March 2005

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ARG Commercial - priorities

- Demand effectiveness
 - Identify opportunities to grow sales through new, emerging and existing product sectors
- Value Chain
 - Identify opportunities to improve product cost prices, supplier rebates and sources of supply

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Reducing the cost of goods is key to increasing competitiveness

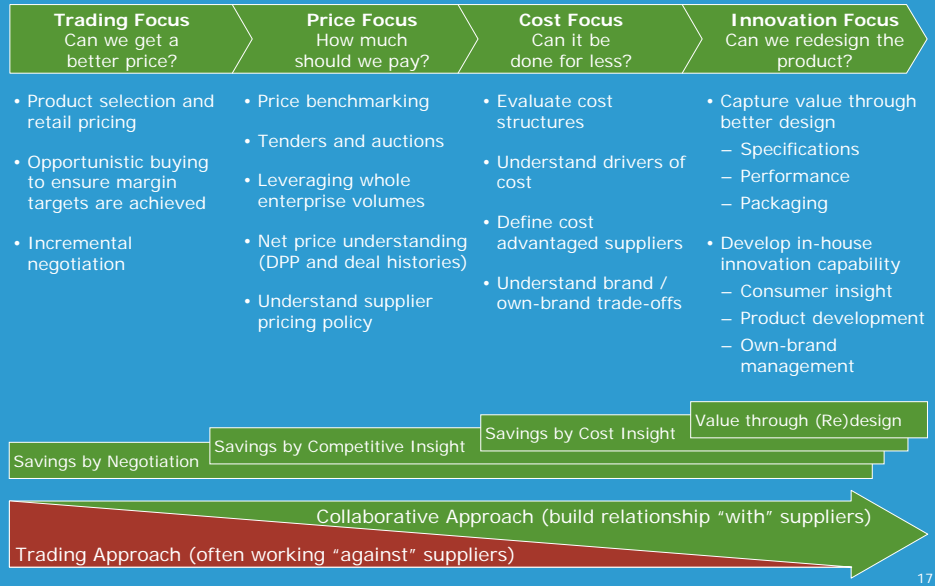
Illustrative financials for a typical retailer:

	Trend	Typical y-on-y change	This year £	Last year £
Retail prices	↓	-3%	97.0	100.0
Cost of goods	↓	-8%	(50.7)	(55.0)
Property costs	↑	5%	(10.5)	(10.0)
Logistics	↑	4%	(10.4)	(10.0)
Personnel costs	↑	3%	(10.3)	(10.0)
Others	↑	2%	(5.1)	(5.0)
Profit requirement	—	0%	10.0	10.0

Reduction in cost of goods required to maintain retail profit

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Value Chain - approach



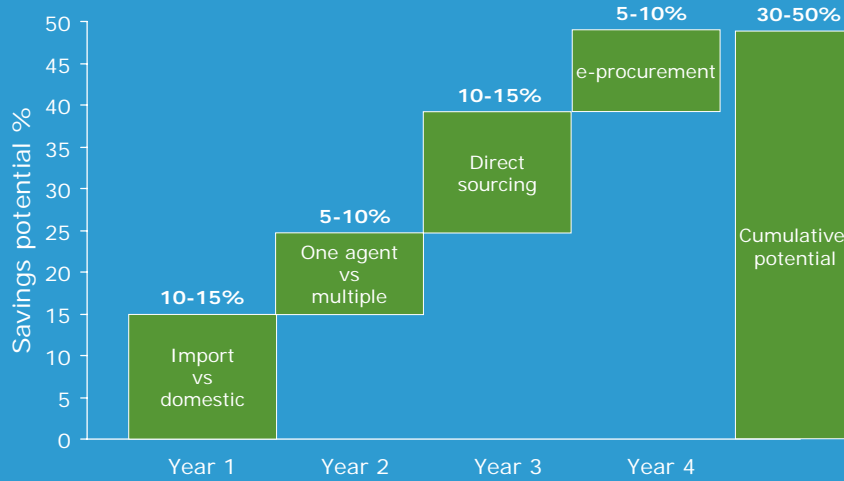
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Strategic sourcing

- Increase direct importing
- Increase direct sourcing by using ARG Hong Kong and Shanghai offices
- e-procurement
- Leverage ARG scale and expertise

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Strategic sourcing – potential benefits



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Supplier management

- Supplier rationalisation
- Harmonisation of terms
- Strategic supplier relationships
- Leverage ARG scale



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Services and processes

- Freight forwarding
- Off-shore consolidation
- Off-shore warehousing
- Ethical sourcing
- Product specifications
- Packaging
- Joint sourcing trips
- Alignment of timetables



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GUS

Strategic Sourcing
Practice - real world examples

Domestic to direct importing

Slimline chrome/seagrass storage



- Approach
 - Product making lower % margin than average for the range
 - Sourcing brief given to a few suppliers
 - Product continued to be sourced via existing supplier but on a DI basis
- Result
 - 18% cost price reduction after DI costs

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Domestic to direct sourcing

Bath/shower mixer tap



- Approach
 - ARG Asia identified three factories for nine specified product lines
 - Product spec comparisons made between domestic supplier and DS sources
- Business awarded to factory which matched quality as well as delivering significant cost savings
- Result
 - 59% cost price reduction

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Direct importing to direct sourcing

Venetian blinds



- Approach
 - Hard blinds previously sourced through agent
 - Rest of range sourced directly from factory in China
 - Contract awarded to same supplier as rest of range
- Result
 - 14% cost price reduction

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Direct sourcing supplier consolidation

Christmas trees



- Approach
 - Eight factories in the Far East, supplying similar types of artificial tree
 - Five factories participated in tender
 - Factories offered better prices for increased volume
 - Supply base consolidated from eight to two
- Result
 - 47% cost price reduction

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Reverse auctions

Inflatable pools



- Approach
 - Online auction for eight inflatable pools
 - Request for quotation sent to five suppliers inviting them to submit samples
 - Buyers and Quality Assurance reviewed samples and chose bidders for auction
- Result
 - Further 14-19% cost price reduction
 - Over and above 31% saved on auction in previous year

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Terms alignment

Bedding and textiles



- Approach
 - Argos and Homebase sourcing from the same suppliers, but rebates not consistent
 - Combined scale greatly increased
 - Joint negotiation held
 - Terms improved to reflect value of growth and alignment of rebates based on greater scale
- Result
 - Improved trading terms by 4%

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Value of growth

Ovenware



- Approach
 - ARG growth allows supplier to spread fixed costs over higher volume
 - Assessment to work out cost price reduction expected from ARG growth
 - Renegotiation of terms to bridge 'gap'
- Result
 - Additional 4% cost saving agreed

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Currency benefit

Sports equipment



- Approach
 - US \$ weakened by over 25% since early 2002
 - Domestic suppliers who invoice in £ but buy products/components in \$ gained cost advantage
 - Gap calculated between \$ benefit and cost price reductions/terms improvement achieved
- Result
 - A further 3% cost reduction

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Packaging design

Toilet seats



- Approach
 - Product packaging redesigned
 - Supplier packaging savings gives lower cost price
 - Savings on shipping and distribution costs
 - Initiative rolled out to a broader range of DS toilet seats
- Result
 - £320k no longer going down the pan!

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Category review

Power tools

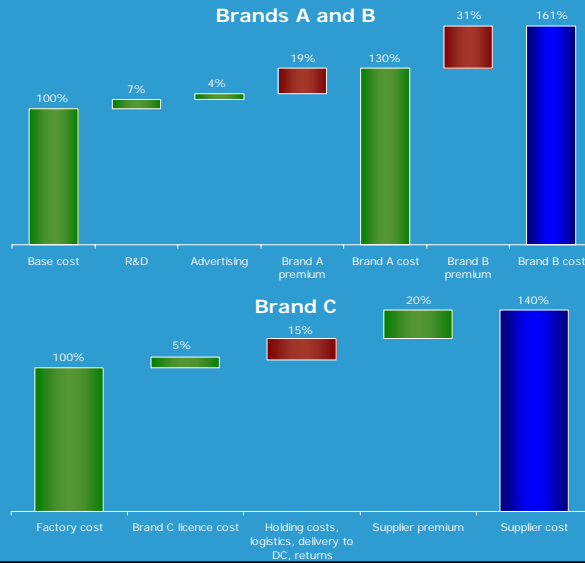


- Process
 - Brand premium - reducing cost of brand premium by changing brand mix, sourcing direct and strengthening own-brand
 - Costs in stages of Value Chain - commission, agent margin, after-sales support
 - Value of growth
- Approach
 - Reduced reliance on branded supply
 - Joint sourcing of own-brand
 - Introduction of exclusive brands
 - Joint tender on accessories
- Result
 - 10%+ cost savings

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Valuing the joint savings opportunity required us to understand costs

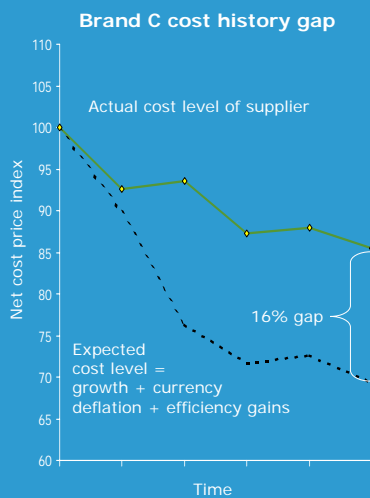
1. What is the brand premium



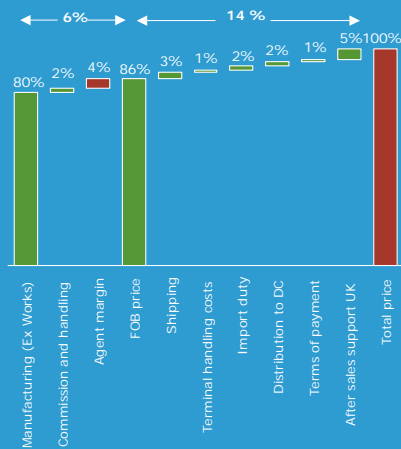
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Valuing the joint savings opportunity required us to understand costs

2. What is the cost price history versus expectations



3. What are the costs in the Value Chain



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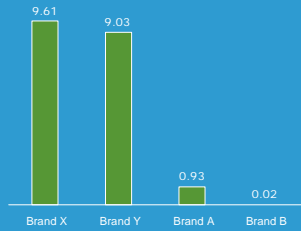
Scenarios used to develop strategies for the category

An understanding of demand side profitability

...lead to the definition of range strategies that could maximise the opportunity..

...and identified consistent actions to capture supply side benefits

Net profitability per linear/cubic metre by brand/agent



Scenario: 1

- Develop a third MPP brand
- Migrate X% unit volumes into more profitable own brand and third brand
- Maintain ranges from Brand A and B

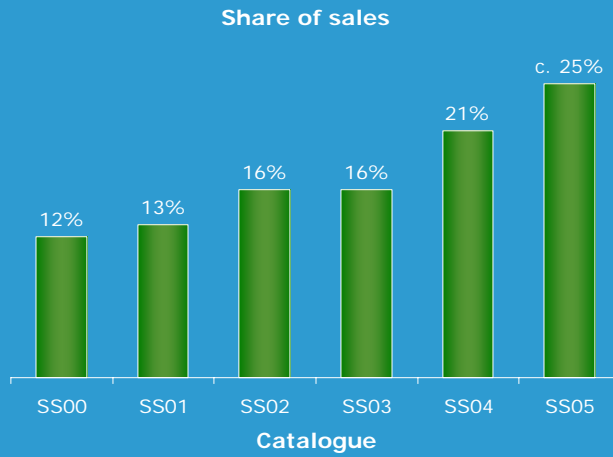
- Brands
 - Lock in benefits of projected value of growth
 - Renegotiate range listing based on profitability
 - Third MPP brand: identify partner to develop MPP brand and commence capability building
- Own brand
 - Short term: cost benchmarking and bidding to achieve lowest possible cost
 - Long term: direct sourcing from China

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GUS

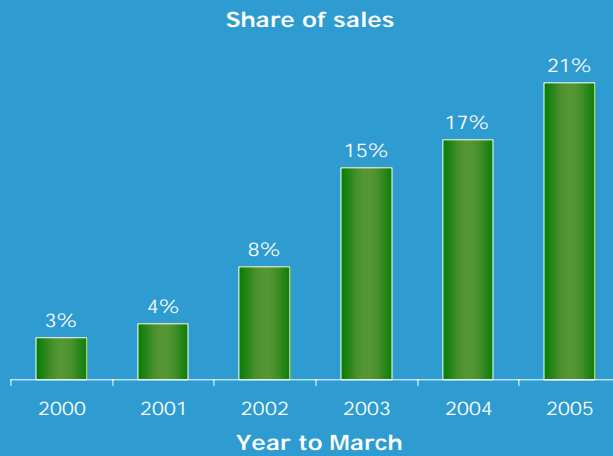
Scale of operations

Argos – growth in direct importing



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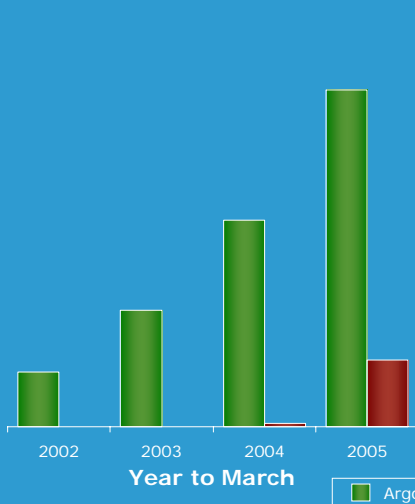
Homebase – growth in direct importing



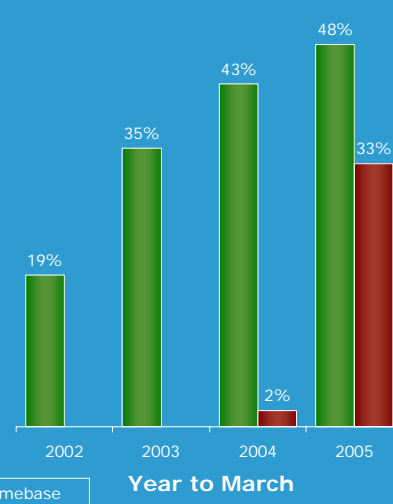
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ARG Asia

ARG Asia purchases
\$m



ARG Asia as
% of total imports



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ARG Asia

- Employ over 120 people with offices in
 - Hong Kong – opened Sept 2001
 - Shanghai – opened March 2004
 - Shenzhen – opened July 2004
- Opportunity
 - Explore developing regions
 - Open further offices in the region
 - <50% of ARG imports are on a direct sourced basis

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Scale of logistics infrastructure

- Off-shore consolidation
- Leading UK break bulk and import distribution centre
- Single freight forwarder appointed
- Systems development
- Trialling/looking at alternative ports
- Expanding use of rail haulage



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Summary

Summary

- Argos : £50m benefits per annum on track
- Homebase integration : £40m benefits per annum on track
- Benefits will be reinvested as appropriate
 - Price
 - Service
 - Infrastructure
 - Gross margin improvement
- Supply chain progress to underpin success in ARG

The GUS logo is displayed in white, serif capital letters against a blue background. The background features a pattern of overlapping, semi-transparent blue squares of varying shades, creating a textured effect.

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