Operational review – Argos Retail Group

Argos Retail Group (ARG) had another successful year, with sales up 9% and profit up 20%, generating a 0.5% improvement in the operating margin.

The highlight of the year under review was Argos' performance (sales up 13% on a like-for-like basis). Profits at UK Home Shopping grew significantly while it continued to reduce marketing spend on unprofitable customers. Profits also rose in European Home Shopping. The major investment of £20m in Financial Services, which has been taken through the profit and loss account, has started to build a valuable long-term business, with over 625,000 Argos store card holders at the year end.

Argos Retail Group

12 months to 31 March	Sales 2002 £m	Sales 2001 £m	Operating profit 2002 £m	Operating profit 2001 £m
Argos	**2,847**	2,387	**204.0**	160.8
Home Shopping – UK & Ireland	**1,533**	1,540	**33.1**	25.1
Financial Services	**11**	–	**(4.8)**	4.5
Home Shopping – Continental Europe	**238**	322	**22.4**	21.7
Total	**4,629**	4,250	**254.7**	212.1
Operating margin			**5.5%**	5.0%

Argos

Argos had an excellent year, increasing sales by 19% and profit by 27%, generating a half point improvement in the operating margin. This performance was aided by strong consumer demand in the UK, which is expected to moderate in the current year. However, we are confident that Argos will continue to perform well in its markets as it pursues a programme of growth initiatives, aimed at improving choice, value and convenience for its customers.

Excluding Argos Additions and jungle.com, Argos' sales increased by 17%, or 13% on a like-for-like basis. Argos grew share in all its major categories, with particularly strong performances from furniture, consumer electronics and electricals. Gross margins remained firm, helped by better buying and direct importing, which now accounts for 17% of sales (up from 12% two years ago). In the core chain, costs as a percentage of sales fell despite continued revenue investment, particularly in the supply chain programme.

As previously outlined, Argos has a clear strategy for growth and has made good progress this year against its objectives:

– *it will increase the planned rate of store openings to about 35 per annum.* At 31 March 2002, Argos had 490 stores, an increase of 18 in the year. Planned new stores for the current year should contribute about 4% to sales growth;

Terry Duddy
Chief Executive
Argos Retail Group

Argos

12 months to 31 March	2002 £m	2001 £m	Change
Sales*	**2,847**	2,387	19%
Operating profit*	**204.0**	160.8	27%
Operating margin	**7.2%**	6.7%	

*includes Argos Additions and jungle.com

- *it will refurbish all remaining small stores by March 2004.* To date, 175 store refurbishments have been completed. Sales uplifts provide a good return on investment, while customers benefit from greater convenience as in-store processes are improved;
- *it will further enhance choice for customers by extending the range of products and services offered to them.* The current Spring/Summer catalogue has over 9,200 lines, a 7% increase on the same catalogue last year. The Autumn/Winter 2002 catalogue, launching in August, will have over 11,000 lines;
- *it is investing £120m over four years in its supply chain.* In the year to March 2002 Argos has initiated its supply chain programme, by starting to build its new central and direct import warehouse, by opening the ARG Hong Kong buying office and implementing the first part of the new IT and software systems, improving stock and sales planning and forecasting. The full supply chain programme will yield benefits of about £50m per annum to invest in supporting margin or improving its value proposition. Pricing in the Spring/Summer 2002 catalogue on re-included lines was 2% below last year; and
- *it will grow capacity and improve customer service in Argos Direct, the delivery to home operation.* Sales via Argos Direct grew by 50% compared to last year. It accounted for 16% of Argos' sales – up from 12% last year. Preparation for the construction of the new Argos Direct warehouse has started, with completion planned before the end of the current financial year.

Following national rollout in January, sales at Argos Additions were £130m, up from £55m last year. The customer base has grown in line with expectations but average spend per customer has lagged, leading to further refinement of the offer in terms of product, credit and marketing to drive sales and profits.

Jungle.com re-launched its website in February 2002 and completed the installation of new enterprise-wide systems in Autumn 2001. Despite cutting costs in personnel, overheads and IT, jungle.com made an operating loss in the full year, against a background of weak demand and pricing for computer products.

Operational review – Argos Retail Group

Home Shopping UK and Ireland

12 months to 31 March	2002 £m	2001 £m	Change
Sales	**1,533**	1,540	(1%)
Operating profit	**33.1**	25.1	32%
Operating margin	**2.2%**	1.6%	

Financial Services

12 months to 31 March	2002 £m	2001 £m
Sales*	**10.7**	–
Operating (loss)/profit	**(4.8)**	4.5

*Sales represent interest income, fees and commissions relating to the Argos store card

Home Shopping UK and Ireland

UK Home Shopping has made further progress this year in creating a smaller, but more profitable agency business, while developing low risk opportunities in the growing direct market.

As expected, sales for UK Home Shopping as a whole were down 1% on last year. Agency sales, which accounted for 80% of the total, were reduced by a further 2%. The active agency customer base fell, as planned, to 2.8m, with average spend per agency customer up 7% year on year. The main direct catalogues include Marshall Ward, Abound and Style Plus. Sales through these direct titles increased by 17% in the year, led by more seasonal and promotional catalogues from Marshall Ward and the successful launch of Abound in August 2001.

Operating profit grew by about a third to £33.1m. Gross margins were unchanged on last year. Further cost savings totalling about £30m were made during the year in areas such as marketing, logistics, call centres and supply chain, in line with our plans to reduce annual fixed costs by £80m in total over the three years to March 2003.

In the current financial year, in spite of a further planned reduction in agency sales, profit at UK Home Shopping will be underpinned by further cost savings and growing sales from direct catalogues.

Financial Services

As previously indicated, about £20m was invested through the profit and loss account during the year, primarily in the launch of the Argos store card. This has progressed well. At 31 March 2002, there were over 625,000 account holders, of which about 460,000 were active. Balances outstanding were £105m and over 5% of Argos' total sales were financed during the year on the card. Argos personal loans were launched as planned in February 2002. Revenue investment spend on the development of Argos personal loans and the further growth of the Argos store card is expected to be about £15-20m in the year to March 2003.

Profit increased from the remaining parts of Financial Services, including insurance and personal loans to Home Shopping customers, despite the decline in their numbers.

Home Shopping Continental Europe

12 months to 31 March	2002 £m	2001 £m	Underlying change*
Sales	**238**	322	5%
Operating profit	**22.4**	21.7	0%
Operating margin	**9.4%**	6.7%	

*at constant exchange rates, excluding disposals

Reality

12 months to 31 March	2002 £m	2001 £m	Change
Sales to external customers	**97**	93	3%
Sales to ARG	**374**	383	(2%)
Total sales	**471**	476	(1%)
Operating profit*	**0.5**	5.1	
Operating margin**	**0.5%**	5.5%	

*after charging £4m of restructuring charges in 2002 (2001: nil)
**operating profit as % of sales to external customers

Home Shopping Continental Europe

Following the disposal of our Austrian and Swiss home shopping businesses, which together generated sales of £94m in the year to March 2001 (2002: nil), Wehkamp now accounts for over 80% of European Home Shopping sales and profits. In the year to March 2002, sales in euros at Wehkamp increased by 5%, driven by a strong performance in branded clothing and publicity around Wehkamp's 50th birthday. Sales and profits in Halens, the Scandinavian operation, were slightly down, as the market remained highly competitive.

e-commerce

Across ARG, e-commerce sales continued to grow strongly to £164m, compared to £78m in the previous year. 3% of Argos' sales were over the Internet, while 12% of Wehkamp's sales were through its website.

Reality

During the year to March 2002, Reality made further progress in reducing costs for ARG and generating third party business.

Sales growth for external customers in the core logistics and call centre activities was over 10% in the year. Total reported sales to external customers grew by 3% as Reality withdrew from some non-core, unprofitable businesses such as vehicle servicing. In addition, there was a marked slowdown in market demand for web design services, where Reality has reduced costs significantly. The outstanding goodwill of £23m relating to the acquisition of Reality Solutions in May 2000 was written off at the end of the year.

As previously stated, Reality is reporting into ARG from 1 April 2002, with Experian International taking responsibility for call centre and related activities, serving predominantly external financial services clients. As already announced, further cost efficiency programmes have identified over 300 redundancies, mainly in managerial and administrative positions. A £4m charge, associated with the cost of these redundancies, has been taken against Reality's operating profit in the year to March 2002.

From 1 April 2002, Reality's external sales will be included in two divisions. The external logistics sales will be reported as a separate line under ARG, with the call centre and related activities sales becoming part of Experian International's Outsourcing business. For the year to March 2002, the split on this basis would have been £74m of external logistics sales within ARG and £23m in Experian International Outsourcing. The majority of the profit would have been included within ARG, predominantly in Home Shopping.