

## **Second Half Trading Update – 12 April 2006**

**David Tyler**

Good morning, everyone. I am here with Fay Dodds and Peg Smith. This presentation is to discuss and to answer questions on GUS's financial performance for the second half of its financial year and, of course, the trading update that we issued this morning. Due to certain legal and regulatory restrictions, we will not be able to discuss or answer questions about the planned demerger of Argos Retail Group (ARG) and Experian beyond what has already been publicly stated and made available previously.

### **1. ARG Performance**

#### **Argos**

Both Argos and Homebase outperformed their markets in what continues to be a very difficult UK retail environment in this period. Argos increased sales by 9%, all of which came from new stores, including the 33 sites that we acquired from Index in the summer of last year. Like-for-like sales for the half at Argos were in line with last year, reflecting a satisfactory Christmas period and the successful launch of the new catalogue in January, which offered the full Extra range for the spring/summer catalogue for the first time. Consumer electronics continue to be a particularly strong performer. Gross margins for Argos were in line with last year. Argos continues to offer its customers more choice, with the national roll-out of Extra; more value, with prices in the current catalogue on re-included lines about 3% lower than last year; and more convenience, with sales ordered over the internet up by nearly 40% in the second half.

#### **Homebase**

Homebase operated in a very difficult DIY market, which worsened as the half progressed. Its sales in the five months to 28 February were down 1%, with new stores contributing 4% to sales. Like-for-like was down about 5% in the period. This performance was helped by the roll-out of Furniture Extra, as well as by more mezzanines, which helped to drive double-digit growth from big ticket areas, especially kitchens and furniture. Core DIY and decorating showed a significant like-for-like sales decline. Faced with an increasingly competitive market as the half progressed, Homebase increased its promotional activity, which was at the expense of gross margins. However, this failed to generate an acceptable increase in volumes, so this is clearly a tactic that will be used with more caution in the current financial year. As a result of these lower gross margins and higher costs, EBIT at Homebase in the year to 28 February is likely to be around £50 million. Looking forward, we remain cautious on the outlook for the DIY market, but we do believe that Homebase will continue to gain share as it benefits from its own initiatives and from being part of ARG, where it can leverage the infrastructure of that business.

## **2. Experian**

### **North America**

We are very pleased with the performance of the business, which recorded its fourth consecutive year of double-digit sales growth, reflecting the success of both its organic growth model and its ability to acquire and integrate related businesses. In the second half, sales at Experian grew by 25% at constant exchange rates, with 9% organic growth in both North America and our international businesses. In dollars, sales in North America increased by 35%, of which 26% came from corporate acquisitions. Credit sales there grew by 10% in the second half, benefiting from good market demand and the continuing growth of our value-added services. It is worth noting, however, that we would expect this growth probably to slow in the first half of our new financial year because the business faces particularly strong comparatives. Sales were up 18% in the six months to September 2005.

Moving on to Marketing, we saw solid organic growth here, helped particularly by our recent investments in email marketing and syndicated marketing research. In the meantime, our Interactive business more than doubled in the half, largely reflecting recent acquisitions, but also very strong 30% growth in our consumer direct business.

As we discussed in the statement, we are withdrawing from MetaReward's incentive marketing website, a market that has become unattractive because consumers no longer wish to fill in numerous offers to get their free gift. As a result, the quality of leads for our corporate clients has deteriorated. We expect to treat this business as a discontinued activity with effect from 1 April 2006. I would stress, however, that MetaReward operates on a very different model to our other lead-generation businesses within Interactive, such as LowerMyBills.com and PriceGrabber.com. These are in strong markets and remain buoyant, with over 40% pro forma growth in these businesses in the second half.

### **Experian International**

Sales here grew by about 13% at constant exchange rates, with 4% coming from acquisitions. Within this, credit growth accelerated slightly in the half, despite continued weakness in gross lending in the UK. Decision analytics in Europe and Asia Pacific were particularly strong. Marketing showed good growth, while outsourcing continued with its steady rate of growth. Experian has a very clear strategy here to deliver long-term growth for its shareholders, building on the core, selling these solutions, and acquiring complementary businesses.

There were many examples of success around the world in the second half. In terms of contract wins, we saw ClarityBlue, our very recent acquisition, securing a very good additional contract with B SkyB. We saw a new contract in France with Prud'homales, and triggers and Scorex wins in the US, as well as wins for Scorex, which was significant, in Japan, Australia and Taiwan. We have also seen a lot of other initiatives, including the launch of new products, such as the VantageScore in the US, where already we have over 200 clients who have indicated interest in purchasing it during the four weeks since the product was launched. It is worth saying that aside from all of that, our recent acquisitions are trading well.

At the same time, we have continued with our investment in new products, our investment in new geographic markets and new product markets, and our investment in infrastructure. All of this has had, and will continue to have, a contribution to Experian's future success.

## **Questions and Answers**

### **Brad Eichler, Stephens Inc.**

Could you comment a bit about the trends in the US information solutions business on the pre-screen side? Could you give a little bit more detail on the VantageScore in terms of the roll-out, the timing, and your expectations for that business looking forward?

### **Peg Smith**

We saw very strong activity in the second half in US information, particularly on pre-screen, and in particular in card marketing, but also in the use of pre-screen in product lines like home equity loans and even into auto loans pre-screening. Demand for pre-screen in the US is very broad-based and very strong.

We announced VantageScore just about a month ago, and in that time over 200 clients have come in to buy VantageScore, which we think is an early indication of interest across the customer base in terms of using a more predictive score. What is encouraging to me is that when I looked at the list of customers, it includes virtually every segment of the market by vertical market, and it is also the entire breadth of our customer base by size: we have everybody from strategic accounts, our highest volume accounts all the way down to small lenders who have come in and actually purchased from us, obviously indicating an interest in looking at the value of a different credit risk score.

### **Brad Eichler**

Do you envisage most people buying VantageScore as an increment to what they are currently buying, or do you think folks are doing more testing to see if this could be a replacement for some of the stuff that they are already buying?

### **Peg Smith**

I think right now clients are testing to figure out how best to use the score in their environment. Some will buy scores in tandem with other scorecards that are out there; others will switch, depending on how predictive business is for their portfolio and whether they can make better quality credit decisions based on Vantage. We think they can.

### **Brad Eichler**

Is it priced comparably to other competitive scores out in the marketplace, or are you trying to be a bit more aggressive on the pricing side?

**Peg Smith**

Pricing is obviously between us and our clients, but it is in line with the market expectations around what they are willing to pay us for.

**Brad Eichler**

As it relates to Marketing, you mentioned in the press release that data was a little soft. Can you elaborate on that? Secondly, what was the organic growth in the Marketing business?

**Peg Smith**

Data continues to be a little soft; that is not new news. In terms of Marketing Information, I think data sales are being impacted by two things in the US: the switch to online marketing obviously does not need as much data, and the more intelligent marketers become about who to target, the less data they need to buy. Both of those affect the overall demand for demographic information in terms of typical marketing. Organic growth in Marketing Information and Solutions is about mid-single-digits.

**Richard Chamberlain, Goldman Sachs**

Digging a bit deeper on Homebase, could you comment on what sort of areas or product areas you are seeing decent volume uplifts when you cut prices and which product areas you are not? What will the goodwill write-off be for MetaReward this year?

**David Tyler**

We are not going to get into the detail, I am afraid, because competitively it is not in our interest to do so. Clearly, however, we are saying that our core DIY and decorative lines did not do well during this period. On the other hand, items like kitchens and furniture benefited particularly from the better displays they got and the better service they are getting, particularly on the mezzanine. When it comes to promotional campaigns, across the board we were generally not getting the response that we had hoped for, and that is making us very thoughtful about how in future to actually run our promotional campaign.

**Fay Dodds**

We are still working through any potential goodwill charge for MetaReward with our auditors because under IFRS it is a little complicated.

**Peg Smith**

I will remind you that the purchase price was \$26 million, so it is by far the smallest of the acquisitions.

**Peter Pesta, One Investment**

Could you explain in greater detail what is happening at Argos? Comments have been made earlier today that costs there in the second half increased by as much as sales. What is driving that?

**David Tyler**

There are several key drivers of increasing costs: first, underlying cost inflation levels have been unduly high in the last 12 months on the UK retail scene; affected by rent, rates, fuel prices and the impact of the minimum wage; second, we are seeing significant expansion, adding 33 Index stores recently, as well as an additional 35 stores overall this year; and, finally, the distribution arm of Argos has been strengthened this year, enhancing future service through the addition of two major warehouses. All of these have a significant effect on costs.

**Peter Pesta**

The Index stores were bought and distribution was being built up in the first half, so why did the cost growth accelerate in the second half versus the first half?

**David Tyler**

At our preliminary announcement on 24 May, we will give much more detail on our P&L, since this is not the objective of today's call. Rather than accelerating, the cost growth has been impacted by the issues that you mentioned. It was also impacted naturally in the second half for the full half-year; some of the things we talked about impacted the full half-year in the first half of the year.

**Peter Pesta**

There is a perception that the decline in and ultimate closure of MetaReward is seen as a harbinger for the closure of other web-based services within Experian in the medium term. Could you give a more thorough explanation as to why you do not think that that is the case?

**David Tyler**

MetaReward is in a very different market to our major lead-generation businesses such as LowerMyBills and PriceGrabber, and our education portal, ClassesUSA. Each are in large market areas; within the mortgage-lending community, for example, there is a long-term, major market of mortgage lenders looking for borrowers, and the opportunity on the internet is to provide these borrowers in a much more efficient way than using the old, offline method. The mortgage-lending community spend more than \$20 billion a year finding borrowers, which is a huge amount of money, and we are seeing that the internet element of that market is growing very rapidly. LowerMyBills.com is very much a central part of that market and one of the market leaders in that space. In terms of comparison shopping engines, I am sure that everyone on the call has used them. PriceGrabber.com is a leading part of that market, which we see growing a long way into the future. The same goes for the

online education market, in which each online university needs to find efficient ways of acquiring customers.

These are long-term, sustainable and robust businesses in big markets, and are different to the small purchase of MetaReward that we made, which was very much in a different sort of market. We have taken the decision to close the great bulk of that business, simply because we do not think that it has a sensible, profit-making future.

**Matthew McEachran, Investec**

My first question is on Homebase: you have given the five-month sales figure and an estimate for full-year profitability; could you give us an idea of the profit impact as a result of the timing of Easter?

**David Tyler**

There is no impact on Homebase because we cut off on 28 February in terms of sales and profits. This year's EBIT contains last year's Easter, which was at the end of March.

**Matthew McEachran**

In terms of the promotional stance, the core DIY area was where the response did not really come through. Were the promotions planned well in advance, or were some in response to worsening performance in the core DIY products?

**David Tyler**

Some were planned well in advance. In the past, we have held 10% off days; we have done the same during this half-year. On this occasion, however, we offered discounts of up to 15% to customers spending £50 or more. This was not something that we planned earlier in the year, and this was clearly affected by competitive pressures.

**Matthew McEachran**

You have indicated that you are being thoughtful about what this means. It looks like it was a tail-end change in performance; do you suspect that you will back away from that? Should we expect that gross margin 'give-up' to persist into the new year?

**David Tyler**

You should not, because I think that we are giving indications that we are not happy with the result of the policy that we have been pursuing recently. Clearly, therefore, we are thinking about handling the promotional opportunities and the overall competitive environment in a different way going forward. I must make it clear that Homebase is benefiting significantly from the supply chain advances that we have made. We are buying much better than we were previously, and those advantages have all been passed on to consumers, with somewhat more during this last six-month period. In retrospect, we are not convinced that that was the right equation,

and we are closely scrutinising how we will handle that over the next six to 12 months.

**Matthew McEachran**

Finally, what was the space growth from mezzanine additions during the year?

**David Tyler**

They grew from 110 to 144 and they are proportionately about the same size, so by one third or modestly less.

**Michael Meltz, Bear Stearns**

It sounds like you had quite good momentum in the credit units in North America towards the end of the quarter; is that the case?

**Peg Smith**

Yes; we had a strong fourth quarter in terms of credit demand.

**Michael Meltz**

For clarification purposes, are you saying in the press release that Consumer Direct was up by 30% in the second half or for the full-year?

**David Tyler**

It was for the second half.

**Michael Meltz**

Are you closing the entire MetaReward business or just a portion of it?

**Peg Smith**

Essentially the entire business, or about 90% of the revenue. We do some of the credit card marketing through MetaReward, which we will preserve, but anything done on incentives to consumers to entice them to respond to offers will be shut down.

**Michael Meltz**

You said that it will be discontinued from 1 April; what is the timing of the actual closure?

**Peg Smith**

We have already notified employees and clients of the closure, and consumers coming to the sites are being notified that the sites are now closed. They have a certain amount of time to redeem any outstanding points if they qualify.

**David Tyler**

We have a talented group of R&D and engineering people on site in the MetaReward business, and we are retaining them to work on other interactive projects, using some of the skills and development from MetaReward elsewhere in the group. The benefits that come out of it, therefore, will be used elsewhere in Experian Interactive.

**Michael Meltz**

In terms of VantageScore, you have 200 clients buying something from you; what are they buying and what kind of implementation is necessary for a bank or a card lender to use the product?

**Peg Smith**

They buy a credit report with the VantageScore calculated on it, which means that their systems need to be able to accommodate the receiving and interpretation of that additional score. This is why the number is 200 and nothing higher, because they need to be able to determine whether this is appropriate for their business.

In terms of a major lending operation, it will take some time for them to validate this score against their existing portfolios and to ensure that they are making better credit decisions based on Vantage. Once they have done that, it is an issue of systems implementation. It is not a major programming effort, but they need to be able to take the score and ensure that they interpret it correctly against their own criteria. Major lenders usually take three to six months to convert to Vantage.

**Michael Meltz**

Can that be done in tandem with a computing product, or is that displaced?

**Peg Smith**

It can be done in tandem with any number of scores that the client wants to purchase from us or any other provider. We are happy to do whatever the client needs in order to help them make a better credit decision.

**Brad Eichler**

What products in the direct-to-consumer business seem to be selling well? You mentioned an increase in average selling price, but what is driving that?

## **David Tyler**

The Triple Advantage product is the main driver, and we have had tremendous success with it since its launch about 12 months ago. It gives the facility to the consumer to gain access to their consumer records held by all three credit bureaux. In addition, however, we have been successful with other products, although the price for Triple Advantage is typically higher than consumers were paying previously.

## **Brad Eichler**

You mentioned the strength in the UK market; is that on the consumer or commercial side?

## **Peg Smith**

We have seen robust growth in the UK in both consumer and business information. Business information has been growing by double digits in the UK. It has been a successful business for us; we are adding our credit solutions directly into commercial lending and it is performing well for us. On the consumer side, while there has been a general slowdown in new account origination in credit in the UK, we are seeing more use of our information across the rest of the credit processes; e.g. in account management, collections, recovery etc. We are also selling more into new vertical markets, including the public sector, telecommunications and utilities. It is broad-based and we are very pleased with our UK performance.

## **John Baillie, SG Securities**

Gross margin at Homebase seemed to move from slightly down in the third quarter to a very material move in the fourth quarter. What does that trend look like in the first quarter?

## **David Tyler**

As I mentioned earlier, we are thoughtful of our promotion strategy, which was the key impact on our gross margin during the last six-month period, and particularly in the latter part of it. Going forward, we have an opportunity to change it, if we wish, and we will not be impacted by what we were doing in the past.

## **John Baillie**

Are you starting from the point of the fourth quarter margin or are you planning to rebuild it from as early as the first quarter this year?

## **David Tyler**

You will have to wait and see. We are not anxious to publicly state our plans going forward. In a business like Homebase, however, we have opportunities to adjust the promotional strategy on a month-by-month basis. You will have to make your own observations, although we will update the market at the right time, as to how we change our strategy going forward.

**Matthew McEachran**

In the Argos Extra catalogue, where does the range extension come from largely?

**David Tyler**

Leisure and DIY have been a big feature, and there have been range extensions in many other categories.

**Matthew McEachran**

On the DIY front, is it mainly home and garden rather than core DIY?

**David Tyler**

Yes, although some core DIY items are bought by the same buying teams as Homebase. There is also a much wider range of leisure items within that.

**Fay Dodds**

Leisure is the area where we have seen the largest number of line extensions, followed by home, and particularly furniture, and electricals.

**Matthew McEachran**

Is the new catalogue already available?

**David Tyler**

It has been out since January.

**Closing Comments**

**David Tyler**

Thank you for attending. The next scheduled call will be on 24 May, when we will make our preliminary announcement of our results for the year.