

Smiths News

**Smiths News PLC
Preliminary Results Announcement
For the twelve months ended 31 August 2006**

Smiths News is the UK's leading newspaper and magazine wholesaler delivering over 60 million publications to 22,000 retailers every week.

OPERATIONAL HIGHLIGHTS

- Major contracts renegotiated - 81% of revenues covered by contracts with average remaining term of four years until expiry
- Additional £50m of annualised sales revenue won from magazine distributor Frontline
- Consolidation of newspaper sales and marketing operation from 36 depots to 2 centres of excellence
- Good start to 2007:
 - New contracts won from Northcliffe Newspapers and Johnston Press to distribute titles in the Plymouth and Peterborough areas
 - The Returns Company is working with Waterstone's to process book returns from Ottakars stores during integration

FINANCIAL HIGHLIGHTS - CONTINUING

- Trading profit⁽¹⁾ up 5.9% to £39.5m (2005: £37.3m)⁽²⁾
- Profit before interest and tax up 4.3% to £34.3m (2005: £32.9m)⁽²⁾
- Profit before tax up 0.9% to £32.0m (2005: £31.7m)⁽²⁾
- Free cash flow of £27.5m⁽²⁾
- Basic earnings per share up 6.3% to 15.1p (2005: 14.2p)⁽²⁾
- Dividend proposed of 4.0p

FINANCIAL HIGHLIGHTS – GROUP (Including discontinued operations)

- Basic earnings per share of 33.7p (2005: 26.6p)

⁽¹⁾ Profit before interest and tax stated before central overheads, share based payments and pension service charges

⁽²⁾ Stated on a continuing basis

Commenting on the results, Mark Cashmore, Chief Executive said:

“Despite the challenging trading environment, these positive results highlight the inherent strengths of the Smiths News business.

The newspaper and magazine distribution markets continue to provide opportunities for growth and development. Trading in the first 5 weeks of 2007 has been in line with expectations. In terms of future trading prospects, whilst we believe strongly in the resilience of the newspaper and magazine markets, we are planning on the basis of limited underlying sales growth this year, probably similar to the levels achieved in 2006.

The combination of a resilient market place, a programme of cost savings and efficiencies and the business's strong market position underpins the Board's confidence in the underlying prospects for Smiths News in its first year as a public company."

Enquiries (for 12 October only):

Smith News PLC

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An interview with Mark Cashmore in video/audio and text is available on:
<http://www.smithsnews.co.uk> and on <http://www.cantos.com>

OPERATIONAL REVIEW

Smiths News has made good progress in a busy year, which culminated in the separation from the Retail business of WHSmith PLC as an independent company. Smiths News produced a market leading performance in a challenging trading environment with increased profitability, improved service delivery to our publishers and retailers and the successful renewal of key contracts, together with some new contract gains. In addition, Smiths News has laid the foundations for developing new revenue growth opportunities.

During the year to 31 August 2006, Smiths News successfully renewed its contracts with Associated Newspapers, Financial Times, Guardian Newspapers and Northern & Shell. Consequently, Smiths News now has approximately 81% of its revenue covered by contracts with an average remaining term of four years until expiry. In addition, we were delighted to win new contracts with publishers in the Derby area and extend our existing contract with Frontline, principally in Newcastle, Northamptonshire, Oxfordshire and Cambridgeshire.

The newspaper market has remained resilient over the year with a continuation of the trends seen in the last few years of publishers increasing cover prices to counter-balance circulation declines. The magazine market continues to show innovation with a number of new launches, predominantly in the weeklies market, which has offset the declines in the monthlies market as consumers switch to weekly titles.

Smiths News has continued to focus on driving business efficiency in order to improve service to publishers and retailers and reduce costs. We have re-sited our newspaper buying and marketing processes from 36 depots into two centres of excellence to both improve customer service levels and reduce costs. In addition, we have improved our order picking and distribution processes. In anticipation of more challenging market conditions, we implemented a plan in the autumn of 2005 to reduce costs across all areas of head office.

In July 2006 the Office of Fair Trading issued a draft opinion on the status of magazine and newspaper distribution contracts under competition law. It also announced its intention to review the Newspaper Code of Practice that was established after the Monopolies and Mergers Commission enquiry into newspaper distribution in 1993. A final opinion is expected in the spring of 2007, together with the outcome of the Newspaper Code review. We believe the current arrangements serve consumers well. For some time our plans have recognised the market is becoming more retailer focused. Regardless of the outcome, our strategy of improving service and efficiency will not alter, and the business is well placed to respond to change and capitalise on opportunities that may arise.

Smiths News has made progress this year in developing new growth opportunities. In the core business, Smiths News has recently won contracts with two regional newspaper publishers to distribute regional newspaper titles in the Plymouth (Northcliffe Newspapers) and Peterborough (Johnston Press) areas. The annualised sales value of these two contracts is expected to be £8m.

The Returns Company is working with Waterstone's to process the return of books from Ottakars during its integration into the Waterstone's estate. This demonstrates the opportunities available to Smiths News as a result of the separation from the Retail business of WHSmith ("Retail Business"). Smiths News is continuing to work with SAP to develop the Newsworks business.

FINANCIAL REVIEW

Smiths News PLC completed the separation of the Retail Business on 31 August 2006. The results of the Retail Business are classified in the financial statements as discontinued operations for the years ended 31 August 2005 and 2006.

The information disclosed in this financial review relates solely to the continuing Smiths News business, unless otherwise stated.

Smiths News has made good progress over the year. Sales and profitability have continued to grow in a more challenging market. This has been achieved through management's continued focus on cost control and high levels of service for publishers and retailers.

Smiths News profit before interest and tax of £34.3m is up 4.3% from £32.9m in 2005. Profit before tax of £32.0m is up 0.9% from £31.7m. Basic earnings per share from continuing operations increased by 6.3% to 15.1p (2005: 14.2p).

The Directors of Smiths News PLC have proposed a dividend of 4.0p.

REVENUE

£m	2006	2005	Growth %	Underlying sales growth⁽¹⁾ %
Revenue				
Reported revenue	1,094.7	1,074.1	1.9%	
Sales to WH Smith PLC ⁽²⁾	115.9	113.0	2.5%	
Total revenue	1,210.6	1,187.1	2.0%	
Comprising:				
Newspapers	628.7	620.0	1.4%	2.3%
Magazines	531.6	519.8	2.3%	(0.9%)
Other	50.3	47.3	6.3%	6.3%
Total revenue	1,210.6	1,187.1	2.0%	1.1%

(1) Underlying sales growth excludes publisher contract gains and one-off prior year book promotions.

(2) Smiths News' sales to the Retail Business are reported as inter-segment sales to discontinued operations and are not included in reported revenue.

Total sales were up 2.0% to £1,210.6m (2005: £1,187.1m). Underlying sales growth was 1.1%.

Newspaper sales increased by 1.4% on last year. This figure includes new business gained in the recent contract renegotiation process, mainly in the Derby area. This partially compensated for the loss of the book promotional sales carried out by Associated Newspapers and Northern and Shell (Express Newspapers) in 2005, which have not been repeated in 2006. Excluding these two items, underlying newspaper sales growth was 2.3%, driven by price increases which more than offset volume declines.

Total Magazines sales were up 2.3% in the year. In April 2006 we won additional territories with the magazine distributor Frontline, equating to circa £50m of annualised revenue. This more than compensated for the loss of some Bauer business in April 2005. If these contract changes are excluded underlying magazines sales were 0.9% down year on year.

We have experienced differing trends in the weekly, monthly and partwork components of our magazine business.

Weekly sales have been buoyant, fuelled by the continued growth in the celebrity and men's lifestyle sectors and new launches. By contrast monthly magazines, as expected, have declined in the year as there has been significant switching by consumers from monthly to weekly titles. Overall the net position of weeklies and monthlies is broadly flat compared to last year. Partwork sales have fallen by 25% in the year ended 31 August 2006. However, this performance needs to be viewed in the context of two exceptional years, fuelled by CD/DVD collectable product. Partwork sales have now reverted to the levels experienced in 2003.

The growth in other revenues is driven by our two fledgling new businesses, Newsworks and The Returns Company. Other revenues also comprise income from publisher services and carriage service charges.

PROFITS

£m	2006	2005	Growth %
Revenue	1,210.6	1,187.1	2.0%
Gross contribution	129.1	130.8	
Operating costs	(90.9)	(93.9)	
Profits on property transactions	1.3	0.4	
Trading profit⁽¹⁾	39.5	37.3	5.9%
Central costs	(5.2)	(4.4)	
Profit before interest and tax	34.3	32.9	4.3%
Finance costs	(2.3)	(1.2)	
Profit before taxation	32.0	31.7	0.9%

(1) Profit before interest and tax stated before central overheads, share based payments and pension service charges.

Gross contribution was down £1.7m in 2006, largely due to margin dilution arising from the renewal of contracts and a change in the sales mix. This has reduced gross margin from 11.0% to 10.6%.

Operating costs reduced by £3.0m compared to 2005. These cost savings have been achieved through process consolidation, greater efficiency and tight cost management. On process consolidation, we have this year, re-sited our newspaper buying and marketing processes into 2 centres of excellence, whereas in the past this was carried out in the majority of our depots. Our focus on service has brought savings in rectification costs, enabling us to reduce significantly our overtime and agency costs. In addition, costs were reduced across all areas of head office.

Trading profit⁽¹⁾ of £39.5m is up 5.9% on the previous year, which represents a 50% increase on the trading profit of £26.0m reported in the year ended 31 August 2001.

Central costs of £5.2m included share based payments, defined benefit pension service charges and central overheads.

Profit before interest and tax of £34.3m (2005: £32.9m) is up 4.3%. Finance costs for 2006 are £1.1m higher than last year due to increased pension interest. Profit before tax of £32.0m is up 0.9% (2005: £31.7m).

Taxation

The tax charge for the year was £6.4m (2005: £7.3m). The effective tax rate on continuing activities was 20% benefiting from settling some of the outstanding prior year issues. This compares to 23% last year.

We anticipate that our effective tax rate will continue to be lower than the standard rate in the medium term.

Earnings per share and dividend

Smiths News generated basic earnings per share from continuing operations of 15.1p (2005: 14.2p), an increase of 6.3%. See Appendix 1 for further detail.

The Board has proposed a dividend of 4.0p per ordinary share. Subject to shareholder approval, the dividend will be paid on 9 February 2007 to shareholders registered at the close of business on 12 January 2007.

The Board intends to adopt a progressive dividend policy, targeting a dividend that would, over time, be broadly covered twice by earnings.

Pro forma

At the balance sheet date the Group had drawn down £50m of term loan. At 1 September 2006 £20m was drawn from the revolving credit facility, bringing the total debt drawn to £70m, from which a one-off payment of £25m was made into the pension fund. The effect of these transactions, had they taken place at 1 September 2005, would have been to increase finance costs by circa £2.7m for the year ended 31 August 2006. This comprises increased interest and fee amortisation on the credit facilities being partially offset by reduced pension interest.

On this pro forma basis we estimate profit before tax for the year ended 31 August 2006 would be £29.3m and taking into account the group's effective tax rate for the year of 20%, earnings per share would be 13.6p.

Discontinued Operations

Following the demerger of the Retail Business on 31 August 2006, the results of the Retail Business have been classified as discontinued operations for both the year ended 31 August 2005 and 2006.

The profit after tax from the discontinued business was £32m (2005: £22m). An exceptional charge after tax of £12m in relation to costs associated with the demerger were charged against the discontinued operations in the Group Income Statement. A £3m exceptional gain after tax was also recognised in the year against discontinued operations as a result of post retirement medical benefit liabilities being settled.

Basic earnings per share including the discontinued business was 33.7p (2005: 26.6p).

CASH FLOW

£m	Continuing Operations 2006
Profit before interest and tax	34.3
Depreciation & Amortisation	6.6
Non cash items	1.2
Working capital	(8.1)
Capital expenditure	(2.1)
Tax	(4.4)
Free cash flow	27.5

A reconciliation to the statutory cash flow is included in Appendix 2.

The outflow on working capital in 2006 is the reversal of timing differences, from which we had benefited in 2005.

Capital expenditure was tightly managed during the year. Going forward we would expect capital expenditure to be broadly in line with depreciation.

BALANCE SHEET

£m	
Non current assets	21.6
Working capital	(36.1)
Deferred tax asset	13.8
Corporation tax	(14.6)
Provisions	(1.3)
Operating liabilities employed	(16.6)
Net debt	(41.7)
Net liabilities excluding pension liability	(58.3)
Pension liability	(49.0)
Total net liabilities	(107.3)

Smiths News PLC is financed through a mixture of debt, comprising a term loan and revolving credit facility, finance leases and equity.

On 26 June 2006, Smiths News entered into a £100m facility agreement with Alliance and Leicester Commercial Bank plc, Barclays Bank plc, Lloyds TSB Bank plc and The Royal Bank of Scotland plc comprising a £50m term loan facility, and a £50m revolving credit facility. At 31 August 2006, the Group

had drawn down £50m of the term loan facility. This was used principally to settle intercompany indebtedness arising on the demerger of the Retail Business.

At 31 August 2006 net debt of £42m comprised £11m cash, £50m floating rate debt and £3m finance leasing. Subsequent to 31 August 2006, the Group drew down £20m from the available revolving credit facility to fund a one-off £25m contribution to the Smiths News section of the WH Smith Pension Trust.

On a pro forma basis, taking into account these transactions, net debt would have been £67m. On 1 September 2006 the Group entered into an interest rate swap to fix 75% of the term loan facility at 5.13% for 5 years.

Pensions

In September 2005, the Trustees of the Pension Trust adopted a new investment policy in order to substantially reduce the volatility in the fund. The assets in the investment fund were restructured in order to adopt this policy. This involved the assets being invested such that they are expected to alter in value in line with changes in the pension liability caused by changes in interest and inflation (“a Liability Driven Investment ‘LDI’ policy”).

On the date of demerger, 31 August 2006, the assets and liabilities of the Pension Trust and WH Smith Retirement Savings Plan were split between Smiths News and the WH Smith Retail Business by way of a ‘sectionalisation’, and are expected to be apportioned 35% to Smiths News and 65% to WH Smith Retail. Each section contains the accounts of members who are or were employed by the relevant business.

At 31 August 2006, the Smiths News gross defined benefit pension deficit under IAS 19 was £49m, approximately £34m net of related deferred taxes.

On 1 September 2006, a one-off contribution of £25m was made to the Smiths News section of the Pension Trust.

In addition to the one-off payment Smiths News has agreed with the Trustees to make aggregate ongoing pension deficit funding payments of approximately £5m each year for the next five years.

Appendix 1 – Earnings per share

Profit after tax from continuing operations (£m)	26
Basic number of shares (millions)	172
Basic EPS	15.1p
Diluted number of shares (millions)	173
Diluted EPS	15.0p

Appendix 2 – Free cash flow

£m	Continuing Operations 2006	Discontinued Operations 2006	Group 2006
Profit before interest and tax	34	60	94
Depreciation & Amortisation	7	37	44
Non cash items	1	1	2
Working capital	(8)	9	1
Capital expenditure	(2)	(29)	(31)
Tax	(4)	(2)	(6)
Net interest paid	-	(5)	(5)
Net provisions spend	-	(3)	(3)
Free cash flow	28	68	96

Group Income Statement for the year ended 31 August 2006

		2006	2005
£m	Note		
Continuing operations			
Revenue	2	1,095	1,074
Operating profit	2,3	34	33
Finance costs		(2)	(1)
Profit before tax		32	32
Income tax expense	5	(6)	(7)
Profit after tax from continuing operations		26	25
Profit for the year from discontinued operations	13	32	22
Profit for the year		58	47

	Note		
Earnings per share			
Basic – continuing operations	7	15.1p	14.2p
Diluted – continuing operations	7	15.0p	14.0p
Basic	7	33.7p	26.6p
Diluted	7	33.5p	26.3p
Non GAAP measures			
Equity dividends per share ⁽¹⁾		4.0p	

(1) Dividend per share is the final proposed dividend

Group Balance Sheet at 31 August 2006

£m	Note	2006	2005
Non-current assets			
Goodwill		-	15
Other intangible assets		3	18
Property, plant and equipment		19	219
Deferred tax assets		16	57
		38	309
Current assets			
Inventories		12	162
Trade and other receivables		70	111
Cash and cash equivalents	8	11	46
		93	319
Total assets		131	628
Current liabilities			
Trade and other payables		(118)	(303)
Current tax liabilities		(15)	(27)
Obligations under finance leases	8	(1)	(6)
Bank overdrafts and other borrowings	8	-	(45)
Short-term provisions		-	(5)
		(134)	(386)
Non-current liabilities			
Bank loans and other borrowings	8	(50)	(37)
Retirement benefit obligation	4	(49)	(103)
Deferred tax liabilities		(2)	(16)
Long-term provisions		(1)	(12)
Obligations under finance leases	8	(2)	(14)
Other non-current liabilities		-	(8)
		(104)	(190)
Total liabilities		(238)	(576)
Total net (liabilities) / assets		(107)	52

Group Balance Sheet at 31 August 2006 (continued)

£m	Note	2006	2005
Total equity			
Called up share capital	11	9	660
“B” Share reserve	11	-	2
“C” Share reserve	11	-	8
ESOP reserve		(7)	(34)
Revaluation reserve		-	3
Other reserve		(280)	(278)
Retained earnings		171	(309)
Total equity		(107)	52

Group Cash Flow Statement for the year ended 31 August 2006

£m	Note	2006	2005
Net cash inflows/(outflows) from operating activities	10	105	(22)
Investing activities			
Interest received		2	4
Proceeds on disposal of property, plant and equipment		10	2
Proceeds on disposal of subsidiary		-	222
Proceeds on settlement of loan notes		11	-
Non-operating disposal costs		(3)	(10)
Net cash in subsidiaries disposed		(66)	-
Purchase of property, plant and equipment		(26)	(29)
Purchase of intangible assets		(5)	(3)
Net cash (outflows)/inflows from investing activities		(77)	186
Financing activities			
Interest paid		(7)	(6)
Dividend paid		(25)	(21)
Repayments of obligations under finance leases		(6)	(6)
New bank loans raised (net of financing costs)		49	61
Repayments of borrowings		(76)	-
Derivative cash movements		(1)	-
“C” share dividend paid on capital reorganisation		-	(143)
Purchase of shares for employee share schemes		-	(12)
Money returned to ESOP Trust after share capital reorganisation		-	5
Issue of shares to satisfy employee share schemes		6	2
Repurchase of equity component of “C” shares		(3)	(62)
Net cash outflows from financing activities		(63)	(182)
Net increase / (decrease) in cash and cash equivalents – continuing operations		4	(6)
Net increase / (decrease) in cash and cash equivalents – discontinued operations		27	(12)
Net cash in subsidiaries disposed – discontinued operations		(66)	-
Net decrease in cash and cash equivalents in year		(35)	(18)
Opening net cash and cash equivalents		46	64
Closing net cash and cash equivalents		11	46
Reconciliation of net cash flow to movement in net (debt) / funds			
Net (debt) / funds at beginning of the year		(56)	35
IAS 39 – “B” and “C” shares reclassified as financial liabilities		(7)	-
Decrease in cash and cash equivalents		(35)	(18)
Decrease / (increase) in debt		39	(63)
Net movement in finance leases		17	(10)
Net debt at end of the year	8	(42)	(56)

Group Statement of Recognised Income and Expense for the year ended 31 August 2006

£m	2006	2005
Exchange differences arising on translation of foreign operations	(2)	-
Loss on cash flow hedges	(2)	-
Actuarial losses on defined pension schemes (Note 4)	(33)	(42)
UK deferred tax attributable to pension scheme liabilities	7	(27)
UK current tax attributable to the additional pension scheme contributions	4	39
Net expense recognised directly in equity	(26)	(30)
Profit for the year	58	47
Total recognised income and expense for the year	32	17

Total recognised income and expense for the year is fully attributable to the equity holders of the parent company.

Reconciliation of movements in equity for the year ended 31 August 2006

£m	Share Capital	“B” Share Reserve	“C” Share Reserve	Share Premium	Other Reserve	Capital Reserve	Revaluation Reserve	ESOP Reserve	Translation & Hedging Reserve	Retained Earnings	Total
Balance at 1 September 2004	139	2	-	93	-	156	3	(27)	-	(105)	261
Capital reorganisation and pro forma restatement	519	-	70	(93)	(278)	(156)	-	-	-	(62)	-
Balance at 1 September 2004 restated	658	2	70	-	(278)	-	3	(27)	-	(167)	261
Total recognised income and expense for the year	-	-	-	-	-	-	-	-	-	17	17
Dividends paid	-	-	-	-	-	-	-	-	-	(164)	(164)
Repurchase of non-equity share capital	-	-	(62)	-	-	-	-	-	-	-	(62)
Purchase of own shares for employee share scheme	-	-	-	-	-	-	-	(12)	-	-	(12)
Money returned to ESOP Trust after share capital reorganisation	-	-	-	-	-	-	-	5	-	-	5
Employee share schemes	2	-	-	-	-	-	-	-	-	-	2
Recognition of share based payments	-	-	-	-	-	-	-	-	-	5	5
Balance at 31 August 2005	660	2	8	-	(278)	-	3	(34)	-	(309)	52
Cumulative adjustment for implementation of IAS 39	-	(2)	(5)	-	-	-	-	-	-	-	(7)
Balance restated at 1 September 2005 for adoption of IAS 39	660	-	3	-	(278)	-	3	(34)	-	(309)	45
Total recognised income and expense for the year	-	-	-	-	-	-	-	-	(4)	36	32
Dividends paid	-	-	-	-	-	-	-	-	-	(25)	(25)
Employee share schemes	8	-	-	-	(2)	-	-	5	-	(5)	6
Recognition of share based payments	-	-	-	-	-	-	-	-	-	6	6
Repurchase of non equity share capital	-	-	(3)	-	-	-	-	-	-	-	(3)
Reduction in capital	(659)	-	-	-	-	-	-	-	-	659	-
Dividend in specie	-	-	-	-	-	-	(3)	22	4	(191)	(168)
Balance at 31 August 2006	9	-	-	-	(280)	-	-	(7)	-	171	(107)

Notes

1. Basis of Preparation

The consolidated Group financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS. These are those standards, subsequent amendments and related interpretations issued and adopted by the International Accounting Standards Board ('IASB') that have been endorsed by the European Union at the year end. The Group previously reported under UK Generally Accepted Accounting Principles ('UK GAAP'). The date of transition to IFRS is 1 September 2004.

The consolidated Group financial statements have also been prepared in accordance with IFRS adopted for use in the European Union and therefore comply with Article 4 of the EU IAS Regulation.

At the date of authorisation of these consolidated Group financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective:

International Financial Reporting Interpretations Committee ('IFRIC')

IFRIC 4	Determining whether the arrangement contains a lease
IFRIC 8	Scope of IFRS2 – Share Based Payments
IFRIC 9	Reassessment of Embedded Derivatives

International Accounting Standards ('IAS')

Amendment to IAS 39	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
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The directors anticipate that the adoption of these standards and interpretations in future years will have no material impact on the Group financial statements except for the additional disclosures on capital and financial instruments when the relevant standards come into effect for the financial year commencing on or after 1 September 2006.

Accounting convention

The financial statements are drawn up on the historical cost basis of accounting. The financial information is rounded to the nearest million, except where otherwise indicated. The principal accounting policies, which have been applied consistently throughout both years, have been set out below.

Basis of consolidation

The consolidated Group financial statements incorporate the financial statements of Smiths News PLC and all its subsidiaries up to the year end date.

Subsidiary undertakings are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights so to obtain benefits from its activities.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, after taking into account recognised goodwill, the excess is immediately recognised in profit and loss.

Notes (continued)

1. Basis of Preparation (continued)

The separable net assets, both tangible and intangible of the newly acquired subsidiary undertakings are incorporated into the financial statements on the basis of the fair value as at the effective date of control, if appropriate.

Results of subsidiary undertakings disposed of during the financial year are included in the financial statements up to the effective date of disposal. Where a business component representing a separate major line of business is disposed of, or classified as held for sale, it is classified as a discontinued operation. The post-tax profit or loss of the discontinued operations is shown as a single amount on the face of the income statement, separate from the other results of the Group.

All intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated.

IFRS 1 First-time adoption

These financial statements show the results for the year ended 31 August 2006 and 31 August 2005. The results for the year ended 31 August 2005 have been extracted from the consolidated WH Smith Group's financial statements for that year and have been adjusted for the effects of changes in accounting policies on transition to IFRS. These adjustments were set out in detail in the WH Smith Group's "Restatement of financial information under International Financial Reporting Standards" document which was published in full on 29 November 2005 and is available on the WH Smith Group's website at www.whsmithplc.com/grp/WHSPLC-IR-Reports.htm.

IFRS 1 *First-time adoption of International Financial Reporting Standards* sets out the requirements for the first time adoption of IFRS. The disclosures required by IFRS 1 – 'First-time Adoption of International Financial Reporting Standards' concerning the transition from UK GAAP to IFRS are given in the full set of financial statements.

Adoption of IAS 32 and IAS 39

As permitted by IFRS 1, Smiths News PLC elected to defer implementation of IAS 32 'Financial Instruments: Disclosure and Presentation' and IAS 39 'Financial Instruments: Recognition and Measurement' until the year commencing 1 September 2005.

The effect of the adoption of IAS 39 is to reduce net assets by £7 million resulting from the reclassification of non-equity share capital to financial liabilities. The Group has designated the majority of its foreign exchange derivatives as cash flow hedges as at 1 September 2005 and there was no effect on the balance sheet in respect of this.

Reverse Acquisition Accounting

During the year under review Smiths News PLC has undergone significant re-organisation in order to effect the demerger of the WH Smith PLC (containing the Retail Business) from Smiths News PLC.

Smiths News PLC, formerly Brightway Services Limited, was incorporated on 2 August 2004. On 23 June 2006 the company re-registered as a public limited company. As part of the reorganisation of the Group prior to demerger Smiths News PLC was inserted as a new holding company over the listed parent company, WH Smith PLC, by way of a Scheme of Arrangement on 30 August 2006 and on that date the shares of Smiths News PLC were admitted to listing on The London Stock Exchange and the shares of WH Smith PLC were delisted. Smiths News PLC then reduced its share capital to create distributable reserves. Following this reduction of capital in Smiths News PLC, WH Smith PLC transferred Greenbridge News Limited (the immediate holding company of the

Notes (continued)

1. Basis of Preparation (continued)

Reverse Acquisition Accounting (continued)

News Business) to Smiths News PLC. This resulted in Greenbridge News Limited (and the News Business) becoming a direct subsidiary of Smiths News PLC. WH Smith PLC then paid a dividend to Smiths News PLC which was satisfied by a set-off against part of an intercompany loan owing from Smiths News PLC to WH Smith PLC. Smiths News PLC then used part of the £50 million drawn down under a Smiths News PLC Term Loan facility to settle the remaining intercompany loan owing from Smiths News PLC to WH Smith PLC.

Finally, and in order to implement the demerger, on 31 August 2006 Smiths News PLC paid a dividend in specie to its shareholders of shares in New WH Smith PLC. The payment of the dividend was effected as follows:

- existing shares in WH Smith PLC (which owned the Retail Business) were transferred by Smiths News PLC to New WH Smith PLC (a newly incorporated company) so that New WH Smith PLC became the holding company of the Retail Business; and
- in exchange for such transfer, New WH Smith PLC allotted and issued to Smiths News PLC Shareholders one New WH Smith PLC Share, credited as fully paid, for each Smiths News PLC Share held.

On 1 September 2006, WH Smith PLC changed its name to WH Smith Retail Holdings Limited. The shares of New WH Smith PLC were admitted to listing on The London Stock Exchange on 1 September 2006; on the same day New WH Smith PLC changed its name to WH Smith PLC and on 7 September 2006 reduced its share capital in order to create distributable reserves.

The consequence of these reorganisation steps was that WH Smith Retail Holdings Limited (formally known as WH Smith PLC) shareholders received one Smiths News PLC share for each WH Smith Retail Holdings Limited share on 30 August 2006 and one WH Smith PLC share for each Smiths News PLC share on 1 September 2006.

The accounts of Smiths News PLC have been prepared as if it had been in existence in its current group form since 1 September 2004. The following summarises the accounting principles that have been applied in preparing the accounts on a reverse acquisition accounting basis.

- the income statements for Smiths News PLC have been prepared as if the continuing operations of Smiths News PLC were in existence the whole of the period from 1 September 2004 through to 31 August 2006.
- share capital and reserves for the prior year consolidated balance sheet have been restated on a proforma basis including the capital reorganisation. Differences between these amounts and the previously reported share capital and reserves have been adjusted in the Other reserve, as set out in the Reconciliation of movements in equity. The proforma restated share capital at 1 September 2004 represents the nominal value of shares in issue as if Smiths News PLC had been in existence in its group form at this date.

Notes (continued)

1. Basis of Preparation (continued)

Reverse Acquisition Accounting (continued)

- as well as costs borne directly by Smiths News PLC (the News Business), the continuing results for the year ended 31 August 2006 and 31 August 2005 include £0.8 million of corporate head office costs of the former parent company, WH Smith PLC which have historically not been recharged to the business. Services provided by the former parent company WH Smith PLC included, but were not limited to, treasury, cash management, human resources, accounting, legal and professional services and IT services. These charges may not be representative of the costs that would have been incurred had the business been a standalone entity.

2. Segmental analysis of results

For management purposes, the Group is currently organised into one continuing operating division – News Distribution. This division is the basis on which the Group currently reports its primary business segment information. Discontinued operations comprise the demerged WH Smith PLC retailing business (High Street and Travel) for both years and the Publishing business for the prior year. Segmental information for these businesses are presented as discontinued operations and can be found in Note 13.

(i) Segmental analysis by business segments

(a) Group revenue

	2006	2005
£m	Continuing operations – News Distribution	Continuing operations – News Distribution
Sales		
Total sales	1,211	1,187
Inter-segment sales to discontinued operations	(116)	(113)
Sales to external customers	1,095	1,074

Inter-segment sales are between Smiths News PLC and WH Smith PLC which are traded at arm's length value. Discontinued revenue is shown in Note 13 of the financial statements.

Notes (continued)

2. Segmental analysis of results

(b) Group Results

	2006	2005
£m	Continuing operations – News Distribution	Continuing operations – News Distribution
Profit		
Operating Profit	34	33
Segmental Result	34	33
Finance Costs	(2)	(1)
Income tax expense	(6)	(7)
Profit after tax from continuing operations	26	25
Profit for the year from discontinued operations	32	22
Profit for the year	58	47

Discontinued operations comprise the demerged WH Smith PLC for both years and the Publishing business in the prior year, which were all individual segments. Additional information on these segments is shown in Note 13.

Notes (continued)

2. Segmental analysis of results (continued)

(i) Segmental analysis by business segments (continued)

(c) Balance Sheet

£m	2006	2005			Group
	Continuing operations – News Distribution	Continuing operations – News Distribution	Unallocated	Discontinued operations	
Assets					
Segment assets	131	91	-	502	593
Unallocated assets	-	-	35	-	35
Consolidated total assets	131	91	35	502	628
Liabilities					
Segment liabilities	(238)	(111)	-	(280)	(391)
Unallocated liabilities	-	-	(185)	-	(185)
Consolidated total liabilities	(238)	(111)	(185)	(280)	(576)
Net (liabilities) / assets	(107)	(20)	(150)	222	52

Segment assets include goodwill, other intangibles, property, plant and equipment, inventories, receivables and operating cash. Segment liabilities comprise of operating liabilities. Information on discontinued operations is shown in Note 13.

(d) Other Segmental Items

£m	2006	2005		
	Continuing operations – News Distribution	Continuing operations – News Distribution	Discontinued operations	Group
Capital additions	2	4	28	32
Depreciation and amortisation of non-current assets	(7)	(6)	(41)	(47)

Information on discontinued operations is shown in Note 13.

(ii) Segmental analysis by geographical area

The total Group revenue and operating profits for both years originate from the UK region. The Directors consider this to be one segment.

Notes (continued)

3. Group Operating Profit

£m	2006	2005
Turnover	1,095	1,074
Cost of sales	(966)	(943)
Gross Profit	129	131
Distribution costs	(63)	(64)
Administrative expenses	(33)	(34)
Other income ¹	1	-
Group Operating profit	34	33

¹ Other income relates to profits on disposals of freehold properties

The operating profit is after charging:-

£m	2006	2005
Cost of inventories recognised as an expense	1,035	1,010
Depreciation and amounts written off property, plant & equipment	4	3
Amortisation of intangible assets	3	3
Net operating lease charges		
- land and building	5	5
- equipment and vehicles	3	2
Other occupancy costs	2	2
Staff costs	77	76
Auditors' remuneration (see below)		

Fees payable in the continuing & discontinued operations to Deloitte & Touche LLP, the Group's auditors, included in the income statement related to:

Audit fees	0.3	0.3
Non-audit fees	1.9	0.2
	2.2	0.5

Fees payable to Deloitte & Touche LLP, the Group's auditors, included in the income statement relating to audit fees amount to £0.3 million (2005: £0.3million) and non-audit fees £1.9million (2005:£0.2million) which comprise further assurance services associated with the demerger of WH Smith PLC £1.9 million (2005: £nil), tax compliance services £nil (2005: £0.1million) and IFRS preparation work £nil (2005: £0.1million).

Notes (continued)

4. Retirement benefit obligation

The Group has operated a number of defined benefit and defined contribution pension plans. The main pension arrangements for employees are operated through a defined benefit scheme WHSmith Pension Trust (“Pension Trust”), and a defined contribution scheme, WHSmith Retirement Savings Plan. The most significant is the Pension Trust for the Group’s UK employees which is described in note 4 a) (i). The scheme is independent of the Company and is administered by a Trustee. The Trustee of the Pension Trust has extensive powers over the pension plans’ arrangements, including the ability to determine the levels of contribution.

Segregation of assets and liabilities of each pension scheme into two sections

On the date of demerger, the assets and liabilities of the defined benefit scheme have been split between the News business, (owned by Smiths News PLC) and the WH Smith Retail business (owned by WH Smith PLC) by way of a “sectionalisation” of the defined benefit scheme into two different sections (i.e. the News business section and the WH Smith Retail business section). The two sections will remain within the defined benefit scheme. Similarly, the assets and liabilities of the defined contribution scheme will be separated (or “sectionalised”) into two different sections, a News business section and a WH Smith Retail business section, with each section only containing the accounts of members who are or were employed by the relevant business. The two sections will remain within the WHSmith Retirement Savings Plan. The demerged WH Smith Retail business section has been disclosed within discontinued operations within the income statement.

Upon sectionalisation of the Pension Trust, the assets and liabilities of the defined benefit scheme will be allocated to the News business section and the WH Smith Retail business section in proportions that reflected the liabilities of active, deferred, pensioner and orphan members belonging to the respective businesses. Orphan members are members (or spouses of members) whose employer had left the Group prior to the split but were classified as either News or Retail for the purpose of the sectionalisation. The proportions are currently expected to be 35 per cent, for the News business and 65 per cent, for the WH Smith Retail business. The participating employers of the News business will contribute to the News business section, and the participating employers of the WH Smith Retail business will contribute to the WH Smith Retail business section.

Assets apportioned to one section of the Pension Trust will not be able to be used for the purposes of the other section. There will be no cross-subsidy or cross-guarantee between the sections of the Pension Trust. However, for administrative and investment purposes the Pension Trust will operate generally on a unified basis, except that the principal employer will be replaced with a sponsor for each section.

On 1 September 2006, a one-off contribution of £25 million was made to the Pension Trust by the Company.

The amounts recognised in the balance sheet within non-current liabilities in relation to these plans are as follows:

£m	2006	2005
Present value of the obligations	(334)	(967)
Fair value of plan assets	285	871
Deficit	(49)	(96)
Retirement medical benefit liability	-	(7)
Retirement benefit obligation recognised in the balance sheet	(49)	(103)
Deferred taxation	15	30
Net retirement obligation	(34)	(73)

Notes (continued)

4. Retirement benefit obligation

a) Defined benefit pension scheme

(i) The WHSmith Pension Trust (“Pension Trust”)

A full actuarial valuation of the Scheme is carried out every three years with interim reviews in the intervening years. The latest full actuarial valuation of the Pension Trust was carried out as at 31 March 2006 by independent actuaries, Mercer Human Resource Consulting, using the projected unit basis, and, as with each such triennial valuation, the valuation currently remains subject to the formal approval of the Pension Trust Trustee. The scheme was closed in September 1995 and under the projected unit method the current service cost would be projected to increase as members approach retirement and the age profile of members increases. On an ongoing basis, the actuarial gross defined benefit pension deficit was approximately £63 million (approximately £44 million net of related deferred taxes) for the Smiths News PLC’s section of the WHSmith Pension Trust. The ongoing deficit is greater than the IAS 19 deficit primarily due to the different assumptions and calculation methodologies.

In September 2005, the Pension Trust Trustee adopted a new investment policy in order to substantially reduce the volatility in the underlying investment performance and reduce the risk of a significant increase in the deficit in the fund. The assets in the investment fund were restructured in order to adopt this policy. This involved the assets being invested such that they are expected to alter in value in line with changes in the pension liability caused by changes in interest and inflation (“a Liability Driven Investment ‘LDI’ policy”).

The key features of the new investment policy were that:

- 94% of the Pension Trust’s assets was invested in an LDI policy with a leading international institutional fund manager; and
- 6% of the Pension Trust’s assets was used to purchase a portfolio of long-dated equity call options. These represented a notional exposure to underlying equities of some £350 million.

The impact of this change in investment policy is to substantially reduce the volatility in the fund and the resultant risk of a significant increase in the overall deficit whilst enabling the fund to continue to benefit from any potential higher returns in the equity markets.

The valuation of the defined benefit pension scheme used for the account disclosures are based upon the most recent valuation. Scheme assets are stated at their market value at the relevant reporting date.

The principal long-term assumptions used to calculate scheme liabilities under IAS 19 are:

%	2006	2005
Rate of increase in salaries	4.00%	3.70%
Rate of increase in pension payments and deferred pensions	3.00%	2.70%
Discount rate	5.10%	4.90%
Inflation assumptions	3.00%	2.70%

The amounts recognised in the income statement were as follows:

£m	2006	2005
Current service cost	(9)	(10)
Interest cost	(47)	(46)
Expected return on scheme assets	42	44
	(14)	(12)

The charge for the current service costs has been included in administrative costs.

Notes (continued)

4. Retirement benefit obligation (continued)

a) Defined benefit pension scheme (continued)

(i) The WHSmith Pension Trust (continued)

Movements in the present value of the defined benefit scheme obligations in the year were as follows:

£m	2006	2005
At 1 September	(967)	(830)
Current service cost	(9)	(10)
Interest cost	(47)	(46)
Actuarial losses	(18)	(113)
Benefits paid	33	32
Subsidiaries disposed	674	-
As at 31 August	(334)	(967)

Movements in the fair value of defined benefit scheme assets in the year were as follows:

£m	2006	2005
At 1 September	871	645
Expected return on scheme assets	42	44
Net actuarial (losses) / gains	(15)	71
Contributions from the sponsoring companies	28	143
Benefits paid	(33)	(32)
Subsidiaries disposed	(608)	-
As at 31 August	285	871

An analysis of the defined benefit scheme assets at the balance sheet date is detailed below:

£m	2006	2005
Equities	-	386
Bonds	-	485
Cash	275	-
Inflation swaps	(7)	-
Equity call options	17	-
	285	871

Notes (continued)

4. Retirement benefit obligation (continued)

a) Defined benefit pension scheme (continued)

(i) The WHSmith Pension Trust (continued)

An analysis of the expected rate of return on the defined benefit scheme assets at the balance sheet date is detailed below:

	2006	2005
Equities	-	7.0%
Bonds	-	4.0%
Cash ⁽¹⁾	-	3.8%
Inflation swaps ⁽¹⁾	-	-
Equity call options ⁽¹⁾	-	-

(1) The expected rate of return on these investments was calculated as a weighted average of the expected return on the LDI fund and the equity call options was 5.01 per cent at 31 August 2006.

Prior to 22 September 2005, the overall expected rate of return on the Trust's assets was calculated as a weighted average return based on the distribution of the assets (between equities, bonds and cash, at the accounting date). On 22 September 2005, the investment strategy was altered to invest in a Liability Driven Investment (LDI) fund and a number of equity call options.

The mortality assumptions (in years) underlying the value of the accrued liabilities are:-

	Male	Female
Life expectancy at age 65		
Member currently aged 65	20.1	22.9
Member currently aged 45	21.4	24.1
Life expectancy at age 60		
Member currently aged 60	24.9	27.7
Member currently aged 45	25.9	28.7

The mortality assumptions are based on the standard PA92 medium cohort tables (as published by the Institute of Actuaries). The mortality rates underlying the table have been increased by 25% to reflect the Trust's actual experience.

The history of experience adjustments is as follows:

£m	2006	2005	2004	2003	2002
Present value of defined benefit obligations	(334)	(967)	(883)	(846)	(740)
Fair value of scheme assets	285	871	678	631	596
Deficit in the scheme	(49)	(96)	(205)	(215)	(144)
Experience adjustments on scheme liabilities					
Amount (£m)	(18)	(113)			
Percentage of scheme liabilities (%)	(5%)	(12%)			
Experience adjustments on scheme assets					
Amounts (£m)	(15)	71			
Percentage of scheme assets (%)	(5%)	8%			

Notes (continued)

4. Retirement benefit obligation (continued)

b) Defined contribution pension scheme

The pension cost charged to income for its defined contribution scheme, WHSmith Retirement Savings Plan, amounted to £3 million for the year ended 31 August 2006 (2005: £3 million).

c) Post retirement medical benefits

The Group provides retirement medical benefits to certain pensioners. Total premiums paid by the Group during the year in respect of these benefits were £0.1 million (31 August 2005: £0.4 million). The present value of the future liabilities under this arrangement at each reporting date has been assessed by independent actuaries Mellon Human Resources & Investor Solutions (Actuaries & Consultants Limited) and this amount was included on the balance sheet within retirement benefit obligations.

In September 2005, the members were offered the option to be bought out of this scheme, which was accepted by the majority of the members. The impact of the settlement was a £5 million reduction in the net deficit and this has been disclosed within discontinued operations. A small number of members opted to remain in the scheme and the present value of the remaining future liabilities relating to Smiths News PLC is valued at £0.1 million net of deferred taxation.

d) Disposals and Post Retirement Medical Benefit Settlement

Year ended 31 August 2006

Retailing Business

On 31 August 2006, the assets and liabilities of the defined benefit scheme, WHSmith Pension Trust were divided into two different sections (the Smiths News PLC and the WH Smith PLC business section). The gross deficit at the date of disposal was £66 million.

On demerger, the post retirement medical benefits of £0.1million were transferred to New WH Smith PLC, which changed its name on 1 September 2006 to WH Smith PLC.

The amounts recognised as current liabilities for the WH Smith PLC's proportion of the defined benefit scheme is as follows:

£m	2006	2005
Present value of defined benefit obligations	(674)	(651)
Fair value of scheme assets	608	598
Deficit	(66)	(53)

Year ended 31 August 2005

Publishing Business

On 25 September 2004, the Group completed the disposal of the Publishing business, including the disposal of that business' pension fund. The gross deficit at the date of disposal was £20 million.

USA Business

The Group made a settlement of £3 million in respect of the US businesses.

Notes (continued)

5. Income tax expense

£m	2006	2005
Tax on profit	10	10
<i>Standard rate of UK corporation tax 30%</i>		
Adjustment in respect of prior year UK corporation tax	(4)	(2)
Total current tax charge	6	8
Deferred tax – current year	-	(1)
Tax on profit	6	7
Discontinued operations	12	9
Total tax on profit	18	16
<i>Effective tax rate on continuing activities</i>	20%	23%

When the profit before tax and the tax charge figures are rounded to the nearest £million the effective tax rate for the year ended 31 August 2006 appears to be 19%. However, the actual detailed figures do result in an effective tax rate of 20%.

Reconciliation of the taxation charge

£m	2006	2005
Tax on profit at standard rate of UK corporation tax 30%	10	9
Tax effect of items that are not deductible or not taxable in determining taxable profit	-	1
Adjustment in respect of prior years	(4)	(2)
Current tax charge	6	8

Notes (continued)

6. Dividends

Amounts recognised as distributions to shareholders in the year are as follows:

£m	Note	2006	2005
Dividends			
Final - paid		16	14
Interim – paid		9	7
		25	21
“C” share dividends			
“C” share dividend paid on capital reorganisation		-	143
		25	164
Dividend in specie relating to the demerger of WH Smith PLC	13	168	-

The proposed dividend of 4.0p is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements. The proposed dividend will be paid on 9 February 2007 to shareholders on the register at close of business on 12 January 2007.

The Group also paid a dividend in respect of “C” shares during the year to 31 August 2006 of £282,688 (2005: £156,647) and paid dividends on the “B” shares during the year to 31 August 2006 of £81,555 (2005: £45,192).

Notes (continued)

7. Earnings per share

a) Earnings

£m	2006			2005		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
Profit attributable to shareholders	26	32	58	25	22	47

b) Basic earnings per share

	2006			2005		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
Earnings per share (note i)	15.1p	18.6p	33.7p	14.2p	12.4p	26.6p

(i) Basic earnings per share has been calculated using profit after tax.

c) Diluted earnings per share

	2006			2005		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
Earnings per share	15.0p	18.5p	33.5p	14.0p	12.3p	26.3p

Diluted earnings per share takes into account various share awards and share options including SAYE schemes, which are expected to vest, and for which a sum below fair value will be paid.

d) Weighted average share capital

millions	2006	2005
Weighted average shares in issue for earnings per share	172	177
Add weighted average number of ordinary shares under option	1	2
Weighted average ordinary shares for diluted earnings per share	173	179

Notes (continued)

8. Analysis of net debt

Movements in net debt can be analysed as follows:

£m	At 31 Aug 2006	Cash flow	Subsidiaries disposed	IAS 32 and 39 reclassification	At 31 Aug 2005
Cash and cash equivalents	11	(35)	-	-	46
Debt					
- Sterling floating rate	(50)	(6)	13	(7)	(50)
- Sterling fixed rate	-	32	-	-	(32)
Obligations under finance leases	(3)	6	11	-	(20)
Net debt	(42)	(3)	24	(7)	(56)

£m	At 31 Aug 2005	Cash flow	Non-cash	At 31 Aug 2004
Cash and cash equivalents	46	(18)	-	64
Debt				
- Sterling floating rate	(50)	(33)	-	(17)
- Sterling fixed rate	(32)	(30)	-	(2)
Obligations under finance leases	(20)	(6)	(4)	(10)
Net debt	(56)	(87)	(4)	35

Analysed by maturity:

£m	2006				2005			
	Less than one year	Between two to five years	After five years	Total	Less than one year	Between two to five years	After five years	Total
Cash and cash equivalents	11	-	-	11	46	-	-	46
Debt								
- Sterling floating rate	-	(50)	-	(50)	(30)	(20)	-	(50)
- Sterling fixed rate	-	-	-	-	(15)	(15)	(2)	(32)
- Obligations under finance leases	(1)	(2)	-	(3)	(6)	(14)	-	(20)
Net debt	10	(52)	-	(42)	(5)	(49)	(2)	(56)

Notes (continued)

8. Analysis of net debt (continued)

Set out below is a comparison by currency and interest price profile of the net debt:

£m	2006				2005			
	Floating Rate	Fixed Rate	Non-interest bearing	Total	Floating Rate	Fixed Rate	Non-interest bearing	Total
Currency								
Sterling	(39)	(3)	-	(42)	(50)	(7)	-	(57)
US dollars	-	-	-	-	1	-	-	1
Total	(39)	(3)	-	(42)	(49)	(7)	-	(56)

9. Contingent liabilities and Capital Commitments

£m	2006	2005
Bank and other loans guaranteed	2	11
	2	11

Other potential liabilities that could crystallise are in respect of previous assignments of leases where the liability could revert to the Group if the lessee defaulted. Pursuant to the terms of the Demerger Agreement, any such contingent liability which becomes an actual liability will be apportioned between Smiths News PLC and WH Smith PLC in the ratio 35:65 (provided that the actual liability of Smiths News PLC in any 12 month period does not exceed £5 million). The company's share of these leases have an estimated future cumulative gross rental commitment at 31 August 2006 of £55 million (2005: £181 million).

Contracts placed for future capital expenditure approved by the directors but not provided amount to £nil (2005: £4 million).

Notes (continued)

10. Net cash inflow / (outflow) from operating activities

£m	2006	2005
Operating profit from continuing operations	34	33
Operating profit from discontinued operations	53	47
	87	80
Operating exceptional items	7	-
Adjustment for pension funding	(19)	(133)
Depreciation of property, plant and equipment	34	39
Profit on sale of property, plant and equipment	(6)	-
Impairment of property, plant and equipment	3	-
Amortisation of intangible assets	7	8
Share based payments	8	5
Decrease in inventories	7	6
(Increase) / decrease in receivables	(7)	1
Increase / (decrease) in payables	1	(9)
Income taxes paid	(6)	(4)
Cash spend against provisions	(3)	(6)
Net cash inflow / (outflow) from operating activities before exceptional items	113	(13)
Cash outflow relating to exceptional operating item	(8)	(9)
Net cash inflow / (outflow) from operating activities	105	(22)

11. Called up share capital

a) Authorised

	2006	
	Number of shares (millions)	Nominal value £m
Equity:		
Ordinary shares of 5p each	300	15
	300	15
Non-Equity:		
“B” shares of 53.75p each	-	-
“C” shares of 85p each	-	-
Deferred shares of 85p each	-	-
	-	-
Total	300	15

Notes (continued)

11. Called up share capital (continued)

b) Allotted and fully paid

	2006		2005 Proforma	
	Number of shares (millions)	Nominal value £m	Number of shares (millions)	Nominal value £m
Equity:				
Ordinary shares of 5p each	183	9	-	-
Ordinary shares of 365p each	-	-	181	660
	183	9	181	660
Non-Equity:				
"B" shares of 53.75p each	-	-	4	2
"C" shares of 85p each	-	-	10	8
	-	-	14	10
Total	183	9	195	670

c) Movement in share capital

	Ordinary shares of 5p each	Ordinary shares of 365p each	Ordinary shares of 55p each	Total
At 1 September 2004	-	-	139	139
Capital reorganisation and proforma restatement	-	658	(139)	519
At 1 September 2004 restated	-	658	-	658
Employee share schemes	-	2	-	2
At 31 August 2005	-	660	-	660
At 1 September 2005	-	660	-	660
Employee share schemes	-	8	-	8
Capital reduction	-	(659)	-	(659)
Capital reorganisation	9	(9)	-	-
At 31 August 2006	9	-	-	9

Notes (continued)

11. Called up share capital (continued)

(c) Movement in share capital (continued)

£m	Non-Equity			Total
	'B' shares of 53.75p each	'C' shares of 85p each	Deferred shares of 85p each	
At 1 September 2004	2	-	143	145
Capital reorganisation and proforma restatement	-	70	(143)	(73)
At 1 September 2004 restated	2	70	-	72
Cancelled	-	(62)	-	(62)
At 31 August 2005	2	8	-	10
At 1 September 2005	2	8	-	10
Restatement for adoption of IAS 39	(2)	(5)	-	(7)
Balance restated at 1 September 2005	-	3	-	3
Cancelled	-	(3)	-	(3)
At 31 August 2006	-	-	-	-

Authorised and issued share capital is shown on a pro forma basis for the year ended 31 August 2005.

On 2 August 2004, the Company was incorporated with authorised share capital of £1,000 divided into one thousand ordinary shares of £1 each. At incorporation one ordinary share was subscribed and fully paid.

On 23 June 2006, the authorised share capital of Smiths News PLC was increased by the creation of one redeemable preference share of £50,000 which was issued as fully paid up. In accordance with IAS32 'Financial Instruments: disclosure and presentation', this amount is presented within liabilities. On the same date Smiths News PLC issued a second ordinary share which was fully paid.

On 6 July 2006, the authorised share capital was increased by £1,094,999,040 through the creation of a further 1,094,999,000 ordinary shares of £1 each and 40 deferred shares of £1 each. All of the deferred shares and 144 ordinary shares were then issued fully-paid to the existing shareholders. The issued and unissued ordinary shares were then consolidated on a 73:1 basis into ordinary shares of £73 each and then subdivided on a 1:20 basis into ordinary shares of £3.65 each. Following this consolidation and subdivision, the authorised share capital was £1,095,050,040 divided into 300,000,000 ordinary shares of £3.65, 40 deferred shares of £1 each and 1 redeemable preference share of £50,000, of which 40 of the ordinary shares, the redeemable preference share and all of the deferred shares were issued and fully paid-up.

On 30 August 2006, Smiths News PLC was inserted as a new holding company over the listed parent company, WH Smith PLC and by way of a Scheme of Arrangement on that date the shares of Smiths News PLC were admitted to listing on The London Stock Exchange and the shares of WH Smith PLC were delisted.

In return for cancellation of WH Smith PLC shares, shareholders in WH Smith PLC received shares in Smiths News PLC, pro rata to existing holdings in WH Smith PLC. The share capital of WH Smith PLC as at 31 August 2006 was 182,919,930 shares. On 31 August 2006 Smiths News PLC issued 182,919,930 ordinary shares with a nominal value of £3.65 per share.

On 31 August 2006, Smiths News PLC reduced its share capital by £659 million to £9 million effected by a written resolution of the company dated 30 August 2006, which was confirmed by a Court Order in accordance with the Companies Act 1985. This effectively reduced Smiths News PLC ordinary shares nominal value to £0.05 per share.

Notes (continued)

On 1 March 2006, the deferred shares were transferred to the Group for a total consideration of one pence.

On 29 August 2006, the 'B' shares and 'C' shares were repurchased for a total consideration of £10 million and subsequently cancelled.

12. Post Balance Sheet Events

Financing Facilities

On 1 September 2006, Smiths News PLC drew down £20 million under the Smiths News PLC revolving credit facility to make its share of the cash contribution to the Smiths News PLC's section of the WH Smith Pension Trust.

WH Smith Pension Trust

Smiths News PLC announced on 31 August 2006 that following the demerger of WH Smith PLC, it would make a contribution of £25 million to the Smiths News PLC's section of the WH Smith Pension Trust. This amount was paid on 1 September 2006.

13. Discontinued operations

Year ended 31 August 2006

At the Extraordinary General Meeting on 2 August 2006 the shareholders of the former WH Smith PLC approved the demerger of the Retailing Businesses. On demerger, the Company declared a dividend in specie, in which the existing shares in the former WH Smith PLC (which owned the Retail Business) were transferred by Smiths News PLC to New WH Smith PLC (a newly incorporated company) so that New WH Smith PLC became the holding company of the Retail Businesses. In exchange for this transfer, New WH Smith PLC allotted and issued to Smiths News PLC Shareholders, one New WH Smith PLC share, credited as fully paid, for each Smiths News PLC Share held. On 1 September 2006, New WH Smith PLC changed its name to WH Smith PLC.

Year ended 31 August 2005

Publishing Business Disposal

On 25 September 2004, the Group completed the disposal of its Publishing business, Hodder Headline Limited.

USA Travel Retail

An amount of £8 million was charged to the income statement relating to the disposal of discontinued businesses. Of this amount, £7 million relates to an impairment review of the loan notes received as deferred consideration in respect of the Group's USA businesses. The balance relates to closure and exit provisions.

Aspac Retail

During the year ended 31 August 2005, £7 million was received for the Aspac Retail disposal, which related to deferred consideration and working capital adjustments.

Notes (continued)

13. Discontinued operations (continued)

(a) The Revenue from discontinued operations were as follows:

£m	2006	2005
Revenue		
Retailing businesses		
High Street	1,021	1,112
Travel	319	311
	1,340	1,423
Publishing business		
Total revenue	-	14
Internal revenue	-	(3)
Total revenue	-	11
Total revenue – discontinued operations	1,340	1,434

(b) The results of the discontinued operations were as follows:-

£m	2006		2005		Total
	Retailing Businesses	USA Travel Retail	Retailing Businesses		
Profit before tax and before exceptional items	51	-	39		39
Income tax expense	(10)	-	(9)		(9)
Profit after tax and before exceptional items and impairment of discontinued operations	41	-	30		30
Exceptional items (note 13e)	(7)	-	-		-
Impairment of discontinued operations	-	(8)	-		(8)
Income tax expense on exceptional items	(2)	-	-		-
Exceptional items and impairment of discontinued operations after tax	(9)	(8)	-		(8)
Profit/ (loss) for the year from discontinued operations	32	(8)	30		22

Notes (continued)

13. Discontinued operations (continued)

(c) The group operating profit from discontinued operations comprise:-

£m	2006	2005
Turnover	1,340	1,423
Cost of sales	(761)	(847)
Gross Profit	579	576
Distribution costs	(434)	(437)
Administrative expenses	(97)	(92)
Other income ¹	5	-
Group Operating profit	53	47

¹ Other Income relates to profit on disposal of property, plant and equipment.

(d) The group profit from discontinued operations is after charging:-

£m	2006	2005
Cost of inventories recognised as an expense	786	854
Writedown of inventories in the period	12	17
Depreciation and amounts written off property, plant & equipment:	33	37
Amortisation of intangible assets	4	4
Net operating lease charges		
- land and building	147	140
- equipment and vehicles	1	2
Other occupancy costs	50	45
Staff costs	192	201
Auditors' remuneration	2	1

(e) Within the results from discontinued operations, certain exceptional charges were made as follows:-

£m	2006	2005
Post retirement medical benefits settlement	5	-
Demerger costs	(12)	-
Impairment and loss on sale of USA Travel Retail	-	(8)
	(7)	(8)

Notes (continued)

13. Discontinued operations (continued)

Year ended 31 August 2006

Post retirement medical benefits settlement

WH Smith PLC provides retirement medical benefits to certain pensioners. Total premiums paid by WH Smith PLC during the year in respect of these benefits were £nil (2005: £0.4 million). The present value of the future liabilities under this arrangement at each reporting date have been assessed by independent actuaries Mellon Human Resources & Investor Solutions (Actuaries & Consultants Limited) and this amount was included on the balance sheet, retirement benefit obligation.

In September 2005, the members were offered the option to be bought out of this scheme, which was accepted by the majority of the members. The impact of the settlement was a £5 million reduction in the net deficit and has been disclosed as an exceptional item in discontinued operations. A small number of members opted to remain in the scheme and the present value of the remaining future liabilities is valued at £0.2 million net of deferred taxation.

Demerger costs

The costs associated with the Retailing Business demerger of £12 million were charged against discontinued operations in the Group Income Statement.

Year ended 31 August 2005

An amount of £8 million was charged to the income statement relating to the disposal of discontinued businesses. Of this amount, £7 million relates to an impairment review of the loan notes received as deferred consideration in respect of the Group's USA businesses. The balance relates to closure and exit provisions

(f) The cash flows of discontinued operations comprise:

£m	2006	2005
From operating activities	82	(23)
From investing activities	(10)	188
From financing activities	(45)	(177)
Net increase/(decrease) in cash and cash equivalents	27	(12)

(g) The taxation from discontinued operations was as follows:

£m	2006	2005
Tax on profit before exceptional items	4	14
Adjustment in respect of prior year UK corporation tax	(7)	(3)
Total current tax charge before exceptional items	(3)	11
Deferred tax – current year	13	(2)
Tax on profit before exceptional items	10	9
Tax on exceptional items	2	-
Tax on profit after exceptional items	12	9

Notes (continued)

13. Discontinued operations (continued)

(h) On 31 August 2006, WH Smith PLC was demerged from the Group. The summary balance sheet of WH Smith PLC and its subsidiaries at the date of demerger was:-

	£m
Goodwill	15
Intangible assets	15
Property, plant and equipment	184
Deferred tax assets	29
Inventories	143
Trade and other receivables	74
Cash and cash equivalents	66
Trade and other payables	(215)
Current tax payable	(20)
Other current liabilities	(20)
Deferred tax liabilities	(13)
Other non-current liabilities	(90)
Group's share of net assets of WH Smith PLC on demerger	168

On demerger, Smiths News PLC paid a dividend in specie of £168 million representing the net assets demerged. The costs associated with the demerger of WH Smith PLC of £12 million were charged as an exceptional item against the discontinued operations in the Group Income Statement.

(2) Prior Year

Publishing business disposal

During the prior year, the Group completed the disposal of its Publishing business, Hodder Headline Limited. A financial summary of the disposal is shown below:

£m	Total
Fixed assets	156
Stock	17
Debtors	80
Creditors	(30)
Net pension liabilities	(14)
Net assets disposed	209
Cash consideration	210
Cash received in respect of working capital adjustments	5
Net assets disposed	(209)
Transaction costs and other charges	(6)
Net result on sale of the Publishing business recognised in the financial year to 31 August 2005	-

The Group incurred a £5 million cash outflow in respect of transaction costs and other charges relating to the Publishing business disposal.

Notes (continued)

Aspac Retail

During the year ended 31 August 2005, £7 million was received for the Aspac Retail disposal, which related to deferred consideration and working capital adjustments.

14. Related party transactions

Transactions between businesses within this Group which are related parties have been eliminated on consolidation and are not disclosed in this note.

WH Smith PLC

During the year, Group companies entered into the following transactions with the Retailing business, which on 31 August 2006 was demerged from Smiths News PLC, and is now controlled by WH Smith PLC.

Purchases were made on an arm's length basis.

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made for doubtful debts in respect of the amounts owed by related parties.

£m	2006	2005
Sales of goods to WH Smith PLC	116	-
Trading amounts owed to WH Smith PLC at end of year	6	-
Amounts owed to WH Smith PLC in respect of prior years corporation tax	15	-

Prior to demerger on 31 August 2006, trading between WH Smith PLC & Smiths News PLC was not classified as a related party transaction as they were both part of the WH Smith Group.

Amounts owed to WH Smith PLC at end of the year are in respect of tax balances that are expected to be recovered from HMRC and repaid.

Transitional services agreement on demerger

On 7 July 2006, WH Smith PLC and Smiths News PLC entered into a transitional services agreement whereby WH Smith PLC has agreed, with effect from the demerger, to supply certain transitional services to Smiths News PLC. These services include, amongst other things, payroll, tax, and property administration. It is expected that the services will be provided for a transitional period of up to 12 months plus such time as is required to complete the 2005/2006 year end tax computation, following which Smiths News PLC will make its own arrangements for the provision of these services. The consideration payable by Smiths News PLC to WH Smith PLC under this agreement from the 12 month period is likely to be approximately £800,000 although this could increase depending on the length of time that the services are provided to Smiths News PLC.

USA Travel Retail - Hotels

The CEO of Travel Traders LLC is Sean Anderson who was Chairman of WH Smith Airports Inc., WH Smith PLC's US subsidiary until September 2003 and he holds a 30 per cent stake in Travel Traders LLC. The total consideration of £7 million for the USA Travel Retail hotel business was satisfied by way of an interest bearing loan note with a 5 per cent coupon, conditional on the trading cash flows of Travel Traders LLC. Additionally, WH Smith Group Holdings (USA) Inc. holds a 15 per cent equity interest in Travel Traders LLC and is also providing a loan facility of up to £4 million to the new company, of which £3 million is drawn down as at 31 August 2006. (31 August 2005: £3 million).

Notes (continued)

14. Related party transactions (continued)

Remuneration of key management personnel

The remuneration of the executive and non-executive directors, who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24 *Related Party Disclosures*.

£000	2006	2005
Short-term employee benefits	2,407	3,048
Post-employment benefits	39	38
	2,446	3,086

The directors and non-executive directors of Smiths News PLC were appointed to the board of Smiths News PLC following close of business on 31 August 2006. For future remuneration commitments, refer to the Remuneration Report.

Directors' transactions

There are no other transactions with directors.

15. Preparation of the Preliminary Announcement

a) Basis of preparation

The preliminary announcement for the 12 months to 31 August 2006 has been prepared on the basis of the accounting policies set out in the Smiths News prospectus issued on 7 July 2006.

While the financial information included in this preliminary announcement has been computed in accordance with International Financial Reporting Standards (IFRS), this announcement does not itself contain sufficient information to comply with IFRS. The Company expects to publish full financial statements that comply with IFRS in November 2006.

b) Preliminary announcement

The financial information for the 12 months to 31 August 2006 and 12 months to 31 August 2005 do not comprise statutory accounts for the purpose of Section 240 of the Companies Act 1985 and have been extracted from the Company's consolidated accounts for the year to 31 August 2006. The statutory accounts for Smiths News PLC (formerly Brightway Services Limited) for the period from incorporation on 2 August 2004 to 31 August 2005 have been filed with the Registrar of Companies and those for the 12 months to 31 August 2006 will be filed following the Company's annual general meeting. The prior year accounts did not require to be audited and the auditors' report on the accounts for the 12 months to 31 August 2006 were unqualified and did not include a statement under Section 237 (2) or (3) of the Companies Act 1985.

The Annual Report and Accounts will be posted to shareholders in November 2006.