WH Smith PLC
Greenbridge Road
Swindon
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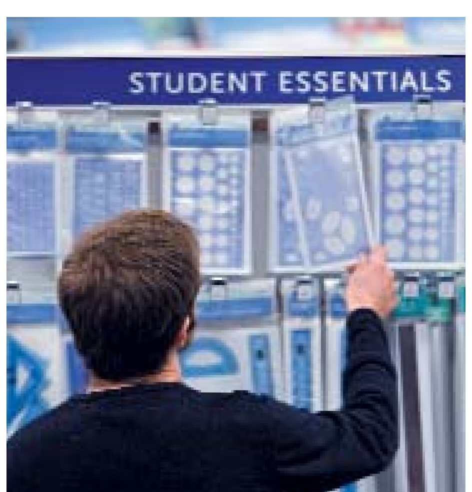
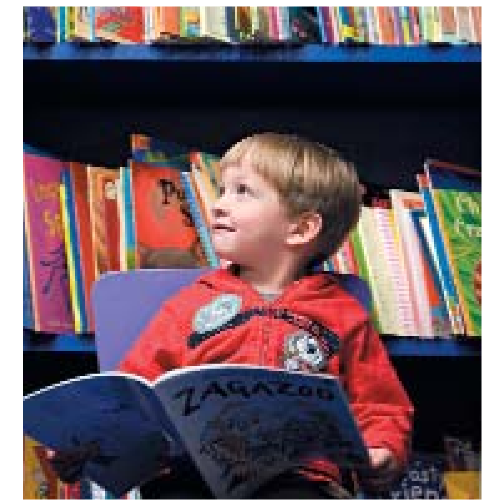


WH Smith PLC Annual Report and Accounts 2005

WH Smith PLC
Annual Report and Accounts 2005



Contents

Please see the Notice of Annual General Meeting on pages 78 to 84. This Notice and the explanatory statements which follow it are important. If you are in any doubt about their contents or the action you should take, you should consult your stockbroker, bank manager, solicitor, accountant or other professional adviser authorised pursuant to the Financial Services and Markets Act 2000.

group at a glance

WHSmith Group*

Sales: £2,497m
Employees: 23,120

*Continuing operations, and includes group head office employees.


WH Smith PLC, one of the UK's leading retail groups, is made up of two core businesses – WHSmith Retail and WHSmith News. WH Smith PLC is listed on the London Stock Exchange (SMWH) and is part of the mid 250 index. More information is available at www.whsmithplc.com.

WHSmith Retail

Sales: £1,423m
Employees: 18,790
Stores: 669
Selling Space: 3.3 msf*

* Million square feet


WHSmith Retail has 542 high street stores, and 127 travel stores at airport and station locations across the UK, and WHSmith Direct – www.whsmith.co.uk – serving customers on the internet 24 hours a day.

High Street Retail sells a wide range of newspapers, magazines, stationery, books and entertainment products.

Travel Retail sells a tailored range of newspapers, magazines, books and confectionery products for people on the move.

WHSmith News

Sales: £1,074m
Employees: 4,275
Distribution Centres: 47


WHSmith News is the UK's market leader in newspaper and magazine distribution and delivers to 22,000 customers daily. Through its 47 distribution centres across England and Wales, it serves both independent and multiple retailers.

delivering value to our shareholders

We have made strong progress over the past year with all our businesses – High Street Retail, Travel Retail and News Distribution – delivering good profit growth despite the difficult consumer spending climate, particularly in the second half of the financial year. The Group has clearly benefited from the increased focus on these businesses, following the disposal of the Group's interests in the United States and Asia Pacific during 2004. During the year we also returned £205m to shareholders following the disposal of Hodder Headline.

The Board is recommending a final dividend of 9.2p (2004: 8.0p), which together with the interim dividend of 4.5p (2004: 4.0p) makes the total dividend for the year 13.7p (2004: 12.0p). This increase reflects the Board's confidence in the future prospects for the Group.

In the past year, we have delivered on the first phase of the High Street Retail recovery programme. We have focused on reducing our costs, improving gross margin and the business's operational procedures. Establishing these retail disciplines is essential if we are to operate successfully in the highly competitive retail environment. The response from our staff to these changes has been outstanding and I would like to take this opportunity to thank them all for their hard work, commitment and loyalty.

The operational base we have established in High Street Retail, with its clear accountabilities for ongoing delivery of objectives, has brought greater efficiency in all areas. From here we will rebuild our authority in our core categories and return WHSmith to the position of Britain's most popular bookseller, newsagent and stationer.

Travel Retail has had a year of strong sales and profit growth. Enhanced customer service and store flexibility, together with the commitment of our Travel Retail staff, have all contributed to this performance. This commitment was clearly demonstrated by our Travel teams working in our London station stores on 7 July, the day of the London bombings. I would like to thank the Travel team for the professional manner in which they assisted the public in every way possible on that terrible day.

News Distribution delivered good profit growth this year and has made further progress in improving both service standards and cost control. This is a notable achievement, particularly against the background of industry uncertainty brought about by the OFT review into distribution arrangements for newspapers and magazines.

We have made strong progress over the past year, with all our businesses delivering good profit growth despite the difficult consumer spending climate.

The challenge we face is to continue to reinvigorate the High Street business through improving customer choice, range and value.

At the time of writing we await the publication of the OFT's final written opinion on the newspaper and magazine supply chain. In their draft opinion, published in May, the OFT recognised the unique nature of the newspaper distribution arrangements but said that magazine contracts must allow for passive sales.

These provisional findings give continued stability to our newspaper distribution contracts, which account for around 50 per cent of revenue. The implications for the magazine market however, are less clear.

We believe that different arrangements for newspapers and magazines may reduce market efficiency over time, with a potentially negative impact on consumer availability. However, as a leading wholesaler and magazine retailer, we are well placed to compete in a more open market and the investments we have made in recent years, in the SAP information system and new warehouses, leave us better placed to adapt to any changes that occur in the market.

During the course of the year, we made a number of changes to the Board. Richard Handover, Chairman, retired from the Board after 40 years' service with the Group. Following the disposal of the international and publishing businesses in 2004, John Warren left the Group at the end of March. Walker Boyd left the Board in accordance with best corporate governance and the Combined Code guidelines regarding cross-directorships. Andrew Rolfe also resigned from the Board following his move to the United States. We thank them all for their contribution to the Board and the Group's businesses.

Alan Stewart replaced John Warren as Group Finance Director. Alan was previously Chief Executive of Thomas Cook UK Limited. Mike Ellis, previously Group Finance Director of HBOS plc, replaced Walker Boyd as Chairman of the Audit Committee and Luke Mayhew, Managing Director of John Lewis until December 2004, replaced Andrew Rolfe as a non-executive director.

WHSmith benefits from a strong, well-established brand with good customer loyalty and leading positions in its key markets of news and magazines, books, and stationery. The challenge we face is to continue to reinvigorate the High Street business through improving customer choice, range and value.

Undoubtedly, further challenges lie ahead as we continue to implement our turnaround plan; Kate Swann and the management team have taken into consideration the current downturn in consumer spending in their plans and I am confident the next 12 months will be a year of further progress for the Group.

Robert Walker
Chairman
13 October 2005

returning to profitability

The Group made important progress during the year with all our businesses delivering strong profit growth. Despite the unhelpful consumer spending climate, Group profit before tax from continuing operations, excluding exceptional items and goodwill amortisation, increased by 59 per cent to £73m. The total Group profit before tax was £64m (2004: loss of £135m).

WHSmith News made steady progress with profit growth of 6 per cent driven by good cost control and continued focus on service development. Travel Retail delivered strong profit* growth of 24 per cent and good sales growth of 3 per cent. High Street Retail improved its profitability* by 87 per cent compared with last year. Our staff have worked hard to manage costs tightly, implement initiatives to increase product availability and choice, and to raise store standards. Customer response to these changes has been positive.

High Street Retail
Last summer we outlined our plans to turnaround the performance of our High Street business by focusing on the retail basics, rebuilding authority in our core categories, optimising margins and controlling costs. After the first full year implementing the turnaround plan we have made significant progress and the business's profitability* has increased by 87 per cent.

Sales for the year were down 3 per cent in a challenging trading environment where consumer spending slowed, particularly in the second half of the year. In the first half of the year our planned focus on profitable promotions impacted sales but benefited profitability.

As part of the turnaround plan, we outlined a target of £30m of cost savings over three years. We planned to save half of the £30m target this year and the remainder over the following two years. I am pleased to report that we have delivered this year's savings faster than planned and by the year end had achieved savings of £18m.

We have done this in a number of ways. We completed the restructure of our head office, which delivered savings of £8.5m year-on-year. In our stores we have improved productivity by giving our managers further training on planning, organising and supervising their teams. This has delivered a saving of £3m year-on-year. We have achieved savings by improving staff flexibility so that we have the right staff working in-store when they are needed most. There were a number of stores where our most knowledgeable staff worked from Monday to Friday and infrequent Saturdays. We have changed this so that our most experienced staff are well represented in-store on Saturdays, our peak trading day. We have also delivered significant savings in logistics, information systems and marketing, as well as reducing the costs associated with the in-store set up of Christmas.

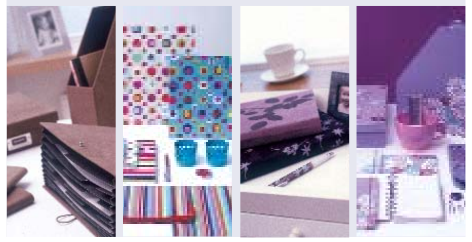
* Business underlying profit/profitability is operating profit before exceptional items, goodwill amortisation and defined benefit pension service costs.

The plan we outlined last year to deliver value to shareholders required us to make progress on many fronts and over the course of this year we have done that.

←↑ Our new basics stationery range offers customers bigger packs at better value. The basics range was introduced ready for the back-to-school period and includes pads, paper, pens and recordable media.

↑ Within our stationery departments we sell a wide range of own-brand and branded pencils and pens to suit all ages. Whether you are writing a letter to a friend, learning to draw or starting school, our pens and pencils will help you. Nearly three million coloured and lead pencils were sold by WHSmith last year.

↓ Our ranges of fashion stationery are designed to cater for different ages and trends. During the year we launched 23 different ranges including *Purple Bloom* and *Candy Stripe*, designed exclusively for WHSmith, as well as licensed brands such as *Bratz* and *The Simpsons*.



During the course of this year we identified a further £18m of cost savings that we will deliver as we make additional changes in support areas such as shared information systems and logistics.

Margin growth is an important part of our return to profitability and more than 50 per cent of the margin improvement we have delivered this year has come from a positive shift in product mix. By switching sales from low margin categories like entertainment to higher margin categories like stationery, we can deliver overall profit growth without relying on top line sales growth.

We have also grown margins by improving promotions and buying terms as well as improving the retail basics. Two of the key retail basics we have focused on are product shrinkage and markdown management.

In terms of shrinkage we focused on reducing losses in the worst one hundred stores, particularly looking at the entertainment category. The team delivered the target of a 10 per cent reduction in shrinkage and also completed audits of all stores. We have reduced the overall level of stock we hold in the business by 4 per cent year-on-year and we have managed our stock markdowns much more effectively. The changes we have made in terms of moving to a performance management culture mean there is now clear accountability for stock, both centrally and in-store.

We have made good progress operationally during the year, although I would be the first to acknowledge that there is still a great deal more to do.

Availability for the top six hundred products is now in excess of 95 per cent. In books, we have made significant changes in the end-to-end supply chain, to allow stores to carry additional range at no additional stock holding cost.

We have invested £12.5m in a new EPOS tilling system, which has been rolled out to all stores. This system will enable us to implement Chip & Pin across the estate and reduce transaction time for customers, which is particularly important over Christmas. It will also enable us to carry out more detailed, forensic analysis of shrinkage and be more flexible with our promotions.

We are also investing in developing our people to make sure we have a pipeline of talent who are equipped to deliver our future business plans. We currently have two hundred and sixty individuals on two programmes that will fast track people to supervisor and store manager positions.

rebuilding authority in our core categories

Over the course of the year we have made some key changes to our product categories. Many of these changes can be seen in stationery. WHSmith is synonymous with stationery and our customers expect us to have the most authoritative range on the high street. Our stationery range now includes many more price points from value lines at one end to premium lines at the other.

We have added in missing essential products such as archiving and storage, including the *Snopake*, *Really Useful Storage*, *Centurion* and *Acco* brands and children's correspondence. We have also continued to launch new fashion stationery ranges including *Punky Fish*, *Animal* and *Bratz*.

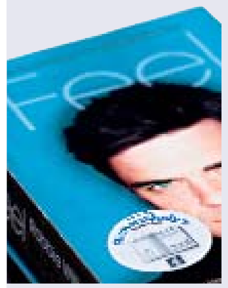
In stores where we have excess space we are also testing new ranges that complement our existing stationery offer. For example, we have introduced new ranges for the home office and new art and craft materials for all the family. We will roll out successful elements of these trials once we are satisfied they deliver the return on investment we require.

In the coming year we will build on the work we have started in books and make further changes to increase product choice and our authority as a specialist retailer in books. We have made some initial changes aimed at improving our range and the operational infrastructure. We have increased the density of fixtures in our book departments so we can stock more books in the same space. We have also reviewed our ranges to make sure the books we stock meet our customers' expectations and we have put in place clear processes for ongoing range reviews.

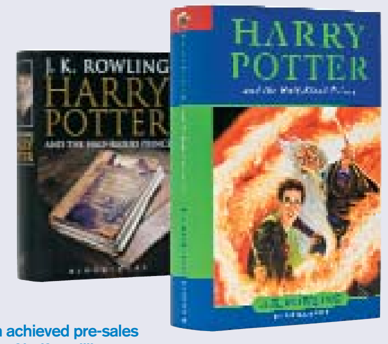
Clearly the books category is highly competitive but we are confident we can rebuild our position as Britain's most popular bookseller. We know that where our offer is compelling we compete effectively with other book retailers. For instance, over Christmas we achieved excellent market shares, all in excess of 30 per cent, according to Bookscan, on top titles like *Robbie Williams – Feel*, *Sheila Hancock – The Two of Us* and *Michael Palin – Himalaya*. Similarly, we held our market share for *Harry Potter and the Half-Blood Prince*, the most competitive book launch of the year, and achieved in excess of half a million pre-orders for it. Overall our book sales during the year fell by 2 per cent. In the first half of the year, book sales fell by 3 per cent, as we did not repeat the previous year's unprofitable promotions. In the second half of the year book sales were down by 1 per cent year-on-year following our strong performance in the market with *Harry Potter and the Half-Blood Prince*.

In entertainment we have rebalanced our space so that more of it is given to growing entertainment subcategories like DVD. In doing this we are developing a strong consumer proposition, underpinned by strong promotional offers that improve our competitiveness.

Whether heading back to school, college or university or if you just want to freshen up the home office, we have put together new collections, with beautiful designs, alongside popular licensed brands, on our stationery ranges.



The publication of *Feel: Robbie Williams*, by Chris Heath in September 2004, revealed a grippingly honest story of an extraordinary man. Truly original, *Feel* was hugely popular with WHSmith customers and was one of our best-selling books of the year.



WHSmith achieved pre-sales in excess of half a million copies for *Harry Potter and the Half-Blood Prince* – our biggest ever pre-sale event.

During the year we have rebalanced entertainment to faster growing subcategories like DVD. Our best-selling DVDs this year were *Little Britain, Spiderman 2, Troy* and *Harry Potter and the Prisoner of Azkaban*.

Strong promotional offers underpin our customer proposition and improve our competitiveness.

As well as having a best-selling book in 2004, Robbie Williams's *Greatest Hits* was our number one selling album last Christmas. Keane and the Scissor Sisters also released albums in 2004 which were hugely popular with our customers and made it onto our best-sellers list.

In news and magazines we already have a leading position that we will build on. We have focused on implementing category promotions and improving our ranges. For example a very successful promotion this year has been the 'Mag &' offer whereby with the purchase of any magazine, customers can buy selected confectionery or drink product for half its usual price. Building on the success of previous 'Bookazines', a cross between a book and a magazine, we expanded the range. They have proved very popular with customers, for example *Fred Dibnah Remembered* was one of our top selling titles for a number of weeks in the category. To improve our range we have also added more products into our impulse category.

Travel Retail

Our Travel business has had a good year and delivered strong profit* growth of 24 per cent from good sales growth, margin growth and tightly controlling its costs.

In our airport stores we have delivered strong sales growth of 7 per cent, 2 per cent ahead of passenger growth, from improving the range of products we sell. For instance, in April we tested a wide range of healthy option snacks and product extensions to our sandwich range to include pastries, salads and desserts. Our customers liked these changes so we will be rolling them out to other stores in the autumn of this year.

We have also reviewed our promotional activity so that our promotions are more targeted for either airport or railway stores. We know that customers going on flights drink more water than customers travelling by train so we have tailored our offers by product to reflect this difference and consequently we are seeing good sales uplifts.

In railway stores, sales for the year were flat. Sales were affected in July following the London bombings. We saw an immediate impact on sales in London station stores and other urban conurbations as passengers cancelled non-essential travel or took other forms of transport. The business responded quickly to manage its costs and partially mitigated the impact on the business's profitability. Staff in all areas of our business also reacted extremely professionally in what was a very traumatic and difficult situation.

To improve our performance, particularly in regional rail stores, we have been working on a number of initiatives. We have rolled out key elements of the trial work we began at King's Cross last year to increase the density of our fixtures, so we can stock more lines in the same space. This is particularly important for lines that sell very quickly as customers can find what they are looking for more easily, store staff spend less time restocking shelves and more time making sure the queues move faster.

* Business underlying profit/profitability is operating profit before exceptional items, goodwill amortisation and defined benefit pension service costs.

continuing business improvements

We have also begun to trial a number of new layouts aimed at dedicating more space to faster growing, more profitable categories like drinks and confectionery. We are still assessing the full effect of these layout changes but early signs from our Leicester and Birmingham New Street stores are encouraging and we have seen positive sales swings. We will continue to assess the data from these trials and we will implement successful elements in other stores.

In 80 of our railway stores we have invested this year in new till systems (EPOS) and we are seeing positive results in terms of reducing shrinkage and improving our forecasting. We anticipate further efficiencies from this investment in the future.

The Travel business has also been successful in winning new business during the year. We opened two WHSmith stores and a specialist bookstore, WHSmith Books, for the first time at London Luton airport. We also converted an existing site at Gatwick's North Terminal into a specialist bookstore and we will be opening a further WHSmith Books store at Bristol airport in spring 2006. We are pleased with the performance of our specialist bookstores and by next spring we will operate six in total.

WHSmith News

Our News business has operated in a challenging market this year with a combination of slowing consumer spending, rising fuel prices and the uncertainty created by the OFT review of the newspaper and magazine supply chain. Against this backdrop the business delivered a good result with profitability* up by 6 per cent to £37m. Total sales were flat at £1,187m (2004: £1,182m).

Newspaper revenues increased by 1 per cent. The volume of newspapers sold declined, however price increases and targeted marketing activities, particularly with book promotions, increased sales.

Magazine sales were flat for the year, influenced by a number of factors. New weekly titles such as *Reveal* and *Pick Me Up*, among others, were launched and their strong performances offset a decline in the sales of monthly magazines. The number of part work and one-shot magazines also declined, following an exceptionally strong performance last year.

Of course controlling costs and ensuring we continuously improve our service to retailers and publishers remain key areas of focus, and during the year we have made some good progress.

* Business underlying profit/profitability is operating profit before exceptional items, goodwill amortisation and defined benefit pension service costs.

← Our wide range of children's books has something for all ages, from toddlers to pre-school and education books to help them through their school years. *Harry Potter and the Half-Blood Prince* was our best-selling children's book last year.

→ *The Da Vinci Code* by Dan Brown was the WHSmith Book of the Year at the 2005 British Book Awards. This title spent a number of months in 2004 at the top of the best-seller charts worldwide and during the year WHSmith sold over 400,000 copies of the paperback version.

↓ By investing in new EPOS we have reduced queuing time in-store by an average of six seconds.

↓ Days Out vouchers are just one of the new products we have launched in-store. These vouchers are exclusive to WHSmith and redeemable at over 80 fantastic UK attractions.

↓→ WHSmith News delivers to customers seven days a week, 364 days per year. We deliver 50 million newspapers and magazines every week to outlets ranging from corner shops and convenience stores to supermarkets and garage forecourts.

← During the year we have doubled the amount of space given to cards, which is the equivalent to opening an additional 540 card departments. Our large stores now sell a range of 7,500 cards. Our best-selling musical sound card is Cliff Richard.

→ The women's weekly magazine sector has continued to grow. *OK!* magazine was the biggest selling weekly magazine at WHSmith this year.

We have consolidated our distribution network further into new purpose-built sites. These sites incorporate industry-leading technology, such as 'Pick and Pack' machinery, and can better accommodate large delivery vehicles thereby improving our customer service and reducing our costs. All of our operations in the North East of England are now delivered out of our central distribution centre in Newcastle. In the Thames Valley area the network has been consolidated into Slough and in the West Midlands all our activities have been consolidated into Wednesbury.

We have improved our service to retailers by leveraging our SAP investment and developing sales-based replenishment. Sales-based replenishment improves product availability and reduces excess copy in stores as products are replenished based on their rate of sale. We tested the new hardware and copy management tools with large retailers and key independent retailers over the course of the year and we are planning for a national roll out to all WHSmith News's locations this year. We are looking at other ways to leverage our skills and technological assets further with third parties, so we can provide additional services to our customers.

With regard to contract renewals, we have re-secured key contracts with Trinity Mirror and the Daily Mail, for an average of three years, and we are in negotiations with a number of other newspaper publishers. We have also renewed contracts with the key magazine distributors for an average of five years. This is a good result, particularly as negotiations for all parties were more difficult than in prior years as the OFT enquiry added a dimension of uncertainty to the entire industry.

Outlook

The plan we outlined last year to deliver value to shareholders required us to make progress on many fronts and over the course of this year we have done that, first focusing on getting the retail basics right and then on developing the most strategically attractive categories.

Our aim is to rebuild our position as Britain's most popular bookseller, newsagent and stationer by increasing our authority in our core categories, re-engineering our ranges to the faster growing, more profitable categories, improving the way we use our space and ensuring we are focused on the needs of our customers. This is all built on the foundations of sound operational performance and delivering the retail basics consistently across the business.

Our staff have worked extremely hard this year and they can be proud of what we have achieved. Trading conditions on the high street remain challenging and while it is still early days in our recovery and much remains to be done, we are on track to deliver value to shareholders.

Kate Swann
Group Chief Executive
13 October 2005

maximising shareholder value

Chairman

Robert Walker joined the Board as a non-executive director in January 2005 and became Chairman on 1 February 2005. He was Group Chief Executive of Severn Trent Plc from August 2000 until January 2005, having joined as Deputy Chief Executive in July 1999. He previously worked for Procter & Gamble, McKinsey & Co and, for over 20 years, at PepsiCo International. He is Chairman of Williams Lea Group Limited and a non-executive director of Wolseley plc and Signet Group plc. Aged 60.

Executive Directors

Kate Swann is Group Chief Executive and joined the Board in November 2003. She started her career at Tesco PLC before moving to positions at Homepride Foods, Coca-Cola Schweppes and Dixons Stores Group. She then worked for Homebase, ultimately as Managing Director, before becoming Managing Director of Argos in December 2000. She is a non-executive director of Lambert Howarth Group plc. Aged 40.

Alan Stewart is Group Finance Director and joined the Board in March 2005. He joined Thomas Cook UK Limited in 1998 as Group Treasurer and was appointed Chief Financial Officer in the same year. In 2001 he was appointed Chief Executive of Thomas Cook UK Limited and became a member of the Thomas Cook AG Board. He is a non-executive director of Games Workshop Group PLC. Aged 45.

Non-Executive Directors

John Barton is a non-executive director and joined the Board in November 1999. He retired as Chairman of Jardine Lloyd Thompson Group PLC in December 2001, having formerly been the Chief Executive of Jardine Insurance Brokers Group PLC. He is Chairman of Wellington Underwriting plc and a non-executive director of Hammerson plc and Next plc. Aged 61.

Mike Ellis is a non-executive director and joined the Board in March 2005. He was Group Finance Director of HBOS plc from 2001 to 2004. Prior to this, for 14 years, he worked in a number of senior executive positions at Halifax plc and was appointed Chief Operating Officer in 1999. He is Chairman of Fund Distribution Limited. Aged 54.

Luke Mayhew is a non-executive director and joined the Board in July 2005. He was Managing Director of John Lewis from 2000 to 2004, prior to which, from 1992 to 2000, he was Development Director of the John Lewis Partnership. He is Chairman of Pets at Home Group Limited, Chairman of Bank Store Holdings Limited, and a non-executive director of Brambles Industries plc. Aged 52.

MT Rainey is a non-executive director and joined the Board in March 2002. She is Chairman of the Marketing Group of Great Britain and was formerly Chairman of advertising agency Rainey Kelly Campbell Roalfe/Y&R, part of the WPP Group. She is also a non-executive director of SMG plc, a Visiting Professor at the University of Glasgow Business School, and a Trustee of think tank Demos and the charity Timebank. Aged 50.

Board Committees

Audit Committee
Mike Ellis – Chairman
John Barton
Luke Mayhew

Nominations Committee
Robert Walker – Chairman
John Barton
MT Rainey

Remuneration Committee
John Barton – Chairman
Luke Mayhew
MT Rainey

targeting our key impacts

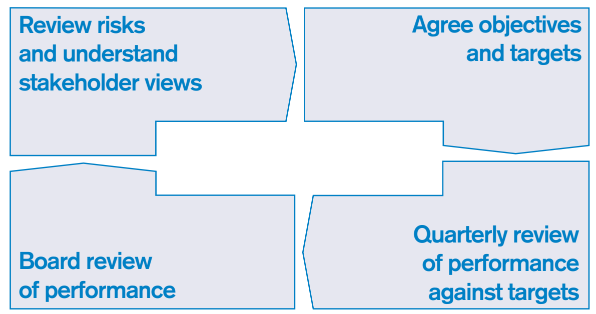
We are committed to managing the impact our business has on society and the environment and work to maximise the positive impact wherever we can. In addition, we recognise that effective management of social, environmental and ethical issues can help us to identify and manage risks as well as develop new commercial opportunities.

The following pages provide a summary of key actions over the last year, together with objectives for the year ahead. The review is divided into four subject areas: community, marketplace, workplace and environment. A full Corporate Responsibility (CR) review is available on our website at www.whsmithplc.com/grp/cr.

This year saw a full review of the key CR risks and opportunities for the business. The revised CR strategy and performance targets were approved by the Board.

A Board director has accountability for each CR area and senior executives in our News and Retail businesses are tasked with ensuring we deliver our CR objectives. Executive ownership of CR extends to the quarterly review of performance against targets, with annual performance reviews submitted to the Board.

CR management process



Benchmarking our performance

— WHSmith's ranking in the Business in the Community Corporate Responsibility Index improved from 122 to 74.
— WHSmith continues to be included in the FTSE4Good Index.

Business in the Community CORPORATE RESPONSIBILITY INDEX

← WHSmith's ranking in the Business in the Community Corporate Responsibility Index improved from 122 to 74.

FTSE4Good Index Series

← WHSmith is included in the FTSE4Good Index. The FTSE4Good Indices are designed to measure the performance of companies that meet globally recognised corporate responsibility standards, and to facilitate investment in those companies. It also provides a reference point for companies wishing to achieve best practice in corporate responsibility standards.

Community

Our community investment continues to focus on supporting education and lifelong learning. This year, in line with our Per Cent Club commitments, we continued to invest over 1 per cent of our pre-tax profits in charity and community projects. We joined the London Benchmarking Group (LBG) and have adopted the LBG reporting model which provides a standardised way of managing and measuring our community involvement.

Our community investment falls into three areas:

Partnership with the WHSmith Trust

WHSmith provides essential management, marketing, communications and fundraising support for the WHSmith Trust. This year, the Company has worked in partnership with the Trust using our combined resources and skills to leverage greater community benefit.

During the summer we worked with the WHSmith Trust and the National Literacy Trust to deliver the Reading is Fundamental 'Summer Read', aimed at maintaining literacy levels and making children enthusiastic about reading. Over 2,500 children took part in the 39 'Summer Read' events across the country.

An evaluation of the project's achievements is available at www.whsmithplc.com/grp/cr. The WHSmith Trust and the Company want to build on the success of this year's scheme and will provide funding and support for 'Summer Reads' in 2006 and 2007.

Employees making a difference in their local communities

Our staff play a vital role in supporting the local communities in which we operate. Actions are often on a small scale, but the cumulative effect is significant. Typical examples include the donation of Christmas gifts to a local shelter by our Leeds store and the donation of stock to a local school by our Minehead store.

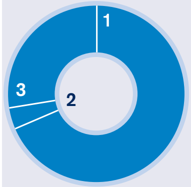
Products to support charity and education

We sell a number of products, ranging from Christmas cards to DVDs, which provide customers with a convenient way to support their favourite charities, as well as giving the charities an opportunity to reach a new audience. These products have raised money for charities including Cancer Research, the RSPCA and Children in Need. Our charity toner cartridge recycling scheme is raising money for Tommy's the baby charity. In addition, WHSmith Educational Achievement Rewards provide a tool for teachers to recognise pupils' achievements and encourage good behaviour. More details are available at www.whsmithplc.com/grp/cr.

Targets for 2005/06 include:

- Work in partnership with the WHSmith Trust to deliver two significant education and literacy projects.
- Establish a scheme to recognise and reward staff for outstanding work in the community and to share best practice.
- Increase the range of products we sell which support charities.

WHSmith community contributions 2004/05



1. Cash (£613,810)
2. Gifts in kind (£25,640)
3. Staff time/ management costs (£245,000)

←
WHSmith has adopted the London Benchmarking Group (LBG) reporting model which provides a standardised way of managing and measuring our community involvement.

←
The WHSmith Trust is an independent registered charity (registered charity no. 1013782). This year the Trust adopted a new strategy to deliver two objectives:
- to support the local communities in which WHSmith staff and customers live and work; and
- to support education and lifelong learning, helping people of any age to achieve their educational potential.

For further details of the Trust's work, see www.whsmithplc.com/grp/trust.

←
The National Literacy Trust is an independent charity dedicated to building a literate nation.

↗
Over 2,500 children took part in the 'Summer Read' events this summer, a partnership between the National Literacy Trust, the WHSmith Trust and the WHSmith Group.

Investor engagement on ethical trading

We met with Insight Investment to discuss our management of ethical trading issues. The winter 2004 edition of the *Insight Investor Responsibility Bulletin* included the following report on the meeting:

WHSmith 'has good governance, policy and systems in place to manage ethical trading issues, which have not been compromised despite recent restructuring … its extensive sourcing from China will likely continue to pose significant ethical trading challenges. The company's active involvement in the ETI and commitment to proactive engagement with suppliers should go some way to addressing them.'

←
The WWF-UK Forest & Trade Network works with UK companies to improve forest management around the world.

↑
This year we introduced new recycled stationery ranges in-store including writing paper, notepads and envelopes.

Marketplace

WHSmith takes its responsibility for the products it sells seriously. We aim to supply high-quality products that are produced by people working in decent conditions with minimal possible impact on the environment. This is the focus for our supply chain management activity.

We are committed to making our Supplier Code of Conduct and Forest Sourcing policy an integral part of our buying decisions. This year, we trained buyers on the role they should play, notably the need to consider ethical trading issues in critical path planning. We also established a review group, comprising senior buyers, quality and corporate responsibility functions to oversee performance and agree actions on ethical trading and forest sourcing.

Ethical trading

We continue to engage with our suppliers to promote improved labour standards and better environmental management. Our 24 month rolling audit cycle monitors supplier compliance with our Code of Conduct. This year, 64 supplier factory audits were carried out by an independent third party, the majority of these in China. After each audit, we agree a corrective action plan with the factory management. Resources and engagement focus is on suppliers in the Far East who provide us with WHSmith branded product, with priority given to suppliers rated high and medium risk.

Twenty six high-value own-brand UK suppliers were also assessed to check they have a process in place for monitoring labour standards in their own supply chains.

As members of the Ethical Trading Initiative (ETI), and specifically through the ETI China Working Group, we continue to work with other members to share best practice and develop solutions to the challenges we all face.

Forest sourcing

Our revised Forest Sourcing policy was approved by the Board. The policy sets out our objective that all virgin (i.e. non-recycled) material used in our products should come from known, legal, well-managed and credibly certified forests. To achieve this objective, we have:

- Continued our membership of the WWF-UK Forest & Trade Network that works with UK companies to improve forest management around the world.
- Extended our annual supplier survey on forest sourcing to cover key suppliers of paper and wood products in the Far East as well as in the UK. This year's return covered over 70 per cent of the volume of the own-brand paper and wood products we sell and helped us identify the suppliers to prioritise for engagement.
- Provided suppliers with guidance notes outlining the issues to consider when sourcing timber or paper from China, Finland and Russia.
- Increased the number of recycled and Forest Stewardship Council (FSC) certified products we sell in-store.

Customer service standards

'Customer Focus' is one of our core business values and underpins everything we do. Increased focus on retail standards in our High Street business has translated into improvements in our mystery shopper scores and a reduction in the number of customer contacts into our central customer service centre.

Our News business carries out twice yearly customer surveys to assess customer service standards. We publish the findings alongside details of the actions we will take in response. The survey results can be found at www.whsmithnews.co.uk and form the basis of the customer service action plan with performance incentives for individual employees based on delivery of the required improvements.

Targets for 2005/06 include:

— Incorporate ethical trading and forest sourcing into the job specifications of key buyers.
— Appoint a specialist internal audit team in our Asian sourcing operation to strengthen our engagement with suppliers on labour standards and forestry issues.
— Work with two key Far East suppliers to improve the way they manage health and safety and human resources.
— Hold workshops for 15 key UK own-brand suppliers to raise awareness of WHSmith's ethical trading and forest sourcing requirements, providing practical tools to help them improve standards.
— Maintain the data coverage of our forest source survey at 70 per cent of the volume of all own-brand paper and wood products or increase coverage further.
— Pilot at least three new lines of recycled or FSC certified stationery to test the commercial opportunities.

Workplace

Embedding our values within the business culture

Last year, we adopted four key business values: Customer Focus, Drive for Results, Value Our People and Accountability. As part of our three year plan to embed the values fully throughout the business, this year we focused on raising awareness, helping staff understand what the values mean and how to apply them in their role.

In November we launched the 'Values in Practice' or VIP scheme for all High Street, Travel and Group head office employees to recognise individuals and teams who are demonstrating the values in their work. Awards were also made to those store staff who are outstanding role models in living the values.

The values are used as a key part of our recruitment and training programmes and our performance management process. Every member of staff, from Board level down, has their performance assessed against the values.

Communicating with and engaging our staff

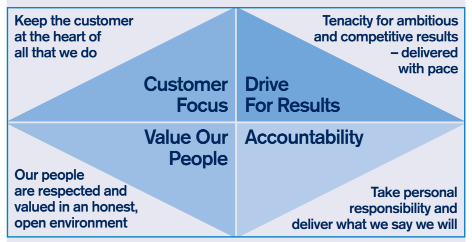
Recent changes within the business make it more important than ever that all employees feel engaged in delivering our turnaround plan. We have substantially improved the quality and effectiveness of our internal communications to update and inform staff on business performance.

We collect feedback to measure the effectiveness of every communication event we hold so that we can continue to make improvements.

FSC

← The Forest Stewardship Council (FSC) is an international network to promote responsible management of the world's forests. Its product label allows consumers to recognise products that support the growth of responsible forest management.

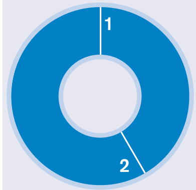
WHSmith values



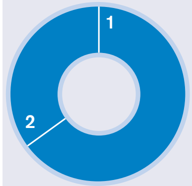
↑ Eye-catching posters raise staff awareness of the Company's values.

Diversity profile: WHSmith Group

All employees



Senior management



Training and developing our staff

The specialist training and development team in WHSmith Retail focuses on helping staff develop the skills to deliver their objectives and help people to reach their potential.

Highlights from 2004/05 include:

— Training provision doubled within WHSmith Retail.
— Launch of an easy-to-use training and development intranet site to raise staff awareness of the resources available, so they can take an active part in requesting training.
— Launch of a Career Development Framework for High Street store staff to support succession planning and provide a clear route map showing how a member of staff can progress from one role to another.
— Development of a 360° feedback process for our top 100 leaders which is aligned to our Values and Leadership behaviours.

Valuing diversity

We want all our employees to contribute as much as they can to the business and its success. Our equal opportunities and diversity policies outline our commitment that all employees should be treated with respect and dignity with people's differences valued and recognised in everything that we do.

Targets for 2005/06 include:

— Further embed the values in our business culture in head office and stores through the launch of a tool for managers to send an immediate message to positively recognise staff who demonstrate the values.
— Launch a Fast Track Development programme for store supervisors.
— Develop a Coaching and Mentoring programme for senior executives.
— Fill 50 per cent of the store manager vacancies in our high street stores with internal candidates.
— Set up a Diversity Working Group to develop initiatives and policies concerning gender, sexual orientation, ethnicity and disability.

Health and safety

The Board is committed to maintaining high standards of health and safety in the business.

Management teams in each business, supported by professional safety advisers from the Group Risk and Occupational Health department, monitor key safety performance indicators and an annual report of each business detailing trends, performance and recommendations is presented to the Board. Each business also has a properly constituted health and safety committee that comprises employees' representatives, management, trade union representatives and officials.

	Accidents and injuries (Rate per 100,000 employees)		
	2005	2004	2003
Major injuries	**86**	76	132
Injuries resulting in over 3 days' absence from work	**557**	628	439
All RIDDORS*	**643**	704	571

* The number of accidents legally reportable under the Reporting of Injuries, Diseases and Dangerous Occurrence Regulations.

This year, the total number of reportable accidents across the Group reduced by 19 per cent which is a good result and is in line with the Health and Safety Executive's 'Revitalising H&S' strategy for businesses to significantly reduce workplace accidents. This result must be tempered by a reported increase in major injury accidents. This equates to 30 such injuries throughout the year and, although a small number, each incident is taken very seriously and measures introduced to avoid similar occurrences. This will be an area for focus in the coming year.

During the year over 1,100 managers have been trained so they can cascade safety training to their staff. Additional training to support the Health and Safety Executive's 'Mind your Back' campaign will be launched next year with the aim of further reducing the number of accidents following manual handling operations.

Targets:
By the end of August 2010, we aim to:
— Reduce reportable accidents in WHSmith Retail by 5 per cent from September 2004 levels.
— Reduce reportable accidents in WHSmith News by 50 per cent from September 2004 levels.

Environment
The environmental impacts of WHSmith's businesses fall into three main areas:
— Energy used to operate our stores, offices and distribution centres.
— Fuel used to distribute our products.
— The production, use and disposal of our products and packaging.

We are committed to energy and fuel efficiency, waste reduction and recycling, recognising that as well as reducing our environmental impact this can also contribute to greater business efficiency.

Energy
During the year, we have reduced energy consumption across the Group by 1.2 per cent (see table). Fifty per cent of the electricity we purchased came from renewable sources helping us to reduce the associated emissions of carbon dioxide from 56,597 tonnes to 23,258 tonnes.

We targeted the 40 stores with the highest levels of energy consumption, developing an improvement plan for each. A checklist of energy-saving measures is now also included in routine maintenance.

Steps have been taken to increase energy awareness including training for High Street store managers, supervisors and all new starters. Store managers now have visibility and direct accountability for energy consumption in their store, with energy costs applied to the store's profit and loss account.

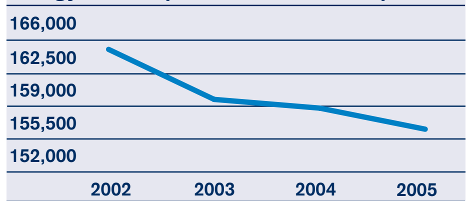
Transport
Through the introduction of Ideal Delivery Frequency routing, we have reduced fuel usage in our Retail distribution fleet by 12.1 per cent with vehicles also travelling less distance (see chart). Other factors include more effective management of vehicle fill and introduction of new vehicles.

Within WHSmith News, we now operate from fewer locations and make greater use of large vehicles. We achieved a 3 per cent reduction in the distances travelled by our own fleet, however we saw an increase of 8 per cent in the distance travelled by our contractors' vehicles, with the whole News fleet covering a total of 49,361,393 km. We continue to work on optimising the efficiency of our distribution network.

Accidents by type 01.09.04 – 31.08.05

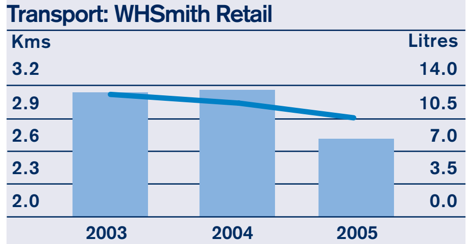
1. Manual handling
2. Striking fixed objects
3. Struck by moving/falling object
4. Slip/trip/fall
5. Fall from height
6. Hand tools

Energy consumption: WHSmith Group



— Energy consumption (in 000's, MwH)

Transport: WHSmith Retail



Total fuel used (in millions)
— Total km travelled (in millions)

WOODLAND TRUST

↑← WHSmith remains a key partner in the Woodland Trust Christmas Card Recycling Scheme. In 2005 the Scheme recycled over 58 million cards.

Packaging and waste
Transit packaging, namely cardboard and polythene, is a major waste stream for our business and has been a focus for our waste reduction and recycling programmes this year.

We have been rolling out a cardboard recycling scheme to those high street stores that have sufficient space to accommodate cardboard collection bins, resulting in a reduction in the volume of waste sent to landfill.

Our News business has now successfully implemented recycling programmes at larger locations and this is already helping us achieve significant reductions.

Data on our waste reduction and recycling programmes is available at www.whsmithplc/grp/cr.

Working with suppliers to reduce transit packaging
An over-packaged product places a burden on the environment, costs more to transport and takes longer to unpack. We are working with key Far East suppliers of own-brand products to reduce transit packaging. To date we have saved 45 tonnes of transit packaging. We are now looking at opportunities to reduce packaging in a wider group of suppliers, both in the UK and the Far East.

Encouraging customers to recycle
Wherever we can we will encourage our customers to recycle our products after use.

WHSmith remains a key partner in the annual Woodland Trust Christmas Card Recycling scheme. Now in its eighth year, the 2005 scheme broke all previous records to recycle over 58 million cards.

All own-brand toner cartridges include a recycling bag providing our customers with a convenient way to recycle their old cartridges. This year, we have collected 22,000 cartridges, raising money for Tommy's, the baby charity.

Targets for 2005/06 include:
— By August 2008, reduce energy consumption by 5 per cent per square foot from September 2004 levels.
— Establish an Environmental Champions scheme to help deliver continuous improvement in energy efficiency and waste minimisation.
— Reduce fuel use in the WHSmith Retail distribution fleet by 15 per cent from September 2004 levels.
— Work with our top 20 own-brand suppliers in the Far East to reduce the amount of transit packaging by 10 per cent from September 2004 levels.
— Extend cardboard recycling to 150 WHSmith High Street stores.

A full CR review is available on our website at www.whsmithplc.com/grp/cr.

Financial Review
Alan Stewart

Operating activities

The Group's profitability has recovered significantly with strong performances from all businesses, despite the tough trading climate, particularly in the second half of the year. High Street Retail's profitability recovered substantially compared with the prior year. The focus in High Street Retail has been on good category mix management and tight cost control. Travel Retail delivered a strong performance through sales growth, margin growth and cost control, and News Distribution delivered another solid result.

The Group generated a profit before tax, exceptional items and goodwill amortisation from continuing businesses of £73m (2004: £46m), an increase of 59 per cent on the prior year. Profit before tax, after exceptional items and goodwill amortisation, was £64m (2004: loss of £135m).

During the year High Street Retail delivered £18m of the three year cost saving programme, £3m more than the announced £15m target for this year. The business is on track to deliver the total £30m target over three years. We have identified a further £18m of cost savings, in support areas such as shared information systems, logistics and store efficiencies. We have delivered £2m of these new savings in 2004/05 and the remainder will be delivered over the next three years. We expect the total cost savings broadly to mitigate inflationary pressures in 2006 and 2007.

Headline earnings per share[1] from continuing operations increased by 121 per cent to 31.6p (2004: 14.3p) with earnings per share from continuing operations of 30.5p (2004: loss per share of 20.5p).

Given the improvement in the Group's trading position, the Board has proposed an increased final dividend of 9.2p per share (2004: 8.0p), making a full year dividend of 13.7p (2004: 12.0p).

Cash generation was strong due to the improved trading performance in the businesses and good stock and debtor control. Group free cash flow was £78m (2004: £12m). The reduction in net assets to £42m (2004: £256m) reflects the return of cash to shareholders and an increase in the pension deficit as a result of falling bond yields.

Non-operating activities

In September 2004, the Group completed the disposal of Hodder Headline for £224m[2] and returned £205m to shareholders.

Following the disposal, the Group made a £120m cash contribution to the WHSmith Pension Trust. This payment was financed from the Group's own resources and new banking facilities.

In September 2005, the Trustees of the WHSmith Pension Trust adopted a new investment policy in order to limit the volatility in the underlying investment performance and reduce the risk of a significant increase in the deficit in the fund. A Liability Driven Investment (LDI) approach has been adopted with 94 per cent of the assets now invested in inflation and interest rate hedged investments (which change in value in line with changes in the underlying liabilities). The balance is in equity options designed to enable the fund to continue to benefit from any potential higher returns from the equity markets.

1) Headline earnings per share: before exceptional items, goodwill amortisation and FRS 17 pension interest – undiluted.
2) £210m in cash and assumption of the Hodder Headline net pension deficit of £14m.

The focus in High Street Retail has been on good category mix management and tight cost control. Travel Retail delivered a strong performance through sales growth, margin growth and cost control, and News Distribution delivered another solid result.

Following this change in the investment policy, the Board and the Trustees have agreed a new deficit funding agreement. This agreement provides the Company with greater predictability over the level of future pension deficit payments. The agreement replaces that reached last year and will result in pension deficit funding payments of £15m in 2005/06, £17m in 2006/07, £20m in 2007/08 and increasing by RPI (capped at 5 per cent) thereafter until the deficit (as calculated under FRS 17) is repaid.

Group profit and loss account
Group sales summary

£m	2005	2004	*Growth %*	*LFL sales growth %*
Sales				
Retail	**1,423**	1,453	*(2%)*	*(2%)*
News Distribution	**1,187**	1,182	–	–
Sales – continuing	**2,610**	2,635	*(1%)*	*(1%)*
Internal sales	**(113)**	(115)	*(2%)*	*(2%)*
Total sales	**2,497**	2,520	*(1%)*	*(1%)*
Discontinued businesses	**11**	314		
Reported sales	**2,508**	2,834	*(12%)*	

Continuing like for like sales were down 1 per cent year-on-year. Retail like for like sales were down 2 per cent in the first half of 2004/05 and were down 1 per cent for the second half. News Distribution sales were flat for the full year, with like for like sales up 2 per cent in the first half and down 1 per cent in the second half. Overall total sales including discontinued businesses were down 12 per cent.

Group trading results

£m	2005	2004	*Profit growth %*
Operating profit[3]			
Retail	**69**	44	*57%*
News Distribution	**37**	35	*6%*
Trading profit[3]	**106**	79	*34%*
Central costs			
Support functions	**(16)**	(15)	*(7%)*
Pension service costs	**(10)**	(14)	*29%*
Internal rents	**1**	1	–
Operating profit[3] – continuing	**81**	51	*59%*
Net finance charges – continuing	**(8)**	(5)	*(60%)*
Profit[3] before taxation – continuing	**73**	46	*59%*
Discontinued businesses	**–**	21	–
Profit[3] before taxation	**73**	67	*9%*

3) Stated before exceptional items and goodwill amortisation.

Trading profit was up 34 per cent to £106m.

Pension service costs were reduced by £4m compared to last year, as a result of the introduction of employee contributions, a reduction in certain scheme benefits such as early retirement terms and an overall reduction in pensionable salaries following the organisational review in 2004.

Group operating profit from continuing operations before exceptional items and goodwill amortisation was up 59 per cent to £81m.

Financial Review
Alan Stewart

Operational review
Retail

£m	2005	2004	Growth %	LFL sales growth %
Sales				
High Street Retail	**1,112**	1,152	*(3%)*	*(3%)*
Travel Retail	**311**	301	*3%*	*4%*
Total divisional sales	**1,423**	1,453	*(2%)*	*(2%)*
Divisional profit				
High Street Retail	**43**	23	*87%*	
Travel Retail	**26**	21	*24%*	
Total divisional profit	**69**	44	*57%*	

Note: All divisional profit and loss figures in this section are stated before defined benefit pension service costs, exceptional items and goodwill amortisation, interest and taxation. High Street Retail numbers incorporate the results of WHSmith Online, which has been integrated.

Retail sales fell by 2 per cent to £1,423m (2004: £1,453m) with like for like sales down 2 per cent. Gross margin increased by 240 basis points to 40.5 per cent. Retail divisional profit increased 57 per cent to £69m (2004: £44m).

Stationery sales were up 3 per cent in the year, with sales up 4 per cent in the first half and up 1 per cent in the second half, as the anniversary of last year's initiatives was reached. Book sales for the full year fell by 2 per cent. Book sales in the first half fell by 3 per cent as we did not repeat the previous year's unprofitable promotions. In the second half sales were down by 1 per cent year-on-year, with a strong performance from sales of *Harry Potter and the Half-Blood Prince*. News and Impulse sales were up 1 per cent on last year; excluding the decline in sales of phone cards, sales grew 2 per cent. In Entertainment, sales fell by 12 per cent versus last year as a result of continued intense competition in the category and our focus on switching sales from low to high margin categories.

Despite difficult trading conditions, profit in the year increased by £25m to £69m with gross contribution increasing by £23m to £576m. Gross margin growth of 240 basis points reflected the shift from lower margin entertainment products to higher margin stationery products and improved buying terms.

High Street Retail has delivered £18m of the three year cost-saving programme during the year, £3m more than the announced £15m target for this year. The business is on track to deliver the total £30m target over three years. During the course of the year, we identified a further £18m of cost savings, in support areas such as shared information systems, logistics and store efficiencies. We have delivered £2m of these savings in 2004/05 and the remainder will be delivered over the next three years. We expect the total cost savings broadly to mitigate inflationary pressures in 2006 and 2007.

As a result of these initiatives, net margin for Retail increased by 180 basis points to 4.8 per cent.

The Retail business now operates from 669 stores, which occupy 3.3 million square feet (2004: 3.3 million square feet). We opened five new stores in the year and closed nine stores.

News Distribution
Total sales of £1,187m (2004: £1,182m) were flat for the year. Newspapers sales were up 1 per cent, with price increases and book promotions offsetting volume declines. Magazine sales were flat, with a steady weeklies market, fuelled by a number of new product launches, offsetting a slower monthly market. The number of part works and one-shots declined by 15 per cent, following an exceptionally strong performance last year, including *Euro 2004*.

Gross contribution reduced by £1m, due to a shift in relative sales from magazines to newspapers.

With a clear focus on tight cost control, profit grew by £2m to £37m. Net margin improved to 3.1 per cent (2004: 3.0 per cent).

Central costs
Centrally controlled support costs were £16m (2004: £15m) and internal rents on freehold property owned by the Group remained at the prior year level of £1m.

Pension service costs were reduced by £4m compared with the prior year, as a result of the introduction of employee contributions, a reduction in certain scheme benefits such as early retirement terms and an overall reduction in pensionable salaries following the organisational review in 2004.

Exceptional items
In the first half, the Group booked pre-tax exceptional charges of £8m, which related to discontinued businesses. Of this amount, £7m related to an impairment review of the loan notes received as deferred consideration in respect of the disposal of the Group's USA businesses in the prior year. The balance related to further closure and exit costs.

On 25 September 2004, the Group completed the disposal of its publishing business, Hodder Headline Limited. The business was sold to Hachette Livre S.A. for £210m cash and the assumption of the Hodder Headline Limited net pension deficit of £14m.

Net finance charges
The results include net interest of £8m (2004: £5m). The increase in the net finance charges from last year is primarily due to the drawdown of the term debt. Net finance costs of the pension fund under FRS 17 were £2m (2004: £4m). This represents the difference between interest earned on pension scheme assets and interest charged on pension scheme liabilities.

Taxation
The tax charge for the year before tax on exceptional items and goodwill amortisation was £18m (2004: £23m). The effective tax rate on continuing activities, excluding exceptional items and goodwill amortisation, was 25 per cent (2004: 30 per cent).

The Group made significant progress in settling prior year corporation tax liabilities with the Inland Revenue. We expect our effective tax rate to be approximately 25 per cent for some years.

Earnings / (loss) per share
The Group generated headline earnings per share[1] from continuing operations of 31.6p (2004: 14.3p) while earnings per share from continuing operations were 30.5p (2004: loss per share of 20.5p).

Dividends
The Board is proposing an increased final dividend of 9.2p per ordinary share (2004: 8.0p). The final dividend will be paid on 7 February 2006 to shareholders registered at the close of business on 6 January 2006. This will give a full year dividend of 13.7p (2004: 12.0p). The total cost of the dividend is £23m. Excluding exceptional items and goodwill amortisation, the equity dividend is covered 2.4 times by earnings.

As part of the capital reorganisation in October 2004, the Group paid a special dividend of £143m.

Fixed charges cover
Fixed charges, comprising operating lease rentals, property taxes, other property costs and interest, were covered 1.4 times by profit before fixed charges, excluding exceptional items and goodwill amortisation (2004: 1.3 times cover).

Free cash flow and cash balances
The operating free cash flow amounted to £78m compared with £12m in the previous year.

£m	2005	2004
Profit before tax, exceptional items and goodwill	**73**	67
Depreciation and amounts written off tangible fixed assets	**42**	46
Cash profit	**115**	113
Working capital	**4**	(27)
Capital expenditure	**(32)**	(49)
Tax	**(4)**	(21)
Net provisions	**(5)**	(4)
Free cash flow	**78**	12

1) Headline earnings per share: before exceptional items, goodwill amortisation and FRS 17 pension interest – undiluted.

The movement in working capital for continuing businesses was £25m favourable to the previous year, principally as a result of the strong focus on stock levels and improved control of debtors. This can be further analysed as follows:

£m	2005	2004
Stock	**6**	(16)
Debtors	**10**	–
Creditors	**(2)**	5
Working capital – continuing	**14**	(11)
Discontinued businesses	**(10)**	(16)
Working capital movement	**4**	(27)

Capital expenditure

£m	2005	2004
New stores	**4**	8
Refurbished stores	**14**	16
Systems*	**23**	13
Other	**4**	6
Discontinued businesses	**–**	6
Total	**45**	49

* Within systems expenditure are assets funded by finance leases of £13m (2004: £nil) which is a non-cash movement.

We have continued to invest in maintaining our retail properties. In High Street Retail we have invested £17m in upgrading our stores and our business systems infrastructure, including installing electronic point of sale (EPOS) systems in all stores.

Net funds
The movement in the net funds position is as follows:

	£m
Opening net funds	**45**
Free cash flow	78
Equity dividends paid	(21)
Cash returned to shareholders	(205)
Net purchase of own shares	(7)
Pension deficit funding	(130)
Net disposals	203
Finance leases	(13)
Financing fees	(2)
Premium on issue of shares	2
Sale and leaseback proceeds	2
Closing net debt	**(48)**

The amount shown for pension deficit funding of £130m represents the difference between the cash contributions to the defined benefit pension scheme of £142m and the associated profit and loss charge, which comprised £10m for operating costs and £2m for financing.

The net disposals of £203m includes gross proceeds of £222m from Hodder Headline and WHSmith Aspac disposals, less £10m of disposal transaction costs and £9m of advisory fees in respect of the bid approach received last year.

Group balance sheet

	£m	£m
Goodwill		14
Fixed assets		231
		245
Stock	162	
Creditors less debtors	(192)	
Working capital		(30)
Deferred tax asset		20
Corporation tax		(27)
Provisions		(31)
Dividends		(16)
Operating assets employed		**161**
Net debt		(48)
Net assets excluding pension liabilities		**113**
Net pension liability		(71)
Total net assets		**42**

The movement of net assets over the year is as follows:

	£m	£m
Opening net assets		**256**
Pre-tax profit before exceptional items and goodwill amortisation	73	
Tax on above	(18)	
		55
Return of cash to shareholders		(205)
Money returned to ESOP Trust after capital reorganisation		5
Dividends		(23)
Increase in pension scheme deficit		(30)
Purchase of own shares for employee share schemes		(12)
Employee share schemes		5
Net assets before exceptional items		**51**
Goodwill amortisation	(1)	
Provision for discontinued businesses	(8)	(9)
Closing net assets		**42**

Following the return of cash to shareholders and the increase in the pension scheme deficit as a result of falling bond yields, the Group's net assets declined substantially from £256m at the end of 2004 to £42m this year.

Return on capital employed (ROCE)

Total capital employed and ROCE were as follows:

	Operating capital employed £m	ROCE %	ROCE % with operating leases capitalised
High Street Retail	187	23%	13%
Travel Retail	24	108%	32%
Retail	**211**	**33%**	**16%**
News Distribution	(25)	–	–
Central items and property	(19)	–	–
Operating assets employed – continuing operations	**167**	**48%**	**19%**

For the prior year, comparable average returns were 37 per cent (14 per cent – after capitalised operating leases).

Pensions

During the year, the Group made significant cash contributions of £142m to its pension scheme. The payments have been funded from the Group's own resources and new banking facilities, now partially repaid. The gross deficit has reduced to £94m from £205m, a total reduction of £111m, with falling bond yields adversely impacting during the year.

In September 2005, the Trustees of the WHSmith Pension Trust adopted a new investment policy in order to limit the volatility in the underlying investment performance and 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 expected liabilities of the scheme being matched by assets that will alter in value as interest and inflation rates change, matching the movements at the same rate as the pension liability changes ('a Liability Driven Investment "LDI" policy').

The key features of this fund restructuring are as follows:

— 94 per cent of the fund's assets are invested in an LDI structure with a leading international institutional fund manager; and
— 6 per cent of the fund's assets have been used to purchase a portfolio of long-dated equity Call options. These represent a notional exposure to underlying equities of some £350m.

The impact of this change in investment policy is to limit 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 overall expected rate of return from the portfolio under the new arrangements is 5 per cent in the 2005/06 financial year.

Following this change in the investment policy the Board and the Trustees have agreed a new deficit funding agreement that gives the Company significantly greater predictability over the level of future deficit reduction payments. This agreement replaces that reached last year and, subject to certain limited conditions, will result in deficit funding payments of £15m in 2005/06, £17m in 2006/07, £20m in 2007/08 and increasing by RPI (capped at 5 per cent) thereafter until the deficit (as calculated under FRS 17) is repaid.

Return of cash to shareholders

On 27 September 2004 the Company undertook a capital reorganisation whereby existing ordinary shareholders received 18 new ordinary shares and 25 new non-cumulative preference shares of nominal value 85p ('C' shares) for every 25 existing ordinary shares. The new ordinary shares have a nominal value of $2^{13}/_{81}$p each. This capital reorganisation was effected by a bonus issue of approximately £78m, using the share premium account to pay up fully undesignated shares of 31p each, which were then allocated to shareholders on the basis of one undesignated share for every existing share held. The existing ordinary shares and undesignated shares were then consolidated and split, resulting in the issue of new ordinary shares with a nominal value of £4m and 'C' shares with a nominal value of £213m.

In accordance with the terms of the capital reorganisation, shareholders could elect to sell 'C' shares to the Company at 85p per share following which all such 'C' shares would be cancelled by the Company or to receive the initial 'C' share dividend of 85p per 'C' share following which all such 'C' shares would be converted into deferred shares. On 27 October 2004, as a result of these elections, the Company repurchased 73,182,358 'C' shares for their nominal value of 85p each, a total repurchase amount of £62m and paid an initial 'C' share dividend of £143m in respect of 167,686,994 'C' shares.

The remaining ten million 'C' shares may be purchased by the Company (subject to the provisions of the Companies Act 1985) or converted into ordinary shares at the Company's option and carry a net non-cumulative dividend set at a rate that is the lower of 75 per cent of six month LIBOR and 20 per cent per annum. The 'C' shares have limited voting rights.

Financing

A three year £270m facility agreement was signed on 26 July 2004 between the Group, Lloyds TSB Bank plc, HSBC Bank plc and Royal Bank of Scotland plc under which up to £120m was available by way of a term loan facility and where amounts repaid or not drawn down may not be re-borrowed, and £150m is available by way of a multicurrency revolving credit facility. The agreement contains provisions, obligations and certain financial covenants, which are customary in such an agreement. The Group drew down £90m of the term loan facility and repaid £25m in the year, leaving a balance of £65m drawn down at the end of the year.

Operating leases

The Group's stores are held mainly under operating leases that are not capitalised and therefore are not included as debt for accounting purposes. The High Street Retail leases are on standard 'institutional' lease terms, typically with a 15 year term subject to five year upwards-only rent reviews. The Travel Retail stores operate mainly through turnover-related leases, usually with minimum rent guarantees, and generally varying in length from five to ten years.

The business has an annual minimum net rental commitment of £139m (net of £11m of external rent receivable). The total future rental commitment at the balance sheet date amounted to £0.9bn with the leases having an average life of seven years. The net present value of these commitments is approximately £0.6bn. This is considered to be a satisfactory situation for, although large, these commitments are characteristic of the retail sector and the risks associated with them depend on their liquidity, influenced mainly by the quality and location of the sites.

Currency

Currency exposures mainly relate to the supply of products from outside the UK. The effects of fluctuations in exchange rates on operating profit before exceptional items and goodwill amortisation were minimal in the year.

International Financial Reporting Standards (IFRS)

The Group is required to prepare its financial statements for the year ended 31 August 2006 and all subsequent periods in accordance with IFRS. This will require an opening balance sheet as at 1 September 2004 together with the income statement and balance sheet for the year ended 31 August 2005 to be prepared under IFRS for comparative purposes.

The principal adjustments to the Group's financial statements will arise from changes to share-based remuneration accounting, leases, pension assets, goodwill, accounting for financial instruments and the recognition of dividends. The net impact of the adjustments on the restated balance sheet as at 31 August 2004 is expected to be broadly neutral.

We plan to report our 2005 restated results under IFRS in late November 2005 and we will provide an analysis of accounting adjustments at that time.

Alan Stewart
Group Finance Director
13 October 2005

Directors' Report

The directors of WH Smith PLC (the 'Company') present their annual report to shareholders together with the audited consolidated accounts of the Company and its subsidiaries for the year ended 31 August 2005.

Principal activities

The principal activities and future prospects of the Company are set out in the Chairman's Statement on page 2, in the Group Chief Executive's Operating Review on pages 4 to 9 inclusive and in the Financial Review on pages 18 to 23 inclusive.

Company results

The Group profit and loss account for the year ended 31 August 2005 is shown on page 39.

Analyses of turnover and operating profit or loss by activity are shown in Note 1 to the accounts.

Share capital

The authorised and issued share capital of the Company, together with details of shares issued during the year, are shown in Note 22 to the accounts.

On 27 September 2004, to facilitate the return of cash to shareholders, there was a capital reorganisation. Details of the return of cash and capital reorganisation are set out below.

On 20 May 2005, following the grant of an order of the High Court dated 18 May 2005, the Company cancelled the 169,072 $5\frac{3}{4}$ per cent cumulative preference shares. Holders of these shares received a capital repayment at par and a final dividend in respect of the period 1 April 2005 to 20 May 2005 on 4 July 2005.

Return of cash and capital reorganisation

At an Extraordinary General Meeting held on 23 September 2004, shareholders approved the disposal of Hodder Headline and the return of £205m to shareholders by way of a 'C' share scheme. In order to provide maximum flexibility in terms of tax treatment, the 'C' share scheme allowed shareholders to choose whether to receive the return as income by way of the Initial 'C' Share Dividend or capital by way of the Repurchase Offer.

The 'C' share scheme was implemented on 27 September 2004 by way of a capital reorganisation under which ordinary shareholders received one non-cumulative preference share of 85p ('C' share) for each ordinary share of $55\frac{5}{9}$p and 18 new ordinary shares of $2\frac{13}{81}$p each for every 25 ordinary shares of $55\frac{5}{9}$p each held on 24 September 2004.

Major shareholders

At 13 October 2005, the Company's share register of substantial shareholdings showed the following interests in 3 per cent or more of the Company's ordinary shares:

Holder	Number	%
Silchester International Investors Limited	32,244,558	17.86
Grantham, Mayo, Van Otterloo & Co. LLC	6,328,566	3.50
Orbis Investment Management Limited	6,014,892	3.33
Legal & General Group Plc	5,929,549	3.28
Co-operative Insurance Society Limited	5,776,728	3.20
Standard Life Group	5,522,332	3.05

Dividends

The directors recommend the payment of a final dividend for the year of 9.2p per ordinary share on 7 February 2006 to members on the Register at the close of business on 6 January 2006.

This final dividend, together with the interim dividend of 4.5p per ordinary share paid on 23 June 2005, makes a total dividend of 13.7p per ordinary share for the year ended 31 August 2005.

Subsidiaries and businesses

On 25 September 2004, the Company sold its Publishing business Hodder Headline to Hachette Livre S.A. for £210m in cash and the assumption of the Hodder Headline net pension deficit estimated at £14m.

Further details of this disposal can be found in Note 4 to the accounts.

Employees

The Company employs approximately 23,000 people throughout the United Kingdom and overseas and we are proud of our long history of being regarded as a responsible and respected employer.

Employees are kept well informed of the performance and objectives of the Group through personal briefings and email and the Company's open management style encourages employees to contribute to the development of the business.

The Company operates a long established Inland Revenue Approved Save-As-You-Earn share option scheme ('Sharesave Scheme') which provides employees with the opportunity to acquire shares in the Company. As at 31 August 2005 some 3,000 employees were participating in this Scheme.

The Board believes in creating a culture throughout the Company that is free from discrimination and harassment and will not permit or tolerate discrimination in any form. The Company gives proper consideration to applications for employment when these are received from disabled people and employs them whenever suitable vacancies arise. Should an employee become disabled when working for the Company, efforts are made to continue their employment and retraining is provided if necessary.

Corporate responsibility

The Board recognises the importance of the social, ethical and environmental issues facing the Company's businesses and is committed to achieving a high standard of corporate responsibility. Further details can be found in the section on corporate responsibility on pages 11 to 17 inclusive and on the Company's website www.whsmithplc.com.

Political and charitable donations

Charitable donations during the year ended 31 August 2005 totalled £1,000 (2004: £12,000).

It is the Company's policy not to make political donations and no political donations were made in the year (2004: £ nil).

Payment policy for suppliers

The Company's policy for the payment of suppliers, which complies with the CBI Code of Practice for Buyers, is to agree the terms of payment in advance in line with normal trade practice and, provided a supplier performs in accordance with the agreement, to abide by such terms. The Group's trade creditors figure as at the balance sheet date was equivalent to 36 days (2004: 38 days) based on average daily amounts invoiced by suppliers during the year.

Directors

The names of the directors as at the date of this report, together with biographical details, are set out on page 10. All the directors served throughout the period except as noted below:

Tim Hely Hutchinson, who served as a director since 1999, resigned on 25 September 2004.

Robert Walker was appointed on 1 January 2005 and became Chairman on 1 February 2005.

Walker Boyd , who served as a non-executive director since 2004, resigned on 27 January 2005.

Andrew Rolfe, who served as a non-executive director since 2003, resigned on 27 January 2005.

Richard Handover, who served as a director since 1995, retired on 31 January 2005.

John Warren, who served as a director since 2000, resigned on 3 March 2005.

Alan Stewart, Group Finance Director, was appointed on 3 March 2005.

Mike Ellis, who is a non-executive director, was appointed on 30 March 2005.

Luke Mayhew, who is a non-executive director, was appointed on 25 July 2005.

The Company's Articles of Association require that directors offer themselves for re-election every three years and that new directors appointed by the Board offer themselves for election at the next Annual General Meeting following their appointment.

Mike Ellis was appointed to the Board as a non-executive director in March 2005 and pursuant to the Company's Articles of Association retires and, being eligible, offers himself for election at the Annual General Meeting. Mike Ellis has been appointed for a fixed term and does not have a contract of service.

Luke Mayhew was appointed to the Board as a non-executive director in July 2005 and pursuant to the Company's Articles of Association retires and, being eligible, offers himself for election at the Annual General Meeting. Luke Mayhew has been appointed for a fixed term and does not have a contract of service.

Alan Stewart was appointed to the Board in March 2005 and pursuant to the Company's Articles of Association retires and, being eligible, offers himself for election at the Annual General Meeting. Alan Stewart has a contract of service which may be terminated by giving one year's notice.

Details of the interests of the directors and their families in the share capital of the Company at 31 August 2005 are shown on page 36.

Annual General Meeting

The Annual General Meeting will be held at the CBI Conference Centre, Centre Point, 103 New Oxford Street, London WC1A 1DU on 2 February 2006 at 11.30am.

The Notice of Annual General Meeting is set out on pages 78 to 84 inclusive and contains 10 items of special business. Explanatory notes relating to the special business are set out on pages 81 to 84 inclusive.

Auditors

A resolution to reappoint Deloitte & Touche LLP as auditors to the Company and to authorise the directors to determine their remuneration will be proposed at the Annual General Meeting.

This Report was approved by the Board on 13 October 2005.

By Order of the Board
Ian Houghton
Company Secretary
13 October 2005

Corporate Governance

The Board is committed to high standards of corporate governance and, except as described at the end of this report, has applied the principles and complied with the provisions set out in Section 1 of the July 2003 FRC Combined Code on Corporate Governance (the 'Code') throughout the financial year.

The Board

On 13 October 2005, the Board comprised the Chairman, two executive directors and four independent non-executive directors. Short biographies of each of the directors, which illustrate their range of experience, are set out on page 10. There is a clear division of responsibility at the head of the Company; Robert Walker (Chairman) being responsible for running the Board and Kate Swann (Group Chief Executive) being responsible for implementing Group strategy. John Barton has been nominated by the Board as the Senior Independent Director. The Board structure ensures that no individual or group dominates the decision-making process.

On 1 February 2005, Robert Walker, who was appointed as a non-executive director on 1 January 2005, replaced Richard Handover as Chairman. Robert Walker is also Chairman of Williams Lea Group Limited and a non-executive director of Wolseley plc and Signet Group plc and, on appointment as Chairman, met the independence criteria set out in the Code. There were a number of other changes to the composition of the Board during the year and these are set out in the Directors' Report on page 25. All of the non-executive directors who served during the year meet the independence criteria set out in the Code.

The Board normally meets 10 times a year and manages the Company through a formal schedule of matters reserved for its decision. These include overall management of the Group; approval of strategic plans including acquisitions and disposals; approval of the Group's commercial strategy and operating and capital expenditure budgets; approval of the financial statements, material agreements and non-recurring projects; treasury policy; control, audit and risk management; remuneration; and, corporate responsibility. It also delegates specific responsibilities to the Board Committees detailed below, the role and responsibilities of each Committee being set out in formal terms of reference which are available on the Company's website and from the Company Secretary on request.

All directors have access to the advice and services of the Company Secretary and may take independent professional advice at the Company's expense in the furtherance of their duties. The Board receives appropriate and timely information, Board and Committee papers being sent out several days before meetings take place.

All newly appointed directors receive induction training on joining the Board which is tailored to meet the needs of the individual. In August 2005 the Board carried out a formal evaluation of its performance. Each director completed an extensive questionnaire covering Board procedures and effectiveness and their own contribution to discussions and decision making. The non-executive directors met separately to review the Chairman's performance and provided feedback to him and the Chairman reviewed the contribution of each of the directors in separate individual sessions. The results of the evaluation were considered by the Board in September 2005 and a number of actions agreed.

Under the Company's Articles of Association, all directors seek election at their first Annual General Meeting ('AGM') following appointment by the Board and, thereafter, are required to offer themselves for re-election every three years. The executive directors have contracts of service with one year's notice whilst non-executive directors are appointed for an initial term of three years, subject to election by shareholders at the first AGM after their appointment. The contracts of service of the executive directors and letters of appointment of the non-executive directors are available for inspection at the registered office of the Company during normal business hours on any weekday, except Saturdays and public holidays, and at the place of the AGM on 2 February 2006 for 15 minutes prior to and during the meeting.

Board Committees

Audit Committee

The Audit Committee, which meets at least three times a year, comprises Mike Ellis (appointed Chairman 30 March 2005), Luke Mayhew (appointed 25 July 2005) and John Barton, all of whom are independent non-executive directors. Walker Boyd (Chairman to 27 January 2005) and Andrew Rolfe were members of the Committee until their resignations on 27 January 2005 and MT Rainey was a member of the Committee from 27 January until 25 July 2005.

The Committee's terms of reference, which are available on the Company's website and from the Company Secretary on request, set out the responsibilities of the Committee, which include monitoring the integrity and clarity of the financial statements and any formal announcements relating to the Company's financial performance and reviewing any significant financial reporting issues and judgements which they contain; reviewing the consistency of, and any changes to, accounting policies, the application of appropriate accounting standards and the methods used to account for significant or unusual transactions; reviewing the effectiveness of the Company's internal controls and risk management systems; reviewing the effectiveness of the Company's internal audit function and approving the internal audit plan; making recommendations as to the appointment, terms of engagement and remuneration of the external auditors; assessing the external auditors' independence and objectivity; approving the annual external audit plan and reviewing with the external auditors the nature, scope and results of their audit and any issues raised by them; developing and implementing the Company's policy on the engagement of the external auditors to supply non-audit services; and, reviewing the Company's arrangements for its employees to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters ('whistleblowing').

In addition to discharging the responsibilities described above, during the year the Committee considered the impact and implementation of International Financial Reporting Standards.

Nominations Committee

The Nominations Committee, which meets as required, comprises Robert Walker (appointed Chairman 1 February 2005), John Barton (Chairman to 31 January 2005) and MT Rainey. Andrew Rolfe was a member of the Committee until his resignation on 27 January 2005.

The Committee's terms of reference, which are available on the Company's website and from the Company Secretary on request, set out the responsibilities of the Committee, which include reviewing regularly the structure, size and composition of the Board and making recommendations with regard to any changes; giving full consideration to succession planning; evaluating the balance of skills, knowledge and experience of the Board; preparing a description of the role and capabilities required for any particular Board appointment; and, identifying and nominating for approval by the Board candidates to fill Board vacancies as they arise.

The appointments of Robert Walker (1 January 2005), Alan Stewart (3 March 2005), Mike Ellis (30 March 2005) and Luke Mayhew (25 July 2005) were made following searches conducted by external consultants and recommendations made by the Committee. The Board, prior to appointing Robert Walker as Chairman, reviewed his other commitments and these are disclosed on page 10.

Remuneration Committee

Details of the composition and terms of reference of the Remuneration Committee are contained in the Remuneration Report on pages 30 to 36 inclusive.

Attendance at Board/Committee meetings

The following table shows the number of Board and Committee meetings held during the year ended 31 August 2005 and the attendance record of individual directors.

	Board meetings	Committee meetings		
		Audit	Nominations	Remuneration
No. of meetings	**11**	**3**	**4**	**6**
Richard Handover (retired 31.01.05)	6			
Robert Walker (appointed 01.01.05)	7		2	
Tim Hely Hutchinson (resigned 25.09.04)	1			
Kate Swann	11			
Alan Stewart (appointed 03.03.05)	4			
John Warren (resigned 03.03.05)	7			
John Barton	11	3	4	6
Walker Boyd (resigned 27.01.05)	4	1		2
Mike Ellis (appointed 30.03.05)	4	2		
Luke Mayhew (appointed 25.07.05)	1	–		–
MT Rainey	11	2	4	6
Andrew Rolfe (resigned 27.01.05)	1	–	–	

Directors' remuneration
Full details of the Company's remuneration policy and individual directors' remuneration are contained in the Remuneration Report on pages 30 and 36 inclusive.

Risk and internal control
The Board has overall responsibility for the Company's system of internal control and for reviewing its effectiveness, whilst the role of management is to implement the Board's policies on risk and control and present assurance on compliance with these policies. Such a system is, however, designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

i) Risk
Following publication of the Turnbull Guidance ('Internal Control – Guidance for Directors on the Combined Code') in September 1999, the Board enhanced its risk management procedures including establishing a Business Risk Steering Committee to co-ordinate risk assessment throughout the Group and a Group internal audit function. It can confirm that for the year under review and up to the date of approval of the annual report and accounts there has been an ongoing process for identifying, evaluating and managing the significant risks faced by the Group, that is regularly reviewed by the Board and accords with the Turnbull Guidance.

The key features of the risk management process are as follows:
— each business conducts an annual risk assessment based on identified business objectives which are reviewed and agreed by its management board. Risks are categorised into strategic, operational, financial and compliance, and are evaluated in respect of their potential impact and likelihood. These risk assessments are updated and reviewed quarterly by the risk committees within each business and are reported to the Business Risk Steering Committee and the Executive and Audit Committees;
— a Group-wide risk assessment is also undertaken by the Group internal audit function, which considers all areas of potential risk across all systems, functions and key business processes. This risk assessment together with the business risk assessments form the basis for determining the internal audit plan. Audit reports in relation to areas reviewed are discussed and agreed with the respective business risk committee and Audit Committee; and
— the Group internal audit team meets annually with senior executives in order to complete a formal certification of the effectiveness of internal controls. These reports are submitted to the respective business risk committee. Certificates are also provided by each business risk committee to the Audit Committee, to assist the Board in conducting its annual review of internal controls in compliance with the Turnbull Guidance.

ii) Internal control
a) Financial controls
The Company has an established framework of internal financial control, the effectiveness of which is regularly reviewed by the executive management and the Board. The key elements of this are as follows:
— the Board is responsible for overall Company strategy, for approving revenue and capital budgets and plans, for approving major acquisitions and disposals and for determining the financial structure of the Company including treasury and dividend policy. Monthly results, variances from plan and forecasts are reported to the Board;
— the Audit Committee assists the Board in the discharge of its duties regarding the Company's financial statements, accounting policies and the maintenance of proper internal financial controls. The Committee provides a direct link between the Board and the external auditors through regular meetings;
— the internal audit function advises and assists business management to establish and maintain adequate financial controls and reports to the Board and Audit Committee on the effectiveness of those controls;
— routine financial reviews are held between the Finance Director and business finance directors and other executives (and their staff). These are held regularly for all businesses;
— the Board has established an organisation structure with clearly defined lines of responsibility and approval controls identifying transactions requiring approval by the Board or by the Approvals Committee. The Finance Director is responsible for the functional leadership and development of the Company's finance activities;
— there is a comprehensive system for budgeting and planning and for monitoring and reporting the performance of the Company's businesses to the directors. Monthly results are reported against budget and prior year, and forecasts for the current financial year are regularly revised in the light of actual performance. These cover profits, cash flows, capital expenditure and balance sheets;
— the Company has established a uniform system of investment appraisal;
— executive management has defined the financial controls and procedures with which each business is required to comply. Key controls over major business risks include reviews against performance indicators and exception reporting and each business is required to prepare monthly management accounts; and
— routine reports are prepared to cover treasury activities and risks, for review by senior executives, and annual reports are prepared for the Board covering treasury policies, insurance and pensions.

b) Non-financial controls
The Company has established a wide range of non-financial controls covering areas such as health and safety, environment, ethical trading, employment and business continuity. The key elements are as follows:
— a revised corporate responsibility strategy was approved by the Board, including objectives and targets to address the impacts our activities have on the community, marketplace, workplace and environment;
— clear accountability for corporate responsibility issues has been defined at Board and operational level;
— within WHSmith Retail, the business audit committee has responsibility for reviewing performance in delivering corporate responsibility objectives. WHSmith News has appointed a Corporate Responsibility Committee to conduct similar reviews;
— annual reports are submitted to the Board covering each area of corporate responsibility;
— the Board is committed to maintaining high standards of health and safety in all its business activities. These standards are set out in the Company's Health and Safety Policy which is regularly reviewed by the Board. The Group Risk Management team works with the businesses to assess health and safety risks and introduce systems to mitigate them. All notified accidents are investigated and targets are set to reduce the level of incidence;
— the Board has approved an Environmental Policy which sets out the Company's objectives and specific targets which are reviewed annually;
— the Board is committed to ensuring reasonable standards among its suppliers and has approved an Ethical Trading Code of Conduct setting out the standards it expects its suppliers to adopt. This policy covers health and safety, child labour, working hours, discrimination and the environment;
— the Company is committed to ensuring that its personnel meet good standards of integrity and competence. The Company's systems cover the recruitment, training and development of personnel, an appropriate division of responsibilities and the communication of Company policies and procedures throughout the organisation; and
— Business Recovery Plans exist to enable businesses to continue in the event of a disaster with minimum disruption to customers.

Auditor independence
The Board is satisfied that Deloitte & Touche LLP has adequate policies and safeguards in place to ensure that auditor objectivity and independence is maintained. The Board has also adopted a formal policy on the Company's relationship with its auditor in respect of non-audit work.

Going concern
The directors consider that the Company has adequate resources to continue in operation for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the accounts.

Relations with shareholders
The Company recognises the importance of communicating with its shareholders to ensure that its strategy and performance is understood. This is achieved principally through the annual report and accounts and the AGM. In addition, a range of corporate information, including all Company announcements and presentations, is available to investors on the Company's website www.whsmithplc.com.

Formal presentations are made to institutional shareholders following the announcement of the Company's full year and interim results. The Board recognises that the AGM is the principal forum for dialogue with private shareholders. All directors normally attend the AGM and are available to answer any questions that shareholders may wish to raise. The Notice of Meeting is contained in the annual report which is sent to shareholders at least 20 working days before the meeting. Those shareholders who have elected to receive electronic communications receive notice of the availability of the annual report on the Company's website.

Shareholders vote on each resolution on a show of hands, unless a poll is validly called, and after each such vote the number of proxy votes received for, against, and withheld is announced. The proxy figures are made available in writing at the end of the meeting, announced to the London Stock Exchange and published on the Company's website.

The Board as a whole is kept fully informed of the views and concerns of major shareholders. The Group Chief Executive and Finance Director update the Board following meetings with major shareholders and analysts' briefings are circulated to the Board. When requested to do so, the Chairman and non-executive directors attend meetings with major shareholders.

Compliance with the Combined Code
Throughout the year ended 31 August 2005 the Company has complied with the Code provisions set out in Section 1 of the July 2003 FRC Combined Code on Corporate Governance, except as follows:

Chairman (A.2.2)
Richard Handover, who retired as Chairman on 31 January 2005, did not meet the independence criteria set out in the Code as he was formerly Chief Executive of the Group.

Remuneration Committee (B.2.1)
During the period 27 January to 24 July 2005 the Remuneration Committee comprised only two independent non-executive directors.

Audit Committee (C.3.1)
During the period 27 January to 29 March 2005 the Audit Committee comprised only two independent non-executive directors.

This report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002. Part A of the report, which is not subject to audit, sets out the Company's remuneration policy. Part B, which has been audited, provides details of the remuneration, pensions and share incentives of the directors for the year ended 31 August 2005.

Part A – Unaudited

Remuneration Committee

The Remuneration Committee, which met six times during the year, comprises three independent non-executive directors, John Barton (Chairman), Luke Mayhew (appointed 25 July 2005) and MT Rainey. Walker Boyd was a member of the Committee until his resignation on 27 January 2005.

The Committee's terms of reference, which are available on the Company's website and from the Company Secretary on request, set out the responsibilities of the Committee which include determining and agreeing with the Board the broad policy for the remuneration of the Chairman, executive directors and certain other senior executives; in determining such policy to take into account all factors which it deems necessary, the objective of such policy being to ensure that executive management are provided with appropriate incentives to encourage enhanced performance and are, in a fair and responsible manner, rewarded for their individual contributions to the success of the Company; approving the design of, and targets for, any performance-related pay schemes operated by the Company and approving the total annual payments made under such schemes; reviewing the design of all share incentive plans for approval by the Board and shareholders; ensuring that contractual terms on termination, and any payments made, are fair to the individual, and the Company, that failure is not rewarded and that the duty to mitigate loss is fully recognised; and in consultation with the Chairman and/or Chief Executive as appropriate, determining the total individual remuneration package of each executive director and other senior executives including bonuses and share incentives.

Following a formal review, on 20 May 2005 the Committee appointed Mercer Human Resource Consulting ('Mercer') as its external independent adviser. Prior to that date the Committee received external advice and services from PricewaterhouseCoopers. During the year the Committee also received advice from Linklaters and Pinsent Masons in respect of share schemes. Mercer also provided the Company with actuarial advice in respect of the Company's pension schemes and PricewaterhouseCoopers also provided the Company with advice on payroll matters including employment taxes. Linklaters and Pinsent Masons also provided the Company with other legal services. Tanith Dodge, Group Human Resources Director, Julia Davenport, Group Head of Reward, and Ian Houghton, Company Secretary, also materially assisted the Committee in carrying out its duties, except in relation to their own remuneration.

Remuneration policy

The Company's remuneration policy aims to encourage a performance-based culture, attract and retain high-calibre executive directors and align executive directors' and shareholders' interests. In forming this policy the Committee has adopted the principles set out in Section B of the July 2003 FRC Combined Code on Corporate Governance.

The aims of the policy are achieved by providing a remuneration package, comprising salary and benefits, positioned at slightly below the median of a comparator group of 20 peer companies in retail and related sectors, pension provision and performance-related benefits. Any payments made to executive directors other than salary are not pensionable. The performance-related benefits, which consist of an annual performance bonus and long term incentives, account for a significant proportion of total remuneration.

Expected relative value of annual remuneration package for executive directors

Fixed	Performance-related	
Salary	Annual bonus	Long term incentives
28%	35%	37%

a) 125 per cent of salary is payable for maximum performance under the Annual Bonus Plan.
b) The value placed on long term incentives assumes maximum performance and comprises the expected present value of shares awarded under the WH Smith 2004 L-TIP assuming shareholders approve the proposal as outlined below.
c) The above table does not include the value of other benefits and employer pension contributions.

During the year under review executive directors were granted awards under the WH Smith 2004 Management Investment Plan ('MIP') (details of the awards granted are shown on page 35), however, they did not participate in the WH Smith Executive Share Option Scheme 1999 ('ESOS') or the WH Smith 2004 L-TIP ('L-TIP').

The Committee undertook a review of senior executive long term incentive arrangements during 2005 and concluded that its existing policy is no longer appropriate. In reaching this conclusion, it took into consideration the need to provide senior executives with long term incentive opportunities that are strongly linked to ongoing business strategy and competitive with the marketplace. In addition, it recognised the need to retain key executives following expiration of the MIP.

To meet these goals in the current year, the Committee intends to make awards to executive directors and other key senior executives only under the L-TIP. After the current year it retains the discretion to make awards under both the L-TIP and ESOS provided that, except in exceptional circumstances, it will not make awards under either or both plans that exceed an expected value of 200 per cent of base salary in any year. In order to provide an appropriate long term incentive which will meet the objectives described above, the Committee believes that it is necessary to amend the limit on the market value of the shares which may be granted to any individual in any year under the rules of the L-TIP and an ordinary resolution seeking shareholders' authority to do this will be proposed at the Annual General Meeting. Further details are set out in the Notice of Annual General Meeting on pages 78 to 84 inclusive.

The fees paid to non-executive directors are determined by the Chairman and the executive members of the Board and take into account the required time commitment and the fee payments for non-executive directors of similar organisations. Non-executive directors do not participate in any bonus or share schemes. Following a review of non-executive directors' fees, with effect from 1 July 2005, the base fee was increased from £31,500 to £38,000 per annum and the additional fee paid to the Senior Independent Director and the chairmen of the Audit and Remuneration Committees reduced from £5,000 to £4,000 per annum.

Salary and benefits

The salaries of executive directors are reviewed annually in September. When conducting this review, the Committee takes into account a range of factors including the Company's performance, market conditions, the prevailing market rates for similar positions in a comparable group of companies, the responsibilities, individual performance and experience of each executive director and the level of salary increases awarded to employees throughout the Group. Following the review in September 2005 the executive directors received basic pay increases of 2 per cent. Executive directors also receive taxable benefits including the provision of a company car and private medical insurance.

Annual Bonus Plan

For the year under review, each executive director had the opportunity to receive an annual bonus up to a maximum of 125 per cent of base salary. The plan is designed so that the level of bonus paid is dependent on the achievement of a Group profit before tax and after interest target and personal performance. No bonus is paid unless the minimum Group profit target is achieved.

The plan will be operated on the same basis in the current financial year.

Long term incentives

WH Smith Deferred Bonus Plan

The Deferred Bonus Plan, under which executive directors received 30 per cent of their annual bonus in ordinary shares of the Company and could invest a further 25 per cent of their annual bonus in ordinary shares of the Company which would be matched on 1:2 basis after three years or on a 1:1 basis after five years, subject to continued employment, was not operated during the year ended 31 August 2005. It is not intended to operate the plan in the current financial year.

WH Smith 2004 Management Investment Plan

Under this plan, approved by shareholders in September 2004, executive directors and key senior executives have invested their own money to buy ordinary shares in the Company and have been granted matching awards (in the form of nil cost options) to acquire further ordinary shares in proportion to the amount they have invested. Executive directors have invested 100 per cent of base salary and other executives up to 75 per cent of base salary. The extent to which matching awards vest will depend on the satisfaction of Earnings per Share ('EPS') and Total Shareholder Return ('TSR') performance targets, as follows:

a) 50 per cent of the award is dependent on the satisfaction of an EPS performance target. EPS will be measured over the three years ending 31 August 2007 and will measure growth in fully diluted EPS before goodwill amortisation, exceptional items and FRS 17 pension interest. The threshold performance target is EPS growth at a compound rate equal to the growth of RPI plus 20 per cent per annum and the maximum performance target is EPS growth at a compound rate equal to or exceeding the growth of RPI plus 30 per cent per annum; and
b) 50 per cent is dependent on the satisfaction of a TSR performance target. The TSR target will compare the TSR on an investment in the Company's ordinary shares with the TSR on a notional investment in the FTSE All Share General Retailers Index (the 'Index') over the period between the date of grant of the award and the announcement of the Company's results for the year ending 31 August 2007. The threshold performance target requires that the Company delivers value per ordinary share equivalent to that achieved from a notional investment of 354p in the Index and maximum performance requires that the Company deliver value per ordinary share equivalent to that achieved from a notional investment in the Index of 449p. In addition, the Remuneration Committee must also be satisfied that there has been an improvement in the Company's underlying financial performance.

These two performance conditions will be tested separately.

For threshold performance, awards will vest in respect of shares having a value equivalent (by reference to the share price at grant) to two times the invested amount for executive directors and one and a half times the invested amount for other executives, and for maximum performance awards will vest in respect of shares having a value equivalent to five times the invested amount for executive directors and three times the invested amount for other executives. Between threshold performance and maximum performance awards vest on a straight-line basis.

If the Company's share price at the end of the Performance Period is less than 354p, irrespective of the satisfaction of the EPS and TSR performance targets described above, all awards granted under the plan will lapse.

The plan will only be operated for the duration of the Performance Period and is closed to new participants.

WH Smith 2004 L-TIP
Under this plan, approved by shareholders in January 2004, executive directors and key senior executives may be awarded each year conditional entitlements to ordinary shares in the Company (in the form of nil cost options) or, in order to retain flexibility and at the Company's discretion, a cash sum linked to the value of a notional award of shares up to a value of 100 per cent of base salary. For awards granted in the year ended 31 August 2005, the number of shares that vest will be dependent on the Company's performance over a fixed three year period against those other companies which comprise the General Retailers Sector of the FTSE All Share Index increasing on a straight-line basis from 40 per cent for median performance to full vesting if the Company is in the top decile. In addition, the Committee must also be satisfied that there has been a corresponding improvement in the Company's underlying financial performance taking into consideration, amongst other things, absolute level of TSR performance, EPS, free cash flow, dividends and book value. The executive directors did not participate in the L-TIP in the financial year ended 31 August 2005.

As described on page 30, following a review of senior executive long term incentive arrangements, the Committee is seeking shareholders' approval to amend the limit on the market value of shares which may be granted to any individual in any year under the rules of the plan.

Following extensive consultation with shareholders regarding the MIP performance targets, the Committee adopted a combination of financial and market based measures. It believes that such a combination of targets is best suited to the needs of the Company and its shareholders and accordingly the performance conditions for L-TIP awards made in the financial year ending 31 August 2006 will be as follows:

The performance condition applying to half of the award shares will be based on a range of stretching targets relating to real growth in the Adjusted Earnings per Share of the Company over the three years ending 31 August 2008 (the 'Performance Period') (the 'Earnings Tranche'). The performance condition applying to the remaining half of such an award will be based on the Company's TSR performance against those other companies which comprise the General Retailers Sector of the FTSE All Share Index over the Performance Period(the 'TSR Tranche').

Award shares in the Earnings Tranche will vest if the following targets are achieved, as set out in the table below:

Annual rate of growth in Adjusted Earnings per Share (compounded annually) in excess of growth in RPI over the Performance Period	Proportion exercisable
Below 3%	Zero
3%	30%
9% or more	100%
Between the above points	Pro rata between 30% and 100%

For these purposes Adjusted Earnings per Share will be determined by reference to fully diluted earnings per share before goodwill amortisation, exceptional items and FRS 17 pension interest adjusted as considered appropriate by the Committee to ensure that a consistent approach is taken to such measurement of earnings per share, particularly in the transition period to international accounting standards.

The one half of an award based on TSR will vest as set out in the table below:

TSR performance ranking at end of Performance Period	Proportion exercisable
Below median	Zero
Median	30%
Upper quartile	100%
Between the above points	Pro rata between 30% and 100%

Share option schemes
The Company operates two types of share option scheme:

a) an Executive Share Option Scheme, approved by shareholders in January 1999 and amended in January 2004, which is used to grant options to executives up to an annual limit of 200 per cent of base salary. The Company has operated this type of scheme since 1981. Since 1995, the exercise of options has been conditional upon the achievement of a performance target which is determined by the Board at the time of grant. The performance target for options granted prior to 29 January 2004 is adjusted EPS growth over a rolling three year period of at least RPI plus 9 per cent. For options granted after 29 January 2004, the performance target is measured over a fixed three year period and the proportion that becomes exercisable increases on a straight-line basis from 40 per cent for adjusted EPS growth of RPI plus 9 per cent to 100 per cent for adjusted EPS growth of RPI plus 15 per cent (the adjusted EPS values for the last five financial years are shown in the Five Year Financial Summary Profit and Loss Account on page 73). The Committee believes that EPS growth is the most appropriate measure of the Company's underlying financial performance and, during the transition to International Financial Reporting Standards, will ensure that it is measured on a consistent basis. The executive directors did not participate in this Scheme in the financial year ended 31 August 2005; and

b) an Inland Revenue Approved Save-As-You-Earn share option scheme (the 'Sharesave Scheme') approved by shareholders in January 1999. The Sharesave Scheme is open to all UK employees who have completed one year's service and who enter an approved savings contract for a term of three or five years. The maximum amount which can be saved is £250 per month, the total savings at the end of the term being used to purchase shares at 80 per cent of their market value at the start of the savings contract. The Company has operated this type of scheme since 1981 and executive directors may participate in it on the same terms as all other employees.

Details of the awards and options granted to executive directors are set out on pages 35 and 36.

Personal shareholdings
Executive directors are encouraged to build up and hold a significant shareholding in the Company.

Contracts of service
The contract dates and notice periods for each executive director are as follows:

	Date of contract	Notice period
Richard Handover	4 November 2003	see note below[a]
Tim Hely Hutchinson	3 June 1993	1 year[b]
Alan Stewart	3 March 2005	1 year
Kate Swann	2 July 2003	1 year
John Warren	24 July 2000	1 year[c]

a) Richard Handover's appointment as Chairman was for a fixed term until 31 January 2005.
b) Tim Hely Hutchinson resigned as an executive director on 25 September 2004.
c) John Warren resigned as an executive director on 3 March 2005.

In the event of a change of control of the Company, there is a provision in each executive director's contract which provides for a payment of liquidated damages of 95 per cent of salary and benefits if the contract is terminated in breach of the notice period. In other circumstances, the Committee believes that any question of compensation should be decided upon at the appropriate time rather than in advance so that the principle of mitigation is applied in the particular circumstances.

The Chairman, who has a letter of appointment, is appointed for an initial term of three years, which may be terminated at any time by the Company and upon at least six months' notice by the Chairman. The maximum amount that he can receive by way of compensation for loss of office is limited to three months' fees.

The non-executive directors, who have letters of appointment, are appointed for an initial term of three years, subject to review thereafter.

Performance graph

Cumulative TSR growth since 31 August 2000

a) The graph illustrates the Company's TSR performance on a cumulative basis (with dividends reinvested) as at the end of each of the last five financial years compared with the FTSE General Retailers Sector Index over the same period.
b) The Company is a member of the FTSE General Retailers Sector and, as such, this sector is considered to be the most appropriate comparator group upon which a broad equity market index is calculated.

W H Smith Employees' Share Trust 1999
The W H Smith Employees' Share Trust is used to facilitate the acquisition of ordinary shares in the Company for the purpose of satisfying awards and options granted under the Company's share schemes. The Trust is a discretionary trust, the sole beneficiaries being employees (including executive directors) and former employees of the Company. The Trustee is Mourant & Co. Trustees Limited, an independent professional trustee company based in Jersey.

Following the capital reorganisation in September 2004 and further purchases of 4,190,669 shares in December 2004, the number of shares held in Trust at 31 August 2005 was 8,999,860. The accounting treatment is described in Note 23 to the Accounts.

Pensions
The Company operates two types of pension scheme: a defined benefit pension scheme, WHSmith Pension Trust and a defined contribution pension scheme, WHSmith Pensionbuilder.

Richard Handover, who was employed before 1 April 1996 and retired as Chairman on 31 January 2005, was a member of the WHSmith Pension Trust until 30 April 2004. This Scheme provides a pension of two-thirds base salary upon retirement at the age of 60, provided that the minimum service requirement of 20 years has been met.

Executive directors employed after 1 April 1996 normally participate in WHSmith Pensionbuilder. Under this Scheme an executive director may contribute up to an amount equivalent to 5 per cent of salary which is then matched by the Company. In addition, a pension supplement is also payable which may be taken as an additional pension contribution or as an addition to basic pay. For Kate Swann, the Company's total contribution under this scheme is equivalent to 35 per cent of salary and for Alan Stewart 30 per cent of salary. John Warren received a Company contribution equivalent to 30 per cent of base salary until his resignation on 3 March 2005.

Tim Hely Hutchinson, who resigned on 25 September 2004, participated in a Self-Administered Pension Scheme, Headline Book Publishing Retirement Fund. Under this Scheme he contributed 15 per cent of salary and Hodder Headline contributed 30 per cent of salary.

External appointments

The Company believes there are significant benefits to the individual and the Company from executive directors accepting non-executive directorships in other organisations. Each executive director may accept up to two non-executive directorships provided they are not both appointments to companies in the FTSE 100 or are chairmanships of a FTSE 100 company. Non-executive directorships must not conflict with the interests of the Company.

The executive directors may retain fees from one of their external directorships. The fees received and retained by the current executive directors in respect of their non-executive directorships are shown in the table below:

	Directorship	Received £'000s	Retained £'000s
Alan Stewart	Games Workshop Group PLC	30	30
Kate Swann	Lambert Howarth Group plc	35	35

Part B – Audited
Directors' remuneration

The remuneration of the directors for the year to 31 August 2005 was as follows:

	Year to 31 August 2005						Year to 31 August 2004
				Compensation for loss of office			
	Salary / fees £'000s	Annual performance bonus £'000s	Benefits, pension supplement and other payments £'000s	Amounts paid to 31 August 2005 £'000s	Maximum further amount payable £'000s	Total £'000s	£'000s
Chairman							
Robert Walker	119	–	–	–	–	119	–
Executive directors							
Alan Stewart	148	168	43	–	–	359	–
Kate Swann	485	606	189	–	–	1,280	1,289
Non-executive directors							
John Barton	45	–	–	–	–	45	40
Mike Ellis	18	–	–	–	–	18	–
Luke Mayhew	4	–	–	–	–	4	–
MT Rainey	33	–	–	–	–	33	32
Directors retiring from the Board during the year							
Walker Boyd	15	–	–	–	–	15	18
Richard Handover	194	–	8	–	–	202	484
Tim Hely Hutchinson	20	–	1	–	–	21	512
Andrew Rolfe	13	–	–	–	–	13	32
John Warren	167	217	93	170	292	939	399
Former directors	–	–	–	–	–	–	931
Total £'000s	1,261	991	334	170	292	3,048	3,737

a) Benefits and other payments relate mainly to the provision of a company car, private medical insurance and any salary supplement paid in respect of pension entitlement.
b) Robert Walker was appointed as a non-executive director on 1 January 2005 and became Chairman on 1 February 2005.
c) Alan Stewart was appointed as an executive director on 3 March 2005.
d) In addition to the base fee paid to non-executive directors, John Barton received an additional £12,600: £4,800 for being Chairman of the Remuneration Committee, £3,000 for being Chairman of the Nominations Committee and £4,800 for being the Senior Independent Director. Walker Boyd received an additional £2,100 for being Chairman of the Audit Committee until 27 January 2005.
e) Mike Ellis was appointed as a non-executive director on 30 March 2005. He received a fee of £10,000 (£40,000 per annum), inclusive of the additional fee payable for being Chairman of the Audit Committee, in respect of the period 30 March 2005 to 30 June 2005. From 1 July 2005 he was paid on the same basis as the other non-executive directors, namely, a base fee at a rate of £38,000 per annum plus an additional fee at a rate of £4,000 per annum for being Chairman of the Audit Committee.
f) Luke Mayhew was appointed as a non-executive director on 25 July 2005.
g) Walker Boyd resigned as a non-executive director on 27 January 2005.
h) Richard Handover retired as Chairman on 31 January 2005.
i) Tim Hely Hutchinson resigned as an executive director on 25 September 2004 on the sale of Hodder Headline.
j) Andrew Rolfe resigned as a non-executive director on 27 January 2005.
k) John Warren resigned as an executive director on 3 March 2005 and left the Company by mutual agreement on 31 March 2005. During this period he received a payment of £34,000 in respect of his salary and salary supplement which is included in the table under Benefits, pension supplement and other payments. He had a contract of service with a one year notice period and under the terms of the Compromise Agreement has received the sum of £170,000 in monthly payments in respect of the period to 31 August 2005. The maximum amount that he may receive in respect of the remainder of his notice period is £292,000.

Directors' pensions
a) Defined benefit pension scheme

Richard Handover, who retired as Chairman on 31 January 2005, was a member of the Company's defined benefit pension scheme until he opted out and transferred his accrued benefits to another approved scheme on 30 April 2004.

b) Defined contribution scheme

The following executive directors were members of a defined contribution scheme during the year ended 31 August 2005:

	Employee contribution		Employer contribution	
	% of salary	£'000s	% of salary	£'000s
Tim Hely Hutchinson	15.0	4	30.0	7
Kate Swann	2.9	14	5.0	24
Alan Stewart	4.9	7	4.9	7
John Warren	–	–	–	–

a) Kate Swann and Alan Stewart participate in WHSmith Pensionbuilder. John Warren participated in WHSmith Pensionbuilder until leaving the Company on 31 March 2005, however, neither he nor the Company made any contributions during the year. Tim Hely Hutchinson, who resigned on 25 September 2004, participated in the Headline Book Publishing Retirement Fund.
b) Executive directors receive a pension supplement which may be taken as an additional pension contribution or as an addition to basic pay; this payment, if taken as an addition to basic pay, is included in the table of Directors' remuneration under the heading Benefits, pension supplement and other payments.
c) The dependants of Kate Swann and Alan Stewart are eligible for payment of a lump sum in the event of death-in-service equivalent to four times salary together with a dependant's pension.

Long term incentives
Deferred Bonus Plan

On 20 November 2003, John Warren purchased 1,913 ordinary shares and was granted a matching award, on a 1:2 basis, of 956 shares to be released on 15 October 2006, subject to continued employment, under the terms of the Deferred Bonus Plan. Following the capital reorganisation on 27 September 2004 and the reinvestment of the proceeds from the sale of the related 'C' shares, this award was adjusted to 925 shares. John Warren left the Company on 31 March 2005 and, under the terms of his Compromise Agreement, received 462 shares with a market value of £1,663 on 25 April 2005.

Conditional share award

On 4 November 2003, as compensation for the loss of benefits under the share schemes of her previous employer, Kate Swann received an award of 141,315 ordinary shares with a market value of £500,000. Following the capital reorganisation on 27 September 2004 and the reinvestment of the proceeds from the sale of the related 'C' shares, this award is now in respect of 142,415 shares. These shares will be released in two equal tranches, subject to continued employment, following the announcement of the Company's results on 13 October 2005 and in October 2006.

Management Investment Plan

Details of the conditional matching awards (in the form of nil cost options) to acquire ordinary shares of the Company granted to executive directors under the Management Investment Plan are as follows:

	31 August 2005	31 August 2004	Date of grant	Market price on date of grant (pence)	Exercise period (see note c below)
Alan Stewart	412,179	–	26.04.05	359	01.02.08–31.01.10
Kate Swann	717,778	–	03.11.04	343	01.02.08–31.01.10
John Warren	163,704	–	03.11.04	343	01.02.08–31.01.10

a) John Warren's award was reduced from 491,111 shares to 163,704 shares on leaving the Company on 31 March 2005.
b) These awards will only vest to the extent that the performance targets set out on page 31 are satisfied.
c) To the extent that an award vests, 75 per cent will be exercisable immediately following the vesting date (31 January 2008) and 25 per cent will be exercisable one year later. Awards will cease to be exercisable on 1 February 2010.

Share option schemes

The interests of executive directors in options to acquire ordinary shares of the Company are as follows:

	Executive Share Option Schemes		Sharesave Scheme				
	31 August 2005	31 August 2004	31 August 2005	31 August 2004	Exercise price (pence)	Date of grant	Exercise period
Richard Handover	–	254,291	–	–	393.25	31.10.00	Lapsed
	–	95,340	–	–	438.00	01.11.01	Lapsed
	–	–	–	1,597	356.80	05.06.02	Lapsed
	94,578	94,578	–	–	361.50	05.11.02	Lapsed
	94,578	444,209	–	1,597			
Tim Hely Hutchinson	–	127,146	–	–	393.25	31.10.00	Lapsed
	–	60,502	–	–	438.00	01.11.01	Lapsed
	79,806	79,806	–	–	361.50	05.11.02	Lapsed
	79,806	267,454	–	–			
Kate Swann	414,847	414,847	–	–	343.50	20.11.03	20.11.06 – 19.11.13
	–	–	3,491	–	271.40	01.06.05	01.08.08 – 31.01.09
	414,847	414,847	3,491	–			
John Warren	–	217,419	–	–	393.25	31.10.00	Lapsed
	–	69,635	–	–	438.00	01.11.01	Lapsed
	–	–	–	4,638	356.80	05.06.02	Lapsed
	27,662	27,662	–	–	361.50	05.11.02	Lapsed
	27,662	314,716	–	4,638			

a) The middle market price of an ordinary share at the close of business on 31 August 2005 was 369p (31 August 2004: 306p).
b) The high and low middle market prices of an ordinary share during the year were 381.75p and 295.75p respectively.
c) Richard Handover left the Company on 31 January 2005. The executive share options granted to him on 31 October 2000 and 1 November 2001 lapsed on 31 January 2005 as the performance targets had not been satisfied. The executive share option granted to him on 5 November 2002 lapsed on 13 October 2005 as the performance target was not satisfied. The Sharesave option granted to him on 5 June 2002 lapsed on 31 January 2005.
d) Tim Hely Hutchinson left the Company on 25 September 2004. Of the executive share options granted to him on 31 October 2000, the Unapproved part, 119,518 shares, lapsed on 25 September 2004 as the performance target had not been satisfied and the Approved part, 7,628 shares, lapsed on 25 March 2005. The executive share option granted to him on 1 November 2001 lapsed on 14 October 2004 as the performance target was not satisfied. The executive share option granted to him on 5 November 2002 lapsed on 13 October 2005 as the performance target was not satisfied.
e) John Warren left the Company on 31 March 2005. The executive share options granted to him on 31 October 2000 and 1 November 2001 lapsed on 31 March 2005 as the performance targets had not been satisfied. The executive share option granted to him on 5 November 2002 lapsed on 13 October 2005 as the performance target was not satisfied. The Sharesave option granted to him on 5 June 2002 lapsed on 31 March 2005.
f) The executive share options can only be exercised if the performance target described on page 32 is satisfied. The target was not met for the three year period ended 31 August 2005.
g) Alan Stewart has not been granted any options under the Company's share option schemes.
h) No options were exercised by directors during the year ended 31 August 2005. No options have been granted to or exercised by directors between 1 September 2005 and 13 October 2005.

Directors' interests in shares

The beneficial interests of the directors and their immediate families in the ordinary shares of the Company are set out below:

	31 August 2005	31 August 2004 (or date of appointment)
John Barton	16,000	11,000
Mike Ellis	–	–
Luke Mayhew	–	–
MT Rainey	–	–
Alan Stewart	82,194	–
Kate Swann	148,229	–
Robert Walker	–	–

There has been no change in the directors' interests shown above between 1 September 2005 and 13 October 2005.

Interest in shares under W H Smith Employees' Share Trust 1999

The executive directors, being potential beneficiaries of the W H Smith Employees' Share Trust 1999, were each treated as at 31 August 2005 as being interested in 8,999,860 ordinary shares held by the Trustee of that Trust. The shares held in the Trust will be used to satisfy awards and options granted under the Company's share schemes.

By Order of the Board
John Barton, Chairman of the Remuneration Committee
13 October 2005

Directors' Responsibilities Statement

The directors are required by the Companies Act 1985 to prepare financial statements which give a true and fair view of the state of affairs of the Company and the Group at the end of the financial year and of the profit for the year then ended.

In preparing the financial statements appropriate accounting policies have been used and applied consistently and reasonable and prudent judgements and estimates have been made. The financial statements have been prepared in accordance with applicable accounting standards.

The directors are responsible for maintaining adequate accounting records which disclose at any time with reasonable accuracy the financial position of the Company. The directors are also responsible for the system of internal control and for safeguarding the Company's assets by taking reasonable steps to ensure the prevention of fraud and other irregularities.

Independent Auditors' Report to the Members of WH Smith PLC

We have audited the financial statements of WH Smith PLC for the year ended 31 August 2005 which comprise the Group profit and loss account, the balance sheets, the Group cash flow statement, the Group statement of total recognised gains and losses, the Group note of historical profits and losses, the reconciliation of movements in Group shareholders' funds, the statement of accounting policies, the related Group Notes 1 to 29 and the Company balance sheet Notes 1 to 9. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the part of the directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibilities, the Company's directors are responsible for the preparation of the financial statements in accordance with applicable United Kingdom law and accounting standards. They are also responsible for the preparation of the other information contained in the annual report including the directors' remuneration report. Our responsibility is to audit the financial statements and the part of the directors' remuneration report described as having been audited in accordance with relevant United Kingdom legal and regulatory requirements and auditing standards.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the Company and other members of the Group is not disclosed.

We also report to you if, in our opinion, the Company has not complied with any of the four directors' remuneration disclosure requirements specified for our review by the Listing Rules of the Financial Services Authority. These comprise the amount of each element in the remuneration package and information on share options, details of long term incentive schemes, and money purchase and defined benefit schemes. We give a statement, to the extent possible, of any non-compliance.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the July 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read the directors' report and the other information contained in the annual report for the above year as described in the contents section including the unaudited part of the directors' remuneration report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with United Kingdom auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the directors' remuneration report described as having been audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements and of whether the accounting policies are appropriate to the circumstances of the company and the group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the directors' remuneration report described as having been audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the directors' remuneration report described as having been audited.

Opinion

In our opinion:

— the financial statements give a true and fair view of the state of affairs of the Company and the Group as at 31 August 2005 and of the profit of the Group for the year then ended: and

— the financial statements and part of the directors' remuneration report described as having been audited have been properly prepared in accordance with the Companies Act 1985.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London
13 October 2005

Group Profit and Loss Account

for the 12 months to 31 August 2005

		2005			2004		
£m	Note	Before exceptional items and goodwill amortisation	Exceptional items and goodwill amortisation	Total	Before exceptional items and goodwill amortisation	Exceptional items and goodwill amortisation	Total
Turnover							
Continuing operations		**2,497**	**–**	**2,497**	2,520	–	2,520
Discontinued operations		**11**	**–**	**11**	314	–	314
Group turnover	1	**2,508**	**–**	**2,508**	2,834	–	2,834
Operating profit / (loss)							
Continuing operations		**81**	**(1)**	**80**	51	(93)	(42)
Discontinued operations		**–**	**–**	**–**	21	(10)	11
Group operating profit / (loss)	1,2,3	**81**	**(1)**	**80**	72	(103)	(31)
Net loss on sale of discontinued operations	4	**–**	**(8)**	**(8)**	–	(101)	(101)
Profit on sale of fixed assets – continuing operations	5	**–**	**–**	**–**	–	2	2
Profit / (loss) on ordinary activities before net finance charges		**81**	**(9)**	**72**	72	(202)	(130)
Net finance charges	9	**(8)**	**–**	**(8)**	(5)	–	(5)
Profit / (loss) on ordinary activities before taxation		**73**	**(9)**	**64**	67	(202)	(135)
Tax on profit / (loss) on ordinary activities	10	**(18)**	**–**	**(18)**	(23)	10	(13)
Profit / (loss) on ordinary activities after taxation for the financial year		**55**	**(9)**	**46**	44	(192)	(148)
Dividends (equity and non equity)	11	**(166)**	**–**	**(166)**	(24)	–	(24)
Retained (losses) / earnings		**(111)**	**(9)**	**(120)**	20	(192)	(172)
Headline earnings per share[1]							
Basic – continuing operations	12			***31.6p***			*14.3p*
Basic	12			***31.6p***			*19.2p*
Diluted	12			***31.3p***			*19.2p*
Earnings / (loss) per share[2]							
Basic – continuing operations	12			***30.5p***			*(20.5)p*
Basic	12			***26.0p***			*(60.7)p*
Diluted	12			***25.7p***			*(60.7)p*
Equity dividends per share	11			***13.7p***			*12.0p*
Fixed charges cover – times	13			***1.4x***			*1.3x*
Equity dividend cover – times	11			***2.0x***			–
Equity dividend cover before exceptional items and goodwill amortisation – times	11			***2.4x***			*1.5x*

1. Headline earnings per share excludes exceptional items, goodwill amortisation and FRS 17 pension interest.
2. Earnings per share is calculated in accordance with FRS 14 'Earnings per share'.

Group Balance Sheet

as at 31 August 2005

£m	Note	2005	2004
Fixed assets			
Intangible assets – goodwill	15	**14**	164
Tangible fixed assets	16	**231**	237
Total fixed assets		**245**	401
Current assets			
Stocks		**162**	184
Debtors due within one year	17	**111**	187
Debtors due after more than one year	17	**21**	25
Cash at bank and in hand	18	**46**	64
		340	460
Creditors due within one year			
Debt	18	**(48)**	(17)
Other creditors	19	**(346)**	(397)
		(394)	(414)
Net current (liabilities) / assets		**(54)**	46
Total assets less current liabilities		**191**	447
Creditors due after more than one year			
Debt	18	**(46)**	(2)
Other creditors	20	**(1)**	(2)
		(47)	(4)
Provisions for liabilities and charges	21	**(31)**	(38)
Net assets excluding pension liabilities		**113**	405
Net pension liabilities	6	**(71)**	(149)
Total net assets		**42**	256
Capital and reserves			
Called up share capital	22	**4**	139
Share premium account	23	**17**	93
Capital redemption reserve	23	**218**	156
Revaluation reserve	23	**3**	3
Other reserve	23	**(34)**	(27)
Profit and loss account	23	**(319)**	(110)
Equity shareholders' (liabilities) / funds		**(111)**	254
Non equity share capital	22	**153**	2
Total shareholders' funds		**42**	256

Approved by the Board of Directors on 13 October 2005.

Kate Swann
Chief Executive

Alan Stewart
Finance Director

Group Cash Flow Statement

for the 12 months to 31 August 2005

£m	Note	2005	2004
Net cash (outflow) / inflow from operating activities before exceptional operating items	24	**(13)**	61
Net cash outflow from exceptional operating items	24	**(9)**	(13)
Net cash (outflow) / inflow from operating activities	24	**(22)**	48
Returns on investment and servicing of finance			
Interest received		**4**	1
Interest paid		**(5)**	(1)
Net charge on pension schemes		**(2)**	(4)
Net cash outflow from returns on investment and servicing of finance		**(3)**	(4)
Taxation		**(4)**	(10)
Capital expenditure and financial investment			
Purchase of tangible fixed assets – owned		**(32)**	(49)
Proceeds on disposal of tangible fixed assets		**2**	5
Cash outflow from capital expenditure and financial investment		**(30)**	(44)
Acquisitions and disposals			
Proceeds on disposal of subsidiary undertakings		**222**	64
Proceeds on disposal of associated undertakings		**–**	1
Non-operating disposal costs		**(10)**	(23)
Net cash in subsidiaries disposed		**–**	(11)
Cash inflow from acquisitions and disposals		**212**	31
Equity dividends paid		**(21)**	(42)
Cash inflow / (outflow) before financing		**132**	(21)
Financing			
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		**2**	–
Non equity dividend		**(143)**	–
Repurchase of 'C' shares		**(62)**	–
Increase / (decrease) in debt (net of financing costs)		**61**	(3)
Capital element of finance leases		**(1)**	–
Cash outflow from financing		**(150)**	(3)
Decrease in cash		**(18)**	(24)

Reconciliation of net cash flow to movement in net funds

£m	Note	2005	2004
Net funds at the start of the year		**45**	68
Decrease in cash in the year		**(18)**	(24)
(Increase) / decrease in debt		**(62)**	3
New finance leases		**(13)**	–
Currency translation differences		**–**	(2)
Net (debt) / funds at the end of the year	18	**(48)**	45

Group Statement of Total Recognised Gains and Losses

for the 12 months to 31 August 2005

£m	Note	2005	2004
Profit / (loss) for the financial year		46	(148)
Actuarial loss relating to the pension scheme	6	(42)	(15)
UK deferred tax attributable to the pension scheme liabilities		(27)	(3)
UK current tax attributable to the additional pension scheme contributions		39	7
Currency translation differences		–	(7)
Total recognised gains / (losses) for the financial year		**16**	(166)

Group Note of Historical Cost Profits and Losses

for the 12 months to 31 August 2005

£m	2005	2004
Reported profit / (loss) on ordinary activities before taxation	64	(135)
Realisation of property revaluation gains of the previous year	–	1
Historical costs profit / (loss) on ordinary activities before taxation	**64**	(134)
Historical cost loss for the year retained after taxation, minority interests and dividends	(120)	(171)

Reconciliation of Movements in Group Shareholders' Funds

for the 12 months to 31 August 2005

£m	Note	2005	2004
Shareholders' funds at beginning of year		**256**	407
Retained losses		(120)	(172)
Repurchase of non equity share capital		(62)	–
Purchase of own shares for employee share scheme		(12)	–
Money returned to ESOP Trust after share capital reorganisation		5	–
Employee share schemes		5	–
Goodwill previously written off directly to reserves now transferred to profit and loss account for the year on sale of USA Travel Retail business	4	–	39
Net gains and losses relating to pension scheme		(30)	(11)
Currency translation differences		–	(7)
Net reduction to shareholders' funds		**(214)**	(151)
Shareholders' funds at end of year		**42**	256

Accounting Policies

for the 12 months to 31 August 2005

a) Basis of preparation

These accounts are prepared under the historical cost convention as modified by revaluations of certain properties and in accordance with applicable United Kingdom accounting standards. All accounting policies have been applied consistently throughout the current and preceding year. The principal accounting policies adopted are set out below.

b) Basis of consolidation

These accounts consolidate the accounts of the Company, its subsidiary undertakings and its associated undertakings for the 12 months to 31 August each year. The results of businesses acquired or sold are consolidated from the effective date of acquisition or to the date of deemed disposal.

c) Turnover

Turnover represents goods and services sold to customers outside the Group, less returns, discounts and sales tax.

d) Pension costs

The Group's main UK pension fund is a defined benefit scheme. In accordance with FRS 17 'Retirement benefits', the service cost of pension provision relating to the year, together with the cost of any benefits relating to past service if the benefits have vested, is charged to the profit and loss account. A charge equal to the increase in the present value of the scheme liabilities (because the benefits are closer to settlement) and a credit equivalent to the Group's long term expected return on assets (based on the market value of the scheme assets at the start of the year), are included in the profit and loss account under net finance charges.

The difference between the market value of the assets of the scheme and the present value of the accrued pension liabilities is shown as an asset or liability on the balance sheet net of deferred tax. Any differences between the actual and expected return on assets during the year are recognised in the statement of total recognised gains and losses along with differences arising from experience or assumption changes.

Costs in respect of the Company's defined contribution pension schemes are charged to the profit and loss account on an accruals basis as contributions become payable.

WH Smith PLC provides medical benefits to certain pensioners. The present value of estimated future benefit payments is included in the balance sheet net of deferred taxation, within net pension liabilities. Any differences arising from assumption changes in respect of the liability are recognised in the statement of total recognised gains and losses.

e) Leases

Rental costs under operating leases are charged to the profit and loss account on a straight-line basis over the applicable lease periods. Lease incentives are charged on a straight-line basis over the shorter of the period to the first market rent review date and the total lease term. The cost of assets held under finance leases is included under tangible fixed assets and depreciation is provided in accordance with the Company's accounting policy for that class of asset. The capital element of future lease payments is included in net debt, and is disclosed in the financial assets and liabilities note. The interest cost is allocated to accounting periods based on the outstanding capital element of the lease.

f) Goodwill

Goodwill represents the excess of the fair value of purchase consideration over the fair value of identifiable assets and liabilities acquired. Goodwill arising on acquisitions prior to 1 June 1997 was written off to reserves in the year of acquisition. Goodwill arising on acquisitions made from 1 June 1997 is capitalised in the balance sheet as an asset and amortised in the profit and loss account over its useful economic life. On disposal of a business, any goodwill previously written off against reserves is written back and included in the calculation of the profit or loss on disposal.

However, in accordance with FRS 10, where goodwill is regarded as having an indefinite life, it is not amortised but is subject to an annual test for impairment. This represents a departure, for the purposes of giving a true and fair view, from the requirements of the Companies Act 1985, which requires goodwill to be amortised. In respect of the acquisition of the Hodder Headline business, this departure was adopted in accounting for the goodwill generated from the purchase of the business.

g) Fixed assets

As permitted by FRS 15 'Tangible fixed assets' the Group has adopted a policy of not revaluing tangible fixed assets. The carrying values of tangible fixed assets previously revalued have been retained at their book amount in accordance with the transitional provisions of FRS 15.

h) Depreciation

Depreciation of tangible fixed assets is calculated by the straight-line method and the annual rates applicable to the principal categories are:

Freehold and long leasehold properties	— over 20 years, except where, in the opinion of the directors, the residual value of the properties is such that any depreciation charge would be immaterial
Short leasehold properties	— shorter of the lease period and the estimated remaining economic life
In-store fixtures and fittings	— 10 years
Equipment	— 8 to 10 years
Computer equipment	— up to 5 years

i) Stocks
Stocks comprise finished goods and goods for resale and are stated at the lower of cost or net realisable value.

j) Property provision
In accordance with FRS 12 'Provisions, contingent liabilities and contingent assets', the Group's property provisions have been discounted, using the Group's weighted average cost of capital, to the present value of future net lease obligations and related costs of leasehold property (net of estimated sublease income and adjusted for certain risk factors) where the space is vacant or currently not planned to be used for ongoing operations. The periodic unwinding of the discount is treated as an imputed interest charge and is disclosed as 'Unwinding of discount on provisions', and is within the net finance charges in the profit and loss account.

k) Royalty advances
In the prior year, the carrying value of advances included in other debtors on the balance sheet represents the total amount of advances paid to authors less any royalties earned in respect of the money advanced, the author's share of other income (mainly subsidiary rights) and provisions. Provisions represent the amount by which the book value of net advances paid exceeds anticipated future earnings attributable to an author. These amounts related to the Hodder Headline business, which was sold on 25 September 2004.

l) Deferred taxation
In accordance with FRS 19 'Deferred tax', the Group provides deferred tax in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when these differences crystallise, based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred taxation is not provided on timing differences arising from the sale or revaluation of fixed assets unless, at the balance sheet date, a binding commitment to sell the asset has been entered into and it is unlikely that any gain will qualify for rollover relief. Deferred taxation is measured on a non-discounted basis.

m) Foreign currencies
Trading transactions denominated in foreign currencies are translated at the exchange rate at the date of the transaction or, where applicable, at forward contract rates. Assets and liabilities denominated in foreign currencies are translated into sterling at the exchange rates prevailing at the balance sheet date or, where applicable, at forward contracted rates. The resulting exchange gains and losses are taken to the profit and loss account.

The results of international subsidiaries are translated at the average exchange rate during the year. The balance sheets of overseas subsidiaries are translated at exchange rates ruling at the balance sheet date. The resulting exchange differences are taken through reserves and reported through the statement of total recognised gains and losses.

n) Financial instruments
The Group uses certain derivative financial instruments to reduce exposure to foreign exchange and interest rate movements. The Group does not hold or use derivative financial instruments for speculative purposes.

The financial instruments used by the Group to manage its currency risks are forward rate contracts and currency options. Interest payments arising from financial instruments are recognised within net interest payable over the period of the contract. Any premiums or discounts arising are amortised over the lives of the instruments.

Forward currency contracts entered into with respect to trading transactions are accounted for as hedges, with the instruments' impact on profit deferred until the underlying transaction is recognised in the profit and loss account.

o) Debt finance costs
Finance costs associated with the issuance of debt and other capital instruments are charged to the profit and loss account over the term of the instrument at a constant rate on the carrying amount.

p) Share Schemes
W H Smith Employees' Share Trust 1999
The shares held by the W H Smith Employees' Share Trust 1999 are valued at the historic cost of the shares acquired and are deducted in arriving at shareholders' funds and presented as the other reserve in line with UITF 38 'Accounting for ESOP Trusts'. Prior to 1 September 2003 the shares were recognised as an asset within investments on the Group balance sheet.

Share Schemes
The Group's share based incentive schemes are accounted for in accordance with UITF Abstract 17 'Employee Share Schemes'. The fair market value of the shares at the date of grant, less any consideration to be received from the employee, is charged to the profit and loss account over the period to which the employee's performance relates. Where awards are contingent upon future events (other than continuing employment) an assessment of the likelihood of these conditions being achieved is made at the end of each accounting year.

The Group operates an Inland Revenue Approved Save-As-You-Earn share option scheme ('Sharesave Scheme') under which it grants options at a discount to the market price at the date of grant. The Group has made use of the exemption under UITF Abstract 17 not to recognise any compensation charge in respect of these options.

1 Segmental analysis of results
a) Segmental analysis of Group turnover

£m	2005	2004
Continuing operations:		
Retailing		
High Street Retail	**1,112**	1,152
Travel Retail	**311**	301
Total	**1,423**	1,453
News Distribution		
Total turnover	**1,187**	1,182
Internal turnover	**(113)**	(115)
Total	**1,074**	1,067
Turnover – continuing operations	**2,497**	2,520
Discontinued operations:		
Retailing		
USA Travel Retail	**–**	49
Aspac Retail	**–**	132
Total	**–**	181
Publishing business		
Total turnover	**14**	155
Internal turnover	**(3)**	(22)
Total	**11**	133
Turnover – discontinued operations	**11**	314
Group turnover	**2,508**	2,834

1 Segmental analysis of results continued
b) Segmental analysis of Group operating profit / (loss)

	2005			2004		
£m	**Before goodwill amortisation**	**Exceptional operating items and goodwill amortisation**	**Total**	Before exceptional items and goodwill amortisation	Exceptional operating items and goodwill amortisation	Total
Continuing operations:						
Retailing						
High Street Retail	**43**	**(1)**	**42**	23	(77)	(54)
Travel Retail (note a)	**26**	**–**	**26**	21	(5)	16
Total	**69**	**(1)**	**68**	44	(82)	(38)
News Distribution	**37**	**–**	**37**	35	–	35
Trading profit	**106**	**(1)**	**105**	79	(82)	(3)
Support functions	**(16)**	**–**	**(16)**	(15)	(11)	(26)
Pension service costs (note b)	**(10)**	**–**	**(10)**	(14)	–	(14)
Internal rents (note c)	**1**	**–**	**1**	1	–	1
Operating profit / (loss) – continuing operations	**81**	**(1)**	**80**	51	(93)	(42)
Discontinued operations:						
Retailing						
USA Travel Retail	**–**	**–**	**–**	(5)	–	(5)
Aspac Retail	**–**	**–**	**–**	7	(1)	6
Total	**–**	**–**	**–**	2	(1)	1
Publishing business	**–**	**–**	**–**	20	(9)	11
Pension service costs (note b)	**–**	**–**	**–**	(1)	–	(1)
Operating profit / (loss) – discontinued operations	**–**	**–**	**–**	21	(10)	11
Group operating profit / (loss)	**81**	**(1)**	**80**	72	(103)	(31)

a) Travel Retail includes profits of £1m (2004: £1m) generated in Continental Europe.
b) The annual pension service costs in respect of the defined benefit scheme, if allocated between the businesses based on pensionable salaries, would be as follows: High Street Retail £5m (2004: £8m), Travel Retail £1m (2004: £1m), Publishing £nil (2004: £1m), News Distribution £3m (2004: £4m) and Support functions £1m (2004: £1m). In addition to these pension costs, £3m of contributions has been charged to the individual businesses in respect of the defined contribution pension scheme (see Note 6).
c) The results for the Retailing businesses are reported after charging an internal arm's length market rent on freehold and long leasehold properties owned by the Group. The internal net income generated of £1m (2004: £1m) is shown as a separate credit to the profit and loss account.
d) Exceptional operating items and goodwill amortisation includes goodwill amortisation for the following businesses: High Street Retail £1m (2004: £1m) and Aspac Retail £nil (2004: £1m).
e) On 1 September 2004 WHSmith Online was integrated into the WHSmith High Street Retail business, the comparable results for the year ended 31 August 2004 were turnover: £7m, operating loss before exceptional items and goodwill amortisation: £2m, exceptional items and goodwill amortisation: £10m, operating loss after exceptional items and goodwill amortisation: £12m.

Exceptional operating items incurred during the prior year are analysed in Notes 2 and 3.

1 Segmental analysis of results continued
c) Geographical split

	Turnover		Profit / (loss) before taxation		Net assets	
£m	**2005**	2004	**2005**	2004	**2005**	2004
Continuing operations before exceptional items and goodwill amortisation – UK / Europe	**2,497**	2,520	**73**	46	**167**	139
Exceptional items and goodwill amortisation			**(1)**	(91)		
Continuing operations – UK / Europe	**2,497**	2,520	**72**	(45)	**167**	139
Discontinued operations before exceptional items and goodwill amortisation:						
UK / Europe	**9**	110	**–**	16	**–**	205
USA	**–**	49	**–**	(5)	**(6)**	11
Asia / Pacific	**2**	155	**–**	10	**–**	5
	11	314	**–**	21	**(6)**	221
Exceptional items and goodwill amortisation			**(8)**	(111)		
Discontinued operations	**11**	314	**(8)**	(90)	**(6)**	221
Net (debt) / funds					**(48)**	45
Net pension liabilities:						
Continuing operations					**(71)**	(132)
Discontinued operations					**–**	(17)
Total Group	**2,508**	2,834	**64**	(135)	**42**	256

Turnover is disclosed by origin. There is no material difference in turnover by destination. Net operating assets by division are analysed in Note 14.

2 Group operating profit

	2005			2004		
£m	**Continuing**	**Discontinued**	**Total**	Continuing	Discontinued	Total
Turnover	**2,497**	**11**	**2,508**	2,520	314	2,834
Cost of sales	**(1,790)**	**(4)**	**(1,794)**	(1,882)	(146)	(2,028)
Pre-exceptional operating items	***(1,790)***	***(4)***	***(1,794)***	*(1,836)*	*(146)*	*(1,982)*
Exceptional operating items	**–**	**–**	**–**	(46)	–	(46)
Gross profit	**707**	**7**	**714**	638	168	806
Distribution costs	**(501)**	**(4)**	**(505)**	(531)	(99)	(630)
Pre-exceptional operating items	***(501)***	***(4)***	***(505)***	(517)	(90)	(607)
Exceptional operating items	**–**	**–**	**–**	(14)	(9)	(23)
Administrative expenses	**(126)**	**(3)**	**(129)**	(149)	(58)	(207)
Pre-exceptional operating items and goodwill amortisation	***(125)***	***(3)***	***(128)***	(116)	(57)	(173)
Exceptional operating items	**–**	**–**	**–**	(32)	–	(32)
Goodwill amortisation	***(1)***	**–**	***(1)***	(1)	(1)	(2)
Group operating profit / (loss)	**80**	**–**	**80**	(42)	11	(31)

The exceptional operating items are detailed in Note 3.

2 Group operating profit continued

Group operating profit before exceptional items and goodwill amortisation is stated after charging:

£m	2005 Continuing	2005 Discontinued	2005 Total	2004 Continuing	2004 Discontinued	2004 Total
Depreciation and amounts written off tangible fixed assets	**42**	**–**	**42**	41	5	46
Net operating lease charges						
– land and buildings	**145**	**–**	**145**	139	25	164
– equipment and vehicles	**10**	**–**	**10**	13	7	20
Other occupancy costs	**47**	**–**	**47**	49	3	52
Staff costs (Note 7)	**273**	**2**	**275**	278	58	336

Fees payable to Deloitte & Touche LLP, the Group's auditors, included in the profit and loss account relating to audit fees amount to £0.3m (2004: £0.4m), and non-audit fees of £0.2m (2004: £2.0m) which comprise audit-related regulatory work £nil (2004: £0.1m), further assurance services £nil (2004: £1.2m), tax compliance services £0.1m (2004: £0.3m), tax advisory services £nil (2004: £0.4m) and IFRS preparation work £0.1m (2004: £nil). In addition, the WHSmith Pension Trust and WHSmith Retirement Savings Plan incurred another £0.1m in respect of audit and other fees (2004: £0.1m).

3 Exceptional operating items

Current year
No exceptional operating charges have been made in the year ended 31 August 2005.

Prior year
In the prior year, the following exceptional charges were made:

a) UK Retailing
An exceptional operating charge of £81m was made relating to UK Retailing. Of this amount, £45m related to the carrying value of stock to reflect redundant and slow-moving items. A fixed asset impairment charge of £20m was made in respect of costs of research work on our concept store, systems development for Travel Retail, and an impairment charge covering goodwill and assets in relation to WHSmith Online. A charge of £12m related to the redundancy and associated costs relating to the internal restructuring of UK Retailing, which led to a material reduction in the number of staff at the London and Swindon locations. A further £4m was written off relating to other items.

b) Corporate advisory costs
In responding to the Permira approach and implementing the consequent change to the Group's structure, the Group incurred exceptional operating costs of £11m.

c) Publishing unearned author advances provision
An exceptional provision of £9m was charged relating to unearned author advances in the Publishing business, to ensure that the balance sheet correctly reflected an up-to-date view of the future sales prospects of backlist titles published in previous years.

The tax effect of the operating exceptional items is disclosed in Note 10 to the accounts.

4 Net loss on sale of discontinued operations

£m	2005	2004
Loss on sale of USA Travel Retail (note a, note d)	**(8)**	(62)
Provision for loss on disposal on sale of Publishing business (note b, note e)	**–**	(48)
Profit on sale of Aspac Retail (note c, note d)	**–**	10
Other	**–**	(1)
Net loss on sale of discontinued operations	**(8)**	(101)

Current year
a) Provisions for discontinued businesses
An amount of £8m has been charged in the current year to the profit and loss account relating to the disposal of discontinued businesses. Of this amount, £7m relates to an impairment review of the loan notes received as deferred consideration in respect of the disposal of the Group's USA businesses. The balance relates to closure and exit provisions.

4 Net loss on sale of discontinued operations continued

b) Publishing business disposal
On 25 September 2004, 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	**–**

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

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

The tax effect of the non-operating exceptional items has been disclosed in Note 10 to the accounts.

Prior year
d) Sale of USA Travel Retail and Aspac Retail businesses
During the prior year, the Group disposed of its USA Travel Retail businesses and the Aspac Retail business. A financial summary of the disposals is detailed below:

£m	USA Travel Retail	Aspac Retail	Total
Fixed assets	5	23	28
Stock	15	28	43
Debtors	10	2	12
Cash	–	11	11
Creditors	(1)	(27)	(28)
Total assets	**29**	**37**	**66**
Minority interest	(1)	–	(1)
Net assets disposed	**28**	**37**	**65**
Consideration:			
Cash	20	44	64
Deferred consideration	19	6	25
Total consideration	**39**	**50**	**89**
Net assets disposed	(28)	(37)	(65)
Net liabilities retained	(28)	–	(28)
Transaction costs	(6)	(3)	(9)
(Loss) / profit before goodwill previously written off directly to reserves	**(23)**	**10**	**(13)**
Goodwill previously written off directly to reserves	(39)	–	(39)
(Loss) / profit on sale of discontinued operations	**(62)**	**10**	**(52)**

Deferred consideration
USA Travel Retail
Deferred consideration of £7m in respect of the Hotel business sale to Travel Traders LLC consists of a loan note, which is interest bearing, with a 5 per cent coupon conditional on the trading cash flows of that company. Deferred consideration of £12m in respect of the Airport business sale to Hudson Group consists of an interest bearing loan note with a 5 per cent coupon, with interest accruing from the second year.

Aspac Retail
The profit on the disposal of Aspac Retail was calculated with reference to the draft completion accounts. The deferred consideration of £6m, which was subject to the finalisation of the completion accounts has been received during the year ended 31 August 2005.

4 Net loss on sale of discontinued operations continued

e) Provision for loss on sale of Publishing business

The Group completed the sale of its Publishing business on 25 September 2004. A provision of £48m was made for the loss on disposal of this business, of which £45m was shown as an impairment of goodwill, and £3m was included in accruals for associated disposal costs.

f) Other

The Group also disposed of associate undertakings Books and More NZ Limited, University Bookshop (Otago) Ltd and University Bookshop Canterbury Limited for a total consideration of £1.3m. The total investments disposed and associated costs were £1.0m and there was a £0.3m profit on disposal.

On 30 June 2004, the Group completed a trade and assets sale of its Singapore business which resulted in a £nil profit on disposal.

5 Profit on sale of fixed assets

In the current year, no profit or loss was recorded on sale of fixed assets.

In the prior year, High Street Retail completed the sale and leaseback of seven freehold properties and sold a further six freehold properties. The profit on the sale of these properties was £2m.

6 Pensions arrangements

The Group's pension arrangements for employees are operated through a defined benefit scheme (the WHSmith Pension Trust) and a defined contribution scheme (WHSmith Pensionbuilder). The most significant scheme is the defined benefit WHSmith Pension Trust. The assets of the pension plans are held in separate funds administered by Trustees, who are independent of the Group's finances. The Trustees have extensive powers over the pension plans' arrangements, including the ability to determine the levels of contribution.

The WHSmith Pension Trust

The latest full actuarial valuation of the scheme was carried out as at 31 March 2003 by independent actuaries, Mercer Human Resource Consulting, using the market value basis. A full actuarial valuation of the scheme is carried out every three years with interim reviews in the intervening years. This scheme was closed in September 1995 and under the projected unit method the current service cost would be expected to increase as members approach retirement and the aged profile of members increases.

Pension valuations

The valuation of the Group's defined benefit pension scheme used for the FRS 17 disclosures is based upon the most recent actuarial valuation, which has been updated by professionally qualified actuaries (Mercer Human Resource Consulting) to take into account the requirements of FRS 17, and to assess the liabilities of the scheme at 31 August 2005. Scheme assets are stated at their market value at 31 August 2005.

The weighted average principal long term assumptions used in the actuarial valuation were:

	2005 %	2004 %	2003 %
Rate of increase in salaries	**3.7**	4.5	4.4
Rate of increase in pensions payments and deferred pensions	**2.7**	2.8	2.7
Discount rate	**4.9**	5.6	5.5
Inflation assumptions	**2.7**	2.8	2.7

The aggregate fair values of the assets in the Group's defined benefit scheme, the aggregate net pension liabilities and the expected weighted average long term rates of return at 31 August 2005 were:

	2005		2004		2003	
	£m	%	£m	%	£m	%
Equities	**388**	***7.0***	368	*7.8*	408	*7.6*
Bonds	**485**	***4.0***	308	*4.8*	219	*4.6*
Cash	**–**	***3.8***	–	*4.3*	4	*4.6*
Other	**–**	**–**	2	*5.5*	–	–
Total fair value of assets	**873**		678		631	
Present value of schemes' liabilities	**(967)**		(883)		(846)	
Deficit in the schemes	**(94)**		(205)		(215)	
Related deferred tax asset	**28**		61		64	
Net defined benefit schemes' liabilities	**(66)**		(144)		(151)	
Net retirement medical benefits	**(5)**		(5)		(5)	
Net pension liabilities	**(71)**		(149)		(156)	

6 Pensions arrangements continued

a) Defined benefit pension schemes

Analysis of the amount charged to operating profit

£m	2005	2004
Current service cost	**(10)**	(15)

Analysis of the amount (charged) / credited to net finance charges

£m	2005	2004
Expected return on pension scheme assets	**44**	42
Interest on pension scheme liabilities	**(46)**	(46)
	(2)	(4)

Analysis of the actuarial loss in the statement of total recognised gains and losses

£m	2005	2004
Actual return less expected return on pension scheme assets	**71**	(9)
Experience gains and losses arising on the scheme liabilities	**(2)**	(8)
Changes in assumptions underlying the present value of the scheme liabilities	**(111)**	2
	(42)	(15)

Movement in scheme deficit during the year

£m	2005	2004
At beginning of year	**(205)**	(215)
Current service cost	**(10)**	(15)
Contributions	**142**	44
Net finance charge	**(2)**	(4)
Settlement	**3**	–
Disposal of subsidiary pension fund	**20**	–
Actuarial loss	**(42)**	(15)
Deficit in scheme at end of year	**(94)**	(205)

History of the weighted average experience gains and losses

	2005	2004	2003	2002	2001
Difference between actual and expected returns on assets:					
Amount (£m)	**71**	(9)	6	(117)	(180)
% of scheme assets	**8%**	(1%)	1%	(20%)	(26%)
Experience gains and losses on scheme liabilities:					
Amount (£m)	**(2)**	(8)	3	(19)	–
% of present value of the scheme liabilities	**0%**	(1%)	1%	(3%)	–
Total amount recognised in statement of total recognised gains and losses					
Amount (£m)	**(42)**	(15)	(77)	(142)	(215)
% of present value of the scheme liabilities	**(4%)**	(2%)	(9%)	(20%)	(31%)

In September 2005, the Trustees of the WHSmith Pension Trust adopted a new investment policy in order to limit 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 expected liabilities of the scheme being matched by assets that will alter in value as interest and inflation rates change, matching the movements at the same rate as the pension liability changes ('a Liability Driven Investment "LDI" policy').

The key features of this fund restructuring are as follows:

— 94 per cent of the fund's assets are invested in an LDI structure with a leading international institutional fund manager; and
— 6 per cent of the fund's assets have been used to purchase a portfolio of long-dated equity Call options. These represent a notional exposure to underlying equities of some £350m.

6 Pensions arrangements continued

a) Defined benefit pension schemes continued

The impact of this change in investment policy is to limit 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 overall expected rate of return from the portfolio under the new arrangements is 5 per cent in the 2005/06 financial year.

Following this change in the investment policy the Board and the Trustees have agreed a new deficit funding agreement that gives the Company significantly greater predictability over the level of future deficit reduction payments. This agreement replaces that reached last year and, subject to certain limited conditions, will result in deficit funding payments of £15m in 2005/06, £17m in 2006/07, £20m in 2007/08 and increasing by RPI (capped at 5 per cent) thereafter until the deficit (as calculated under FRS 17) is repaid.

Post retirement medical benefits

WH Smith PLC provides retirement medical benefits to certain pensioners. Total premiums paid during the year in respect of those benefits were £0.4m (2004: £0.4m). The present value of the future liabilities under this arrangement has been assessed by independent actuaries (Buck Consultants (Healthcare) Limited) and this amount is included on the balance sheet, net of deferred taxation under pension and other post retirement liabilities, as follows:

£m	2005	2004
Post retirement medical benefits	**(5)**	(5)

During September 2005, the members were offered the option to be bought out of this scheme. The financial effect of the proposed settlement of this scheme will be included in the accounts for the financial year ending 31 August 2006.

b) Defined contribution pension scheme

The Group's pension cost charge to its defined contribution scheme, WHSmith Pensionbuilder, for the year amounted to £3m (2004: £2m).

7 Staff costs and employees

a) Staff costs

	2005			2004		
£m	Continuing	Discontinued	Total	Continuing	Discontinued	Total
Wages and salaries	**240**	**2**	**242**	243	52	295
Social security	**17**	**–**	**17**	18	4	22
Net pension cost	**13**	**–**	**13**	17	2	19
Employee share schemes	**3**	**–**	**3**	–	–	–
	273	**2**	**275**	278	58	336

b) Employee numbers

	2005		2004	
	Average full time equivalent	Average number of employees	Average full time equivalent	Average number of employees
Continuing:				
High Street Retail	**7,688**	**15,981**	8,442	16,774
Travel Retail	**1,808**	**2,809**	1,864	2,869
Total Retailing	**9,496**	**18,790**	10,306	19,643
News Distribution	**3,325**	**4,275**	3,289	4,312
Support functions	**50**	**55**	103	106
Continuing operations	**12,871**	**23,120**	13,698	24,061
Discontinued:				
USA Travel Retail	**–**	**–**	848	984
Aspac Retail	**–**	**–**	1,636	2,944
Publishing	**62**	**67**	753	815
Discontinued operations	**62**	**67**	3,237	4,743
Total Group	**12,933**	**23,187**	16,935	28,804

8 Operating lease commitments

At the year end the Group had the following future commitments in respect of operating leases for the following year:

	2005			2004		
£m	Land and buildings	Equipment and vehicles	Total	Land and buildings	Equipment and vehicles	Total
Annual net lease commitments expiring:						
Within one year	**10**	**2**	**12**	8	1	9
Within two to five years	**50**	**4**	**54**	49	8	57
In more than five years	**73**	**–**	**73**	76	–	76
	133	**6**	**139**	133	9	142

The annual net rental is further analysed as follows:

	2005					2004
	Annual net lease commitment					
	Land and buildings £m	Equipment and vehicles £m	Total commitment £m	Future cumulative net lease commitment £m	Average lease term (years)	Annual net lease commitment £m
High Street Retail	**86**	**–**	**86**	**756**	**9**	85
Travel Retail	**43**	**–**	**43**	**125**	**3**	40
Total Retailing	**129**	**–**	**129**	**881**	**7**	125
News Distribution	**5**	**–**	**5**	**43**	**9**	4
Support functions	**1**	**6**	**7**	**17**	**3**	8
Property sublet to third parties	**9**	**–**	**9**	**51**	**6**	10
Gross rental commitment	**144**	**6**	**150**	**992**	**7**	147
Less – external rent receivable	**(10)**	**–**	**(10)**	**(39)**	**4**	(8)
– internal rent receivable	**(2)**	**–**	**(2)**	**(21)**	**10**	(3)
Total continuing operations	**132**	**6**	**138**	**932**	**7**	136
USA Travel Retail	**2**	**–**	**2**	**8**	**4**	3
Aspac Retail	**–**	**–**	**–**	**–**	**–**	–
Publishing business	**–**	**–**	**–**	**–**	**–**	4
Less – external rent receivable	**(1)**	**–**	**(1)**	**(6)**	**6**	(1)
Total discontinued operations	**1**	**–**	**1**	**2**	**2**	6
Total	**133**	**6**	**139**	**934**	**7**	142

a) High Street Retail lease commitments include internal rent of £2m (2004: £3m) relating to those properties which are owned by the Group.
b) External rent receivable relates to properties let by the Group to third parties. Of the total external rent receivable, £1m (2004: £1m) relates to USA Travel Retail which sublet retail space in airports where it operated a master contract and £10m (2004: £8m) represents income on subletting other surplus Group property.
c) Potential liabilities that could crystallise under previous assignments of leases where the liability would revert to the Group if the lessee defaulted are estimated at £24m (2004: £25m) per year with a future cumulative rental commitment of approximately £181m (2004: £201m), and an average lease term of approximately eight years (2004: eight years).
d) For those leases that are turnover-related leases, the annual net lease commitment is calculated using the minimum lease liability. The aggregate lease liability for these stores with minimum guaranteed leases is £43m (2004: £42m) and relates to Travel Retail stores.

9 Net finance charges

£m	2005	2004
Interest payable on bank loans and overdrafts	**(8)**	(1)
Net charge on pension schemes (Note 6)	**(2)**	(4)
Unwinding of discount on provisions	**(1)**	(1)
Interest receivable	**3**	1
	(8)	(5)

10 Taxation

£m	2005	2004
Tax on profit before exceptional items and goodwill amortisation	24	20
Standard rate of UK corporation tax 30% (2004: 30%)		
Adjustment in respect of prior year UK corporation tax	(5)	(3)
Foreign tax	–	3
Total current tax charge before exceptional items and goodwill amortisation	19	20
Deferred tax – current year	(1)	–
Deferred tax – prior years	–	3
Tax on profit on ordinary activities before exceptional items and goodwill amortisation	18	23
Tax on exceptional items and goodwill amortisation	–	(10)
Tax on profit on ordinary activities after exceptional items and goodwill amortisation	18	13
Effective tax rate on continuing activities before exceptional items and goodwill amortisation	*25%*	*30%*

Reconciliation of the taxation charge

£m	2005	2004
Tax on profit on ordinary activities before exceptional items and goodwill amortisation at standard rate of UK corporation tax 30% (2004: 30%)	22	20
Permanent differences	1	1
Depreciation for which no tax relief is available	1	1
Losses not available for Group relief	–	2
Adjustment in respect of prior years	(5)	(3)
Other	–	(1)
Current tax charge before exceptional items and goodwill amortisation	19	20
Tax on exceptional items and goodwill amortisation at standard rate of UK corporation tax of 30% (2004: 30%)	(2)	(62)
Goodwill	–	28
Disposal of subsidiary undertaking	–	7
Other disallowable expenses	–	7
Write-off of tangible and intangible assets	–	3
Non-allowable provisions	2	7
Current tax charge after exceptional items and goodwill amortisation	19	10
Deferred tax	(1)	3
Tax on profit on ordinary activities after exceptional items and goodwill amortisation	18	13

11 Dividends

Equity dividend per ordinary share	2005	2004
Interim	4.5p	4.0p
Final – proposed	9.2p	8.0p
Total dividend per ordinary share	13.7p	12.0p
Non equity dividend per share		
'C' share dividend paid on capital reorganisation (Note 22)	85.0p	–

£m	2005	2004
Equity dividends		
Interim	7	10
Final – proposed	16	14
Total equity dividends	23	24
Non equity dividends		
'C' share dividend paid on capital reorganisation (Note 22)	143	–
Total non equity dividends	143	–
Total	166	24

11 Dividends continued

	2005	2004
Equity dividend cover – times	2.0x	–
Equity dividend cover before exceptional items and goodwill amortisation – times	2.4x	1.5x

The final dividend will be paid on 7 February 2006 to shareholders registered at the close of business on 6 January 2006. As at 31 August 2005, the Group had 180,887,036 (2004: 250,559,907) ordinary shares in issue.

On 27 October 2004, the Group paid a 'C' share dividend of £142,533,945 to the holders of 167,686,994 'C' shares who had elected under the terms of the capital reorganisation to receive the initial 'C' share dividend. On payment of this dividend, these 'C' shares were converted to deferred shares. The Group paid dividends in respect of those 'C' shares not repurchased or converted to deferred shares on 28 February 2005 and 31 August 2005, at a rate of 75 per cent of six month LIBOR, totalling £104,441 and £156,647 respectively. In addition, the Group paid dividends on the 'B' shares on 28 February 2005 and 31 August 2005, at a rate of 75 per cent of six month LIBOR, totalling £44,914 and £45,192 respectively.

12 Earnings / (loss) per share

a) Earnings

	2005			2004		
£m	Continuing	Discontinued	Total	Continuing	Discontinued	Total
Headline earnings attributable to shareholders	56	–	56	35	12	47
Pension interest net of related taxation	(1)	–	(1)	(3)	–	(3)
Exceptional items net of related taxation	–	(8)	(8)	(81)	(109)	(190)
Goodwill amortisation	(1)	–	(1)	(1)	(1)	(2)
Profit / (loss) attributable to shareholders	54	(8)	46	(50)	(98)	(148)

b) Basic earnings / (loss) per share

	2005			2004		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
Headline earnings per share (note a)	31.6p	–	31.6p	14.3p	4.9p	19.2p
Pension interest net of related taxation	(0.6)p	–	(0.6)p	(1.2)p	–	(1.2)p
Exceptional items net of related taxation	–	(4.5)p	(4.5)p	(33.2)p	(44.7)p	(77.9)p
Goodwill amortisation	(0.5)p	–	(0.5)p	(0.4)p	(0.4)p	(0.8)p
Earnings / (loss) per share (note b)	30.5p	(4.5)p	26.0p	(20.5)p	(40.2)p	(60.7)p

a) Headline earnings per share has been calculated using profit after tax but before exceptional items, goodwill amortisation, and FRS 17 net interest charges on the defined benefit pension scheme.
b) Basic earnings per share has been calculated using profit after tax, exceptional items and goodwill amortisation.

c) Diluted earnings / (loss) per share

	2005			2004		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
Headline earnings per share	31.3p	–	31.3p	14.3p	4.9p	19.2p
Pension interest net of related taxation	(0.6)p	–	(0.6)p	(1.2)p	–	(1.2)p
Exceptional items net of related taxation	–	(4.5)p	(4.5)p	(33.2)p	(44.7)p	(77.9)p
Goodwill amortisation	(0.5)p	–	(0.5)p	(0.4)p	(0.4)p	(0.8)p
Earnings / (loss) per share	30.2p	(4.5)p	25.7p	(20.5)p	(40.2)p	(60.7)p

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 at 31 August 2005 will be paid. In the prior year, as the Group recorded a loss from continuing operations, the diluted loss per share is the same as the basic, as any dilutive shares reduce the loss per share for continuing operations.

d) Weighted average share capital

Millions	2005	2004
Weighted average shares in issue for earnings per share	177	244
Add weighted average number of ordinary shares under option	2	–
Weighted average ordinary shares for fully diluted earnings per share	179	244

The weighted average number of ordinary shares in issue is stated after excluding 8,999,860 (2004: 6,682,660) shares held solely for the purpose of satisfying obligations under employee share schemes.

13 Fixed charges cover

£m	2005	2004
Interest expense	8	5
Net operating lease rentals	155	184
Property taxes	37	37
Other property costs	10	15
Total fixed charges	**210**	**241**
Profit before tax, exceptional items and goodwill amortisation	**73**	**67**
Profit before tax, exceptional items, goodwill amortisation and fixed charges	**283**	**308**
Fixed charges cover – times	**1.4x**	**1.3x**

Fixed charges cover is calculated by dividing profit before exceptional items, goodwill amortisation, tax and fixed charges by total fixed charges.

14 Segmental analysis of operating assets employed

	Operating assets as at 31 August 2005 £m	Return on capital employed %	ROCE % after capitalised net operating leases including internal rent %	Operating assets as at 31 August 2004 £m	Return on capital employed %	ROCE % after capitalised net operating leases including internal rent %
Continuing operations:						
High Street Retail	187	23%	13%	187	12%	9%
Travel Retail	24	108%	32%	25	83%	24%
UK Retailing	211	33%	16%	212	21%	12%
News Distribution	(25)	–	–	(18)	–	–
Continuing trading operations	186	57%	21%	194	41%	17%
Freehold property	18			21		
Support functions	(13)			(48)		
Provisions for liabilities and charges	(24)			(28)		
Operating assets employed continuing operations	167	48%	19%	139	37%	14%
Discontinued operations:						
USA Travel Retail	1			21		
Aspac Retail	–			–		
Publishing	–			210	9%	9%
Provisions for liabilities and charges	(7)			(10)		
Operating assets employed discontinued operations	(6)			221		
Total operating assets employed	161	50%	19%	360	20%	19%
Net (debt) / funds	(48)			45		
Net assets excluding pension liabilities	113			405		
Net pension liabilities:						
Continuing operations	(71)			(132)		
Discontinued operations	–			(17)		
Total net assets	42			256		

a) Return on capital employed is calculated as the operating profit before exceptional items and goodwill amortisation as a percentage of operating capital employed.
b) Return on capital employed after capitalised net operating leases including internal rent is calculated as the adjusted profit as a percentage of operating assets after capitalising operating leases. Adjusted profit is stated after adding back the annual net rent and charging depreciation on the value of capitalised leases. The value of capitalised operating leases is based on the net present value of future rent commitments.

15 Goodwill

	£m
Cost:	
At 1 September 2004	226
Disposals	(195)
At 31 August 2005	**31**
Accumulated amortisation:	
At 1 September 2004	62
Amortised in year	1
Disposals	(46)
At 31 August 2005	**17**
Net book value	
At 31 August 2005	**14**
At 1 September 2004	164

Goodwill arising on the earlier acquisitions of John Menzies Retail and TM Retail is regarded by the directors as having a useful life of 20 years and is therefore amortised through the profit and loss account over this period. At 31 August 2005, the balance of goodwill is £2m in respect of the acquisition of TM Retail and £12m in respect of John Menzies.

The net book value of the goodwill disposed during the year of £149m relates to the disposal of the Publishing business, which was completed on 25 September 2004.

16 Tangible fixed assets

	Land and Buildings					
£m	Freehold properties	Long term leasehold	Short term leasehold	Fixtures and fittings	Equipment and vehicles	Total
Cost or valuation:						
At 1 September 2004	28	1	168	162	122	481
Additions	–	–	7	12	26	45
Disposals	(1)	–	(1)	(3)	(5)	(10)
Disposal of subsidiary undertakings	–	–	(4)	(1)	(4)	(9)
At 31 August 2005	**27**	**1**	**170**	**170**	**139**	**507**
Accumulated depreciation:						
At 1 September 2004	7	1	89	89	58	244
Depreciation charge	1	–	10	14	16	41
Impairment losses	–	–	–	–	1	1
Disposals	–	–	(1)	(2)	(4)	(7)
Disposal of subsidiary undertakings	–	–	(1)	(1)	(1)	(3)
At 31 August 2005	**8**	**1**	**97**	**100**	**70**	**276**
Net book value						
At 31 August 2005	**19**	**–**	**73**	**70**	**69**	**231**
At 1 September 2004	21	–	79	73	64	237

a) The Group's property portfolio (of freehold and long leasehold properties) was last revalued in 1990. Following the implementation of FRS 15 'Tangible fixed assets' the Group has adopted a policy of not revaluing tangible fixed assets. The carrying amounts of tangible fixed assets, previously revalued, have been retained at their book amount in accordance with the transitional provisions of FRS 15.
b) Freehold properties include assets not depreciated at cost or valuation of £9m (2004: £10m).
c) Assets held under finance leases, with a cost of £12.6m (2004: £nil) and depreciation of £0.4m (2004: £nil), are included within equipment and vehicles.

16 Tangible fixed assets continued
Freehold and long leasehold land and buildings

£m	2005	2004
i) The net book value of freehold and long leasehold properties comprises:		
Properties – at cost	**2**	2
– at valuation	**17**	19
Net book value	**19**	21
ii) If shown on an historical cost basis, properties would be stated at:		
Cost	**27**	28
Depreciation	**(11)**	(10)
Net book value	**16**	18

17 Debtors

£m	2005	2004
Amounts falling due within one year:		
Trade debtors	**37**	87
Other debtors	**43**	74
Prepayments and accrued income	**31**	26
	111	187
Amounts falling due after more than one year:		
Other debtors	**21**	25
	132	212

A deferred tax asset of £20m has been recognised at 31 August 2005 (2004: £nil), of which £15m has been included in other debtors falling due within one year and £5m in other debtors due after more than one year. This relates to tax losses resulting from the significant company contributions paid to the WHSmith Pension Trust. The directors are of the opinion, based on recent and forecast trading that the level of profits in future periods will exceed the tax losses incurred as a result of the Company's contribution to the WHSmith Pension Trust.

Debtors falling due after more than one year include deferred consideration in respect of the disposal of businesses.

18 Financial assets and liabilities

£m	2005	2004
Cash at bank and in hand	**46**	64
Debt repayable in one year or less or on demand	**(48)**	(17)
Debt repayable between two to five years	**(44)**	–
Debt repayable in more than five years	**(2)**	(2)
Net (debt) / funds	**(48)**	45

After taking into account various interest rate swaps, the net debt structure of the Group was:

£m	2005	Cash flow	Non-cash	2004
Cash at bank and in hand (note a)	**46**	(18)	–	64
Debt – Sterling floating rate (note b)	**(50)**	(33)	–	(17)
– Sterling fixed rate (note c)	**(32)**	(30)	–	(2)
– Obligations under finance leases (note d)	**(12)**	1	(13)	–
Net (debt) / funds	**(48)**	(80)	(13)	45

18 Financial assets and liabilities continued

a) Cash at bank is held on short term deposit, bearing interest at a weighted average rate of 4.70 per cent during the year. Following the disposal of the Publishing business during the year, there are no material foreign exchange exposures relating to the Group's financial assets and liabilities as at 31 August 2005. Cash at bank and in hand at 31 August 2005 includes:

£m	2005	2004
US dollars	**1**	1
Australian dollars	**–**	4
New Zealand dollars	**–**	3
Net foreign currency	**1**	8

b) At 31 August 2005, floating rate debt comprises (1) £35m of unsecured term loan bearing an interest rate of three month LIBOR plus 175 basis points (2004: £nil) of which £15m is repayable on 26 July 2006 and £20m on 26 July 2007, and (2) £15m of unsecured loan notes (which are redeemable at par on demand up until expiry on 28 February 2008) which bear an interest rate of 100 basis points below six month LIBOR (2004: £17m).

c) Fixed rate debt at 31 August 2005 comprises (1) £30m of unsecured term loan bearing an interest rate of 6.67 per cent (2004: £nil) of which £15m is repayable on 26 July 2006 and £15m on 26 July 2007, and (2) £2m of undated 5.125 per cent unsecured (redeemable at par) loan stock (2004: £2m).

d) Obligations under finance leases can be analysed as follows:

£m	2005	2004
Amounts payable within one year	**(3)**	–
Amounts payable within 2 to 5 years	**(10)**	–
	(13)	–
Less: finance charges allocated to future periods	**1**	–
	(12)	–

The Group's financial instruments are accounted for under FRS 13 'Derivatives and other financial instruments' and comprise borrowings, some cash and liquid resources and various items, such as trade debtors and trade creditors that arise directly from its operations. In addition the Group has significant property operating leases, described in Note 8. The Group is required to state under FRS 13 that it has applied an exemption available under FRS 13 from making disclosures of short term debtors and creditors.

The main purpose of these financial instruments is to raise finance for the Group's operations. The Group finances its operations through a mixture of share capital, retained profits, trade credit and bank borrowings and currently holds surplus cash. The Group has entered into a limited number of derivative transactions and has procedures in place to monitor and control their use. The Group's use of derivatives is primarily to hedge certain product purchases and have been approved by the Board. It is and has been throughout the year (and prior year), the Group's policy that no speculative trading in financial instruments shall be undertaken. The main risks arising from the Group's financial instruments are interest rate risk and liquidity risk.

Interest rate risk: The Group's fixed interest debt comprises £30m of unsecured term loan (where interest rate swaps have been used to fix the interest rate over the life of the loan) and a loan of £2m which was entered into in connection with previous financing strategies and which is repayable at the Group's option. Cash deposits and remaining debt are at variable rates. The fair value of interest rate swaps at 31 August 2005 show a loss of £0.2m.

Liquidity risks: On 26 July 2004, the Group entered into committed three year syndicated borrowing facilities comprising a £120m unsecured term loan facility (of which £55m has been cancelled during the year) and a £150m working capital revolving credit facility. At 31 August 2005, no amounts were drawn down from the available committed facilities of £150m, which are due to expire in July 2007.

Foreign currency risk: Following disposal of the Publishing business during the year, the Group's turnover and net operating assets have no material exposure to foreign currency risk. However, during the period, the Group entered into a number of forward currency derivative contracts to manage the foreign exchange exposure arising from stock purchases from the Far East.

Currency exposures: At 31 August 2005, the fair value of the forward currency derivative contracts show a gain of £0.8m, which is expected to be recognised in the profit and loss account in the year ended 31 August 2006. At 31 August 2005, the Group had no other material currency exposures that would give rise to net currency gains or losses being recognised in the profit and loss account.

Fair values of financial assets and financial liabilities: At 31 August 2005, there was no material difference between the fair value of financial assets and financial liabilities and their book value.

Market price risk: The Group's exposure to market price risk comprises interest rate risk. It regularly monitors this exposure and considers from time to time whether there would be a benefit in further hedging this risk. The Group avoids the use of derivatives or other financial instruments in circumstances when the outcome would effectively be largely dependent upon speculation on future rate movements.

19 Other creditors (amounts falling due within one year)

£m	2005	2004
Trade creditors	**176**	209
Corporation tax	**27**	30
VAT, payroll taxes and social security	**16**	17
Other creditors	**56**	58
Accruals and deferred income	**55**	69
Proposed dividends	**16**	14
	346	397

20 Other creditors (amounts falling due after more than one year)

£m	2005	2004
Other creditors	**1**	2

21 Provisions for liabilities and charges

£m	Disposal provisions	Deferred taxation	Non-trading property provisions	Total
Gross provision:				
At 1 September 2004	10	15	18	43
Charged / (released) during the year	1	(1)	1	1
Utilised in the year	(4)	–	(5)	(9)
At 31 August 2005	**7**	**14**	**14**	**35**
Discount:				
At 1 September 2004	–	–	(5)	(5)
Unwinding of discount utilisation	–	–	1	1
At 31 August 2005	**–**	**–**	**(4)**	**(4)**
Net provision				
At 31 August 2005	**7**	**14**	**10**	**31**
At 1 September 2004	10	15	13	38

Disposal provisions of £7m arise from commitments in respect of the disposal of the USA Travel Retail businesses. The provisions will be predominantly utilised over the next few years.

The non-trading property provision is the estimated future cost of the Group's onerous leases based on known and estimated rental subleases. The costs include provisions for required dilapidation costs and any anticipated future rental shortfalls. This provision has been discounted at 10 per cent and this discount will be unwound over the respective lives of the leases, which range from the year 2006 through to 2016.

The deferred tax balance comprises the following:

£m	2005	2004
Accelerated capital allowances	**16**	17
Short term timing differences	**(2)**	(2)
	14	15

22 Called up share capital

a) Authorised

	2005		2004	
	Number of shares (millions)	Nominal value £m	Number of shares (millions)	Nominal value £m
Equity:				
Ordinary shares of 2$\frac{13}{81}$p each	**2,305**	**50**	–	–
Ordinary shares of 55.55p each	**–**	**–**	333	185
		50		185
Non equity:				
'B' shares of 53.75p each	**286**	**153**	286	153
'C' shares of 85p each	**83**	**70**	–	–
Deferred shares of 85p each	**168**	**143**	–	–
		366		153
Total		**416**		338

b) Allotted and fully paid

	2005		2004	
	Number of shares (millions)	Nominal value £m	Number of shares (millions)	Nominal value £m
Equity:				
Ordinary shares of 2$\frac{13}{81}$p each	**181**	**4**	–	–
Ordinary shares of 55.55p each	**–**	**–**	251	139
		4		139
Non equity:				
'B' shares of 53.75p each	**4**	**2**	4	2
'C' shares of 85p each	**10**	**8**	–	–
Deferred shares of 85p each	**168**	**143**	–	–
		153		2
Total		**157**		141

22 Called up share capital continued

c) Movement in share capital

£m	Equity: Ordinary shares of $2^{13}/_{81}$p each	Equity: Ordinary shares of 55.55p each	Equity: 'B' shares of 53.75p each	Non equity: 'C' shares of 85p each	Non equity: Deferred shares of 85p each	Total
At 1 September 2004	–	139	2	–	–	**141**
Capital reorganisation	4	(139)	–	213	–	**78**
Converted	–	–	–	(143)	143	–
Cancelled	–	–	–	(62)	–	**(62)**
At 31 August 2005	**4**	**–**	**2**	**8**	**143**	**157**

The number of ordinary shares of 55.55p issued in the year to 31 August 2005 (during the period 1 September 2004 to 26 September 2004) was 2,593 (2004: 122,477) with a nominal value of £0.001m (2004: £0.068m). Of these, nine were issued in connection with the capital reorganisation and 2,584 were issued on the exercise of share options for a cash consideration of £0.007m (2004: £0.4m).

The number of ordinary shares of $2^{13}/_{81}$p issued in the year to 31 August 2005 (during the period 27 September 2004 to 31 August 2005) was 482,036 (2004: nil) with a nominal value of £0.01m (2004: £nil). These were issued on the exercise of share options for a cash consideration of £1.5m (2004: £nil). Other movements in ordinary shares in the year, due to the restructuring of share capital, are noted in further detail below.

At 31 August 2005, the number of options held under employee share schemes was 17.9 million shares (2004: 16.5 million). The proceeds due to the Company upon exercise of these options would be £47.7m (2004: £59.4m).

On 27 September 2004 the Company undertook a capital reorganisation whereby existing ordinary shareholders received 18 new ordinary shares and 25 new non-cumulative preference shares of nominal value 85p ('C' shares) for every 25 existing ordinary shares. The new ordinary shares have a nominal value of $2^{13}/_{81}$p each. This capital reorganisation was effected by a bonus issue of £78m, using the share premium account to fully pay up undesignated shares of 31p each, which were then allocated to shareholders on the basis of one undesignated share for every existing share held. The existing ordinary shares and undesignated shares were then consolidated and split, resulting in the issue of new ordinary shares with a nominal value of £4m and 'C' shares with a nominal value of £213m.

In accordance with the terms of the capital reorganisation, shareholders could elect to sell 'C' shares to the Company at 85p per share following which all such 'C' shares would be cancelled by the Company or to receive the initial 'C' share dividend of 85p per 'C' share following which all such 'C' shares would be converted into deferred shares. On 27 October 2004, as a result of these elections, the Company repurchased 73,182,358 'C' shares for their nominal value of 85p each, a total repurchase amount of £62m, and paid an initial 'C' share dividend of £143m in respect of 167,686,994 'C' shares. The remaining ten million 'C' shares may be purchased by the Company (subject to the provisions of the Companies Act 1985) or converted into ordinary shares at the Company's option and carry a net non-cumulative dividend set at a rate that is the lower of 75 per cent of six month LIBOR and 20 per cent per annum. The 'C' shares have limited voting rights. On a return of capital on winding up or otherwise, the holders of the 'C' shares shall be entitled in priority to any payment to the holders of the ordinary and deferred shares, and ranking pari passu with the holders of the 'B' shares, to repayment of the nominal capital paid up on the 'C' shares held, together with a sum equal to any outstanding dividend.

The deferred shares may be purchased by the Company (subject to the provision of the Companies Act 1985), at the Company's option for not more than 1p for all the shares and carry no dividend or voting rights. On a return of capital on winding up or otherwise, the holders of the deferred shares shall be entitled after firstly paying to the holders of the 'B' and 'C' shares any amounts owing to them and, secondly, paying to the holders of the ordinary shares the nominal capital paid up plus £100,000 on each ordinary share held, to repayment of the nominal capital paid up on the deferred shares held.

The 'B' shares are redeemable at their nominal value at the shareholders' option during any period declared by the Company, or at the Company's option, or at maturity on 31 August 2008. The 'B' shares carry a net non-cumulative dividend set at a rate that is the lower of 75 per cent of six month LIBOR and 20 per cent per annum and have limited voting rights. On a return of capital on winding up or otherwise, the holders of the 'B' shares shall be entitled in priority to any payment to the holders of the ordinary and deferred shares, and ranking pari passu with the holders of the 'C' shares, to repayment of the nominal capital paid up on the 'B' shares held, together with a sum equal to any outstanding dividend.

On a return of capital on winding up or otherwise, the holders of the ordinary shares shall be entitled after paying to the holders of the 'B', 'C' and deferred shares any amounts owing to them, to the repayment of any further amount rateably according to the amounts paid up in respect of each ordinary share.

At 31 August 2004, the Group had 169,072 authorised, allotted and fully paid 5.75 per cent cumulative preference shares in issue, on which dividends were paid half yearly. These preference shares were repurchased and cancelled in full on 20 May 2005.

23 Reserves

£m	Share premium account	Capital redemption reserve	Revaluation reserve	Other reserve	Profit and loss account
Reserves at 1 September 2004	**93**	**156**	**3**	**(27)**	**(110)**
Loss retained for the year	–	–	–	–	(120)
Bonus issue (Note 22)	(78)	–	–	–	–
Employee share schemes	2	–	–	–	3
Repurchase of shares (Note 22)	–	62	–	–	(62)
Purchase of own shares for employee share schemes	–	–	–	(12)	–
Money returned to ESOP Trust after share capital reorganisation	–	–	–	5	–
Reserves excluding current year pension deficit adjustment	17	218	3	(34)	(289)
Current year net pension deficit adjustment	–	–	–	–	(30)
Reserves at 31 August 2005	**17**	**218**	**3**	**(34)**	**(319)**

The profit and loss reserve at 31 August 2005 is stated after writing off previously acquired goodwill of £19m (2004: £19m).

The opening capital redemption reserve was created from the repurchase of ordinary and 'B' shares. The addition during the year relates to the repurchase of 'C' shares after the capital reorganisation (see Note 22).

The W H Smith Employees' Share Trust 1999 (the 'Trust') holds ordinary shares in WH Smith PLC which may be used to satisfy options and awards granted under the Company's share schemes. The Trustee, which is an independent professional trust company based in Jersey, purchases the shares in the open market with financing provided by the Group as required, on the basis of regular reviews of the anticipated share liabilities of the Group.

In accordance with UITF 38, which requires shares held by the Trust to be shown as a deduction in arriving at shareholders' funds, the other reserve comprises 8,999,860 shares (2004: 6,682,660) with a nominal value of £194,441 (2004: £3,712,218) and a market value at 31 August 2005 of approximately £33m (2004: £20m). Dividends are waived for all ordinary shares held by the Trust.

The reserves before and after net pension liabilities are:

£m	2005	2004
Profit and loss reserve excluding net pension liabilities	**(248)**	39
Amount relating to pension liabilities, net of related deferred tax	**(71)**	(149)
Profit and loss reserve	**(319)**	(110)

24 Notes to the cash flow statement

Reconciliation of operating profit / (loss) to net cash (outflow) / inflow from operating activities

£m	2005	2004
Operating profit / (loss)	**80**	(31)
Adjustment for pension funding (note a)	**(130)**	(25)
Operating exceptional items	**–**	101
Depreciation and other amounts written off tangible fixed assets	**42**	46
Amortisation of goodwill	**1**	2
Decrease / (increase) in stock	**6**	(17)
Decrease / (increase) in debtors	**1**	(1)
Decrease in creditors	**(7)**	(9)
Cash spend against provisions	**(6)**	(5)
Net cash (outflow) / inflow from operating activities before exceptional operating items	**(13)**	61
Corporate advisory costs	**(9)**	–
Internal restructuring of UK Retailing	**–**	(11)
Other items	**–**	(2)
Cash outflow relating to exceptional operating items	**(9)**	(13)
Net cash (outflow) / inflow from operating activities after exceptional operating items	**(22)**	48

a) For the year ended 31 August 2005, £142m (2004: £44m) cash contributions have been made to the pension schemes. The associated profit and loss charge comprises £10m (2004: £15m) for operating costs and £2m charge (2004: £4m charge) for financing. The Group has made an additional contribution of £130m over and above the required profit and loss charge (2004: £25m additional contribution).

25 Contingent liabilities

£m	2005	2004
Bank and other loans guaranteed	**11**	20

No amount has been included above for taxation that would arise in the event of certain international subsidiaries distributing the balance of their reserves.

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. These leases are disclosed in Note 8 and have an estimated future cumulative gross rental commitment of approximately £181m (2004: £201m).

26 Capital commitments

Contracts placed for future capital expenditure approved by the directors but not provided for in these financial statements amounts to £4m (2004: £33m).

27 Transactions with related parties

USA Travel Retail – Hotels

The CEO of Travel Traders LLC is Sean Anderson who was Chairman of WHSmith Airports Inc, WH Smith PLC's USA subsidiary, until September 2003, and he holds a 30 per cent stake in Travel Traders LLC. The total consideration of £7m 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 the Group is providing a loan facility of up to £4m to the new company, of which £3m was drawn down as at 31 August 2005.

28 Principal subsidiaries

The principal subsidiaries of the Company at 31 August 2005 are disclosed below:

Name	Nature of the business	Country of incorporation/ registration	Class of share	Group interest %
Held directly				
Greenbridge News Limited	Holding Company	England and Wales	Ordinary	100%
WH Smith (Holdings) Limited	Holding Company	England and Wales	Ordinary	100%
Held indirectly				
WH Smith Retail Limited	Retailing	England and Wales	Ordinary	100%
WH Smith Trading Limited	Distribution	England and Wales	Ordinary	100%
WH Smith Group Holdings (USA) Inc.	Retailing	USA	Common	100%
WH Smith France S.A.S	Retailing	France	Ordinary	100%

29 Share options and awards

a) Share options

i) Sharesave Scheme

Under the terms of the Sharesave Scheme, approved by shareholders in 1999, the Board each year grants options to purchase ordinary shares in the Company to employees with at least one year's service who enter into an Inland Revenue Approved Save-As-You-Earn (SAYE) savings contract for a term of three or five years. Options are granted at a 20 per cent discount to the market price of the shares on the day preceding the date of offer and are normally exercisable for a period of six months after completion of the SAYE contract.

Outstanding options granted under the Sharesave Schemes are as follows:

Date of grant	Number of shares 2005	Number of shares 2004	Exercise price (pence)	Exercise period
16 June 1999 (5 year)	**–**	196,111	545.20	01.08.04 – 31.01.05
7 June 2000 (5 year)	**92,598**	519,125	293.40	01.08.05 – 31.01.06
6 June 2001 (3 year)	**–**	347,279	382.40	01.08.04 – 31.01.05
6 June 2001 (5 year)	**164,093**	212,469	382.40	01.08.06 – 31.01.07
5 June 2002 (3 year)	**375,424**	576,374	356.80	01.08.05 – 31.01.06
5 June 2002 (5 year)	**310,611**	386,716	356.80	01.08.07 – 31.01.08
4 June 2003 (3 year)	**833,066**	1,123,923	251.20	01.08.06 – 31.01.07
4 June 2003 (5 year)	**567,807**	703,080	251.20	01.08.08 – 31.01.09
2 June 2004 (3 year)	**456,703**	633,899	284.40	01.08.07 – 31.01.08
2 June 2004 (5 year)	**253,258**	332,313	284.40	01.08.09 – 31.01.10
1 June 2005 (3 year)	**682,844**	–	271.40	01.08.08 – 31.01.09
1 June 2005 (5 year)	**394,118**	–	271.40	01.08.10 – 31.01.11
	4,130,522	5,031,289		

29 Share options and awards continued
a) Share options continued
ii) Executive Share Option Schemes

Under the terms of the current Executive Share Option Schemes, approved by shareholders in 1999 (and amended in January 2004), the Board may grant options to executives up to an annual limit of two times their rate of basic annual salary. Since 1995, the exercise of options has been conditional on the achievement of a performance target, which is determined by the Board at the time of grant. Further details are set out in the Remuneration Report.

Outstanding options granted under the Executive Share Option Schemes are as follows:

Date of grant	Number of shares 2005	2004	Exercise price (pence)	Exercise period
19 September 1995	**20,000**	20,000	371.00	19.09.98 – 18.09.05
22 December 1998	**22,960**	40,695	473.50	22.12.01 – 21.12.08
25 February 1999	**55,950**	73,858	530.50	25.02.02 – 24.02.09
1 June 1999	**–**	13,888	648.00	01.06.02 – 31.05.09
7 December 1999	**402,063**	1,010,740	387.00	07.12.02 – 06.12.09
11 May 2000	**13,947**	40,273	382.00	11.05.03 – 10.05.10
11 May 2000	**17,714**	77,715	385.00	11.05.03 – 10.05.10
31 October 2000	**639,325**	1,924,479	393.25	31.10.03 – 30.10.10
1 May 2001	**18,595**	39,694	488.00	01.05.04 – 30.04.11
1 May 2001	**37,654**	65,470	491.50	01.05.04 – 30.04.11
1 November 2001	**776,392**	2,085,732	438.00	01.11.04 – 31.10.11
5 November 2002	**446,509**	446,509	355.50	05.11.05 – 04.11.12
5 November 2002	**2,663,073**	2,869,408	361.50	05.11.05 – 04.11.12
20 November 2003	**2,512,776**	2,805,724	343.50	20.11.06 – 19.11.13
3 November 2004	**1,951,672**	–	340.00	03.11.07 – 02.11.14
26 November 2004	**24,116**	–	311.00	26.11.07 – 25.11.14
26 April 2005	**263,578**	–	360.00	26.04.08 – 25.04.15
	9,866,324	11,514,185		

b) Awards
i) Deferred Bonus Plan

Under the terms of the Deferred Bonus Plan, which was operated for annual bonuses earned in the financial year 2002/03, 19 senior executives received a part of their annual bonus in the form of ordinary shares of the Company which will be released after three years, subject to continued employment. In addition, four participants opted to invest up to 25 per cent of their total annual bonus in ordinary shares of the Company which will be matched on a 1:2 basis after three years or on a 1:1 basis after five years, subject to continued employment. The numbers of matching shares were adjusted following the capital reorganisation in September 2004.

Outstanding awards granted under the Deferred Bonus Plan are as follows:

	Number of shares						
	2005			2004			Vesting date
Date of award	Bonus	Matching (1:1)	Total	Bonus	Matching (1:1)	Total	(see note below)
20 November 2003	45,497	3,087	48,584	54,118	5,204	59,322	15.10.06

The bonus shares will vest on 15 October 2006. The matching shares will vest on a 1:2 basis on 15 October 2006 or on a 1:1 basis on 15 October 2008.

29 Share options and awards continued
b) Awards continued
ii) Conditional share award – Kate Swann

Kate Swann received an award of 141,315 ordinary shares on 4 November 2003. Following the capital reorganisation in September 2004 and the reinvestment of the proceeds from the sale of the related 'C' shares, this award is now in respect of 142,415 ordinary shares. These shares will be released in two equal tranches, subject to continued employment in October 2005 and October 2006.

iii) 2004 Management Investment Plan

Under the terms of the Management Investment Plan, approved by shareholders in September 2004, executive directors and key senior executives have invested their own money to buy ordinary shares in the Company and have been granted matching awards (in the form of nil cost options) to acquire further ordinary shares in proportion to the amount they have invested. These awards will only vest and become exercisable if underlying performance targets are met. Further details are set out in the Remuneration Report.

Outstanding awards granted under the Management Investment Plan are as follows:

Date of grant	Number of shares 2005	2004	Exercise price	Exercise period (see note below)
3 November 2004	**2,620,431**	–	Nil	01.02.08 – 31.01.10
26 November 2004	**9,604**	–	Nil	01.02.08 – 31.01.10
24 February 2005	**155,844**	–	Nil	01.02.08 – 31.01.10
26 April 2005	**412,179**	–	Nil	01.02.08 – 31.01.10
3 June 2005	**24,954**	–	Nil	01.02.08 – 31.01.10
	3,223,012	–		

To the extent that awards vest, 75 per cent will be exercisable immediately following the vesting date (31 January 2008) and 25 per cent will be exercisable one year later. Awards will cease to be exercisable on 1 February 2010.

iv) 2004 L-TIP

Under the terms of the L-TIP, approved by shareholders in January 2004, executive directors and key senior executives may be granted conditional awards to acquire ordinary shares in the Company (in the form of nil cost options) which will only vest and become exercisable to the extent that the related performance target is met. Further details are set out in the Remuneration Report.

Outstanding awards granted under the L-TIP are as follows:

Date of grant	Number of shares 2005	2004	Exercise price	Exercise period (see note below)
3 November 2004	**574,196**	–	Nil	11.10.07 – 03.11.14
26 April 2005	**60,453**	–	Nil	09.04.08 – 26.04.15
	634,649	–		

Awards will first become exercisable on the vesting date, which is the date (as soon as practicable after the announcement of the Company's results for the final year of the Performance Period) that participants receive notification of the number of award shares that have vested. For awards granted on 3 November 2004, the Performance Period is the three year period ending 31 August 2007 and for the award granted on 26 April 2005, the Performance Period is the three year period ending 29 February 2008.

c) Changes in the number of shares under share option and award schemes

Number	Sharesave scheme	Executive share option schemes	Share award	Deferred bonus plan	MIP	L-TIP	Total
Balance at 1 September 2004	5,031,289	11,514,185	141,315	59,322	–	–	16,746,111
Capital reorganisation adjustment	–	–	1,100	(266)	–	–	834
Options and awards granted	1,089,118	2,420,091	–	–	3,672,766	680,587	7,862,562
Options and awards exercised	(404,246)	(80,374)	–	(2,324)	–	–	(486,944)
Options and awards lapsed	(1,585,639)	(3,987,578)	–	(8,148)	(449,754)	(45,938)	(6,077,057)
Balance at 31 August 2005	**4,130,522**	**9,866,324**	**142,415**	**48,584**	**3,223,012**	**634,649**	**18,045,506**

Company Balance Sheet
as at 31 August 2005

£m	Note	2005	2004
Fixed assets			
Tangible fixed assets	2	**23**	25
Investments	3	**968**	1,132
Total fixed assets		**991**	1,157
Current assets			
Debtors	4	**16**	43
Creditors due within one year	5	**(404)**	(534)
Net current liabilities		**(388)**	(491)
Total assets less current liabilities		**603**	666
Creditors due after more than one year			
Debt	6	**(2)**	(2)
Provisions for liabilities and charges	7	**(4)**	–
Total net assets		**597**	664
Capital and reserves			
Share capital	8	**4**	139
Share premium	9	**17**	93
Capital redemption reserve	9	**218**	156
Merger reserve	9	**34**	34
Profit and loss account	9	**171**	240
Equity shareholders' funds		**444**	662
Non equity share capital		**153**	2
Total equity		**597**	664

Approved by the Board of Directors on 13 October 2005.

Kate Swann
Chief Executive

Alan Stewart
Finance Director

Notes to the Company Balance Sheet
as at 31 August 2005

1 Profit for the year
The Company has not presented its own profit and loss account as permitted by section 230 of the Companies Act 1985. The profit for the year attributable to shareholders, which is stated on an historical cost basis, was £159m (2004: £206m). There were no other recognised gains or losses.

2 Tangible fixed assets

	Land and buildings		
£m	Freehold properties	Long term leasehold	Total
Cost or valuation:			
At 1 September 2004	31	1	32
Disposals	(1)	–	(1)
At 31 August 2005	**30**	**1**	**31**
Accumulated depreciation:			
At 1 September 2004	6	1	7
Depreciation charged	1	–	1
At 31 August 2005	**7**	**1**	**8**
Net book value			
At 31 August 2005	**23**	**–**	**23**
At 1 September 2004	25	–	25

3 Investments in subsidiary undertakings
The Company's investments comprise shares in subsidiaries of £906m (2004: £1,070m) and loans to subsidiaries of £62m (2004: £62m).

4 Debtors

£m	2005	2004
Amounts owed by Group undertakings	**16**	43

5 Creditors (amounts falling due within one year)

£m	2005	2004
Amounts owed to third parties	**15**	17
Amounts owed to Group undertakings	**372**	502
Dividends	**16**	14
Other creditors	**1**	1
	404	534

The amounts owed to third parties represent loan notes of £15m (2004: £17m) issued as part of the purchase consideration of Hodder Headline plc. These loan notes are repayable at par on demand until expiry on 28 February 2008.

Amounts owed to Group companies include inter-company loan notes issued by the Company to Greenbridge News Limited with a nominal value of £154m in respect of an internal reorganisation which took place on 26 July 2004. These loan notes are interest bearing at six month LIBOR and are repayable on demand. Amounts owed to Group undertakings at 31 August 2005 also include £218m owing to other Group companies (2004: £348m).

6 Creditors (amounts falling due after more than one year)

£m	2005	2004
Amounts owed to third parties	**2**	2

The amounts owed to third parties represent 5.125 per cent redeemable unsecured loan stock of £2m (2004: £2m).

7 Provisions for liabilities and charges
The provision of £4m relates to closure and exit provisions on the disposal of the Group's USA businesses.

8 Called up share capital
a) Authorised

	2005 Number of shares (millions)	2005 Nominal value £m	2004 Number of shares (millions)	2004 Nominal value £m
Equity:				
Ordinary shares of $2^{13}/_{81}$p each	**2,305**	**50**	–	–
Ordinary shares of 55.55p each	–	–	333	185
		50		185
Non equity:				
'B' shares of 53.75p each	**286**	**153**	286	153
'C' shares of 85p each	**83**	**70**	–	–
Deferred shares of 85p each	**168**	**143**	–	–
		366		153
Total		**416**		338

b) Allotted and fully paid

	2005 Number of shares (millions)	2005 Nominal value £m	2004 Number of shares (millions)	2004 Nominal value £m
Equity:				
Ordinary shares of $2^{13}/_{81}$p each	**181**	**4**	–	–
Ordinary shares of 55.55p each	–	–	251	139
		4		139
Non equity:				
'B' shares of 53.75p each	**4**	**2**	4	2
'C' shares of 85p each	**10**	**8**	–	–
Deferred shares of 85p each	**168**	**143**	–	–
		153		2
Total		**157**		141

c) Movement in share capital

£m	Equity: Ordinary shares of $2^{13}/_{81}$p each	Equity: Ordinary shares of 55.55p each	Non equity: 'B' shares of 53.75p each	Non equity: 'C' shares of 85p each	Non equity: Deferred shares of 85p each	Total
At 1 September 2004	–	139	2	–	–	**141**
Capital reorganisation	4	(139)	–	213	–	**78**
Converted	–	–	–	(143)	143	–
Cancelled	–	–	–	(62)	–	**(62)**
At 31 August 2005	**4**	**–**	**2**	**8**	**143**	**157**

The number of ordinary shares of 55.55p issued in the year to 31 August 2005 (during the period 1 September 2004 to 26 September 2004) was 2,593 (2004: 122,477) with a nominal value of £0.001m (2004: £0.068m). Of these, nine were issued in connection with the capital reorganisation and 2,584 were issued on the exercise of share options for a cash consideration of £0.007m (2004: £0.4m).

8 Called up share capital continued
c) Movement in share capital continued

The number of ordinary shares of $2^{13}/_{81}$p issued in the year to 31 August 2005 (during the period 27 September 2004 to 31 August 2005) was 482,036 (2004: nil) with a nominal value of £0.01m (2004: £nil). These were issued on the exercise of share options for a cash consideration of £1.5m (2004: £nil). Other movements in ordinary shares in the year, due to the restructuring of share capital, are noted in further detail below.

At 31 August 2005, the number of options held under employee share schemes was 17.9 million shares (2004: 16.5 million). The proceeds due to the Company upon exercise of these options would be £47.7m (2004: £59.4m).

On 27 September 2004 the Company undertook a capital reorganisation whereby existing ordinary shareholders received 18 new ordinary shares and 25 new non-cumulative preference shares of nominal value 85p ('C' shares) for every 25 existing ordinary shares. The new ordinary shares have a nominal value of $2^{13}/_{81}$p each. This capital reorganisation was effected by a bonus issue of £78m, using the share premium account to fully pay up undesignated shares of 31p each, which were then allocated to shareholders on the basis of one undesignated share for every existing share held. The existing ordinary shares and undesignated shares were then consolidated and split, resulting in the issue of new ordinary shares with a nominal value of £4m and 'C' shares with a nominal value of £213m.

In accordance with the terms of the capital reorganisation, shareholders could elect to sell 'C' shares to the Company at 85p per share following which all such 'C' shares would be cancelled by the Company or to receive the initial 'C' share dividend of 85p per 'C' share following which all such 'C' shares would be converted into deferred shares. On 27 October 2004, as a result of these elections, the Company repurchased 73,182,358 'C' shares for their nominal value of 85p each, a total repurchase amount of £62m, and paid an initial 'C' share dividend of £143m in respect of 167,686,994 'C' shares. The remaining ten million 'C' shares may be purchased by the Company (subject to the provisions of the Companies Act 1985) or converted into ordinary shares at the Company's option and carry a net non-cumulative dividend set at a rate that is the lower of 75 per cent of six month LIBOR and 20 per cent per annum. The 'C' shares have limited voting rights. On a return of capital on winding up or otherwise, the holders of the 'C' shares shall be entitled in priority to any payment to the holders of the ordinary and deferred shares, and ranking pari passu with the holders of the 'B' shares, to repayment of the nominal capital paid up on the 'C' shares held, together with a sum equal to any outstanding dividend.

The deferred shares may be purchased by the Company (subject to the provision of the Companies Act 1985), at the Company's option for not more than 1p for all the shares and carry no dividend or voting rights. On a return of capital on winding up or otherwise, the holders of the deferred shares shall be entitled after firstly paying to the holders of the 'B' and 'C' shares any amounts owing to them and, secondly, paying to the holders of the ordinary shares the nominal capital paid up plus £100,000 on each ordinary share held, to repayment of the nominal capital paid up on the deferred shares held.

The 'B' shares are redeemable at their nominal value at the shareholders' option during any period declared by the Company, or at the Company's option, or at maturity on 31 August 2008. The 'B' shares carry a net non-cumulative dividend set at a rate that is the lower of 75 per cent of six month LIBOR and 20 per cent per annum and have limited voting rights. On a return of capital on winding up or otherwise, the holders of the 'B' shares shall be entitled in priority to any payment to the holders of the ordinary and deferred shares, and ranking pari passu with the holders of the 'C' shares, to repayment of the nominal capital paid up on the 'B' shares held, together with a sum equal to any outstanding dividend.

On a return of capital on winding up or otherwise, the holders of the ordinary shares shall be entitled after paying to the holders of the 'B', 'C' and deferred shares any amounts owing to them, to the repayment of any further amount rateably according to the amounts paid up in respect of each ordinary share.

At 31 August 2004, the Group had 169,072 authorised, allotted and fully paid 5.75 per cent cumulative preference shares in issue, on which dividends were paid half yearly. These preference shares were repurchased and cancelled in full on 20 May 2005.

9 Reserves

£m	Share premium account	Capital redemption reserve	Merger reserve	Profit and loss account
At 1 September 2004	93	156	34	240
Bonus issue (Note 8)	(78)	–	–	–
Employee share schemes	2	–	–	–
Repurchase of shares (Note 8)	–	62	–	(62)
Loss retained for the year	–	–	–	(7)
At 31 August 2005	**17**	**218**	**34**	**171**

The loss retained for the year of £7m represents the profit of £159m attributable to shareholders less equity dividends payable of £23m and non equity dividends payable of £143m.

Analysis of Retail Stores and Selling Space

Number of stores

	1 September 2004	Opened	Closed	31 August 2005
High Street Retail	544	2	(4)	542
Travel Retail (note a)	129	3	(5)	127
Total Retailing businesses	**673**	**5**	**(9)**	**669**

Retail selling square feet (000's)

	1 September 2004	Opened	Closed	31 August 2005
High Street Retail	3,056	10	(31)	3,035
Travel Retail	214	8	(6)	216
Total Retailing businesses	**3,270**	**18**	**(37)**	**3,251**

a) Travel Retail store numbers have been restated to reflect the number of stores rather than the number of units.

Five Year Financial Summary

Group Profit and Loss Account

£m	12 months to 31 August 2005	31 August 2004	31 August 2003	31 August 2002	31 August 2001
Turnover					
Continuing operations	**2,497**	2,520	2,469	2,463	2,336
Discontinued operations	**11**	314	451	473	399
Group turnover	**2,508**	2,834	2,920	2,936	2,735
Operating profit					
Continuing operations	**81**	51	99	102	105
Discontinued operations	**–**	21	7	7	25
Group operating profit before exceptional items and goodwill amortisation	**81**	72	106	109	130
Exceptional operating items and goodwill amortisation	**(1)**	(103)	(57)	(33)	(19)
Group operating profit / (loss)	**80**	(31)	49	76	111
Net loss on sale of discontinued operations	**(8)**	(101)	–	–	–
Profit on sale of fixed assets – continuing operations	**–**	2	7	–	–
Profit / (loss) on ordinary activities before net financing charges	**72**	(130)	56	76	111
Net finance charges	**(8)**	(5)	(4)	8	3
Profit / (loss) on ordinary activities before taxation	**64**	(135)	52	84	114
Tax on profit / (loss) on ordinary activities	**(18)**	(13)	(29)	(37)	(39)
Profit / (loss) on ordinary activities after taxation for the financial year	**46**	(148)	23	47	75
Minority interests	**–**	–	–	–	(1)
Profit / (loss) attributable to shareholders	**46**	(148)	23	47	74
Dividends	**(166)**	(24)	(47)	(47)	(47)
Retained (losses) / earnings	**(120)**	(172)	(24)	–	27
Headline earnings per share					
– Basic – continuing operations	***31.6p***	*14.3p*	*30.3p*	*33.3p*	*30.1p*
– Basic	***31.6p***	*19.2p*	*30.3p*	*33.3p*	*30.1p*
– Diluted	***31.3p***	*19.2p*	*30.3p*	*33.1p*	*29.8p*
Earnings / (loss) per share					
– Basic – continuing operations	***30.5p***	*(20.5)p*	*9.4p*	*19.1p*	*30.1p*
– Basic	***26.0p***	*(60.7)p*	*9.4p*	*19.1p*	*30.1p*
– Diluted	***25.7p***	*(60.7)p*	*9.4p*	*19.0p*	*29.8p*
Dividend per share	***13.7p***	*12.0p*	*19.0p*	*19.0p*	*19.0p*
Net assets per share	***23p***	*102p*	*163p*	*204p*	*249p*
Net assets excluding pension liabilities per share	***62p***	*161p*	*226p*	*245p*	*249p*
*Fixed charges cover**	***1.4x***	*1.3x*	*1.4x*	*1.5x*	*1.6x*
*Dividend cover**	***2.4x***	*1.5x*	*1.5x*	*1.7x*	*1.9x*
Tax rate – continuing operations*	***25%***	*30%*	*30%*	*32%*	*30%*

** Before exceptional items and goodwill amortisation*

Notes
a) 2002 and 2001 figures have not been restated for the impact of FRS 5, Application Note G.
b) The 2002 and 2001 figures have not been restated for the adoption of UITF 38.
c) Headline earnings per share excludes exceptional items, goodwill amortisation and FRS 17 pension interest. 2001 figures have not been adjusted for pension interest.

Five Year Financial Summary

Group Balance Sheet

£m	31 August 2005	31 August 2004	31 August 2003	31 August 2002	31 August 2001
Fixed assets					
Intangible assets – goodwill	**14**	164	228	240	236
Tangible fixed assets	**231**	237	272	326	326
Investments	**–**	–	1	17	14
Total fixed assets	**245**	401	501	583	576
Current assets					
Stock	**162**	184	257	254	255
Debtors due within one year	**111**	187	204	187	180
Debtors due after more than one year	**21**	25	5	5	5
Creditors due within one year	**(346)**	(397)	(443)	(432)	(447)
Net current operating (liabilities) / assets	**(52)**	(1)	23	14	(7)
Creditors due after more than one year	**(1)**	(2)	–	(2)	(2)
Provisions for liabilities and charges	**(31)**	(38)	(27)	(25)	(23)
Operating capital employed	**161**	360	497	570	544
Net (debt) / cash	**(48)**	45	68	44	75
Net assets excluding pension liabilities	**113**	405	565	614	619
Net pension liabilities	**(71)**	(149)	(156)	(104)	–
Total net assets	**42**	256	409	510	619
Return on operating capital employed	*50%*	*20%*	*20%*	*19%*	*24%*
Average number of shares in issue (millions)	*185*	*251*	*250*	*250*	*249*

Notes
a) The 2002 and 2001 figures have not been restated for the adoption of UITF 38.
b) It has not been practicable to restate comparative year 2001 for FRS 17 'Retirement benefits'.

Five Year Financial Summary

Group Cash Flow Statement

£m	12 months to 31 August 2005	31 August 2004	31 August 2003	31 August 2002	31 August 2001
Cash flow from operating activities	**(22)**	48	135	128	165
Returns on investments and servicing of finance	**(3)**	(4)	(4)	8	3
Taxation	**(4)**	(10)	(32)	(36)	(38)
Purchase of fixed assets	**(32)**	(49)	(47)	(66)	(68)
Disposal of tangible fixed assets	**2**	5	26	2	2
Cash flow from capital expenditure and financial investment	**(30)**	(44)	(21)	(64)	(66)
Cash flow from acquisitions and disposals	**212**	31	(1)	(18)	(51)
Dividends paid	**(21)**	(42)	(47)	(47)	(48)
Cash flow before financing	**132**	(21)	30	(29)	(35)
Premium on issue of shares	**2**	–	2	2	3
Purchase of shares for employee share schemes	**(12)**	–	(10)	(3)	(13)
Money returned to ESOP Trust after share capital reorganisation	**5**	–	–	–	–
Repurchase of own shares	**(62)**	–	–	–	(9)
Non equity dividend	**(143)**	–	–	–	–
Increase / (decrease) in debt*	**60**	(3)	(32)	(9)	34
Cash flow from financing	**(150)**	(3)	(40)	(10)	15
Decrease in cash	**(18)**	(24)	(10)	(39)	(20)

** Includes finance leases (net of financing costs)*

Analysis of net funds movement

£m	12 months to 31 August 2005	31 August 2004	31 August 2003	31 August 2002	31 August 2001
Profit before tax, exceptional items and goodwill amortisation	**73**	67	102	117	133
Depreciation and other amounts written off fixed assets	**42**	46	49	52	47
Movement in working capital	**4**	(27)	(8)	(28)	(9)
Capital expenditure on fixed assets	**(32)**	(49)	(47)	(66)	(68)
Disposal of tangible fixed assets	**–**	–	1	2	2
Tax paid (before receipt of tax refund relating to exceptional items)	**(4)**	(21)	(32)	(36)	(38)
Provisions	**(5)**	(4)	(4)	(3)	(3)
Free cash flow (before dividends and investment activity)	**78**	12	61	38	64
Dividends	**(21)**	(42)	(47)	(47)	(48)
Adjustment for pension funding	**(130)**	(25)	(6)	1	–
Premium on issue of shares	**2**	–	2	2	3
Sale and leaseback proceeds	**2**	5	25	–	–
Net disposal proceeds	**212**	42	–	2	–
Acquisitions	**–**	–	(2)	(22)	(51)
Purchase of own shares	**(74)**	–	(10)	(3)	(22)
Return of cash to shareholders	**(138)**	–	–	–	–
Cash outflow relating to exceptional operating items	**(9)**	(2)	(2)	(3)	–
(Cash) / debt in subsidiaries disposed / acquired	**–**	(11)	1	2	6
Bank fees	**(2)**	–	–	–	–
New finance leases	**(13)**	–	–	–	–
Currency translation movements	**–**	(2)	2	(1)	–
Net funds movement	**(93)**	(23)	24	(31)	(48)
Opening net funds	**45**	68	44	75	123
Closing (debt) / net funds	**(48)**	45	68	44	75

Five Year Financial Summary

Segmental Analysis of Group Turnover and Group Operating Profit / (Loss)

Segmental analysis of Group turnover

£m	31 August 2005	31 August 2004	12 months to 31 August 2003	31 August 2002	31 August 2001
Retailing					
High Street Retail	**1,112**	1,152	1,172	1,195	1,128
Travel Retail	**311**	301	291	306	287
Total Retailing businesses	**1,423**	1,453	1,463	1,501	1,415
WHSmith News Distribution	**1,187**	1,182	1,115	1,069	1,024
Internal turnover	**(113)**	(115)	(109)	(107)	(103)
WHSmith News Distribution	**1,074**	1,067	1,006	962	921
Turnover – continuing operations	**2,497**	2,520	2,469	2,463	2,336
Discontinued operations:					
USA Travel Retail	**–**	49	181	216	245
Aspac Retail	**–**	132	149	138	39
Retailing businesses	**–**	181	330	354	284
Publishing business	**14**	155	143	138	131
Internal turnover	**(3)**	(22)	(22)	(19)	(16)
Publishing business	**11**	133	121	119	115
Turnover – discontinued operations	**11**	314	451	473	399
Group turnover	**2,508**	2,834	2,920	2,936	2,735

Notes
a) 2002 and 2001 figures have not been restated for the impact of FRS 5, Application Note G.
b) On 1 September 2004 WHSmith Online business was integrated into the High Street Retail business and the turnover in the years 2001 to 2004 have been restated accordingly.

Segmental analysis of Group operating profit / (loss)

£m	31 August 2005	31 August 2004	12 months to 31 August 2003	31 August 2002	31 August 2001
Retailing					
High Street Retail	**43**	23	71	76	71
Travel Retail	**26**	21	19	21	20
Total Retailing businesses	**69**	44	90	97	91
News Distribution	**37**	35	32	29	26
Connect2U	**–**	–	–	(2)	(3)
Trading profit	**106**	79	122	124	114
Support functions	**(16)**	(15)	(14)	(14)	(12)
Internal rents	**1**	1	3	4	3
Net pension costs	**(10)**	(14)	(12)	(12)	–
Operating profit before exceptional items and goodwill amortisation – continuing operations	**81**	51	99	102	105
Exceptional items and goodwill amortisation	**(1)**	(93)	(20)	(1)	(10)
Operating profit / (loss) – continuing operations	**80**	(42)	79	101	95
Discontinued operations:					
USA Travel Retail	**–**	(5)	(16)	(16)	11
Aspac Retail	**–**	7	5	5	(2)
Retailing businesses	**–**	2	(11)	(11)	9
Publishing business	**–**	20	19	19	16
Net pension costs	**–**	(1)	(1)	(1)	
Operating profit before exceptional items and goodwill amortisation – discontinued operations	**–**	21	7	7	25
Exceptional items and goodwill amortisation	**–**	(10)	(37)	(32)	(9)
Operating profit / (loss) – discontinued operations	**–**	11	(30)	(25)	16
Group operating profit / (loss)	**80**	(31)	49	76	111

Note
a) On 1 September 2004 WHSmith Online business was integrated into the High Street Retail business and the results in the years 2001 to 2004 have been restated accordingly.

Information for Shareholders

Company Secretary and Registered Office
Ian Houghton, WH Smith PLC, Greenbridge Road, Swindon, Wiltshire SN3 3RX. Telephone 01793 616161.

WH Smith PLC is registered in England and Wales (Number 471941).

Company website
This annual report and accounts together with other information can be found on the WH Smith PLC website at www.whsmithplc.com.

Annual General Meeting
The Annual General Meeting will be held at the CBI Conference Centre, Centre Point, 103 New Oxford Street, London WC1A 1DU on Thursday 2 February 2006 at 11.30am. The Notice of Annual General Meeting on pages 78 to 84 inclusive sets out the business to be transacted. Ordinary shareholders who wish to attend the meeting should detach the Attendance Card from the Form of Proxy and present it at the Registrar's desk on arrival.

Form of Proxy
A Form of Proxy is enclosed for those ordinary shareholders unable to attend the Annual General Meeting. To be effective it must be completed and lodged with the Company's Registrar, Lloyds TSB Registrars, by not later than 11.30am on 31 January 2006.

Electronic proxy voting
You may if you wish register the appointment of a proxy for the meeting electronically, by logging onto the website www.sharevote.co.uk. Full details of the procedure are given on the website. You will need to have your Form of Proxy to hand when you log on as it has information required in the process. CREST members may appoint a proxy electronically via Lloyds TSB Registrars (ID 7RA01).

Registrar
If you have any enquiries about your shareholding in WH Smith PLC or wish to advise of a change of address, please contact Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA (telephone 0870 600 3970). A textphone facility for shareholders with hearing difficulties is available by telephoning 0870 600 3950. In addition, Lloyds TSB Registrars provide a range of shareholder information online at www.shareview.co.uk (to register for this service you will need your shareholder account number which can be found on the Form of Proxy).

Summary annual report and accounts
To achieve cost savings, the Company will produce a summary annual report and accounts for 2006 and future years. You will receive the summary annual report and accounts unless you elect, by completing and returning the enclosed card (which for ordinary shareholders is attached to the Form of Proxy), to continue to receive the full annual report and accounts.

Electronic communications
If you wish to receive future WH Smith annual and interim reports electronically rather than in paper format, you can arrange this at www.shareview.co.uk.

Financial calendar

Financial year end	31 August 2005
Results announced	13 October 2005
Annual report posted	late November 2005
Final dividend ex-dividend date	4 January 2006
Final dividend record date	6 January 2006
Christmas trading statement	mid-January 2006
AGM	2 February 2006
Final dividend payment date	7 February 2006
Half-year end	28 February 2006
Interim results announced	12 April 2006
Interim dividend ex-dividend date	17 May 2006
Interim dividend record date	19 May 2006
Interim dividend payment date	15 June 2006
Financial year end	31 August 2006
Results announced	12 October 2006

a) The dividend dates shown above are in respect of the Company's ordinary shares of $2^{13}/_{81}$p.
b) Dividends in respect of the non-cumulative redeemable preference shares of $53^{3}/_{4}$p ('B' shares) and non-cumulative preference shares of 85p ('C' shares) are paid on 28 February and 31 August.

Share dealing services
The Company has arranged for Shareview Dealing, a telephone and internet share dealing service offered by Lloyds TSB Registrars, to be made available to UK shareholders wishing to buy or sell the Company's shares. For telephone dealing call 0870 850 0852 between 8.30am and 4.30pm, Monday to Friday, and for internet dealing log on to www.shareview.co.uk/dealing. You will need your shareholder reference number shown on your share certificate.

JPMorgan Cazenove provides a postal share dealing service for private investors who wish to buy or sell the Company's shares. Further details are available from JPMorgan Cazenove, telephone 020 7155 5155.

ShareGIFT
If you only have a small number of shares which are uneconomic to sell, you may wish to consider donating them to charity under ShareGIFT, a charity share donation scheme administered by the Orr Mackintosh Foundation. A ShareGIFT transfer form may be obtained from Lloyds TSB Registrars. Further information about the Scheme can be found on the ShareGIFT website at www.sharegift.org.

Information for Shareholders continued

UK Capital Gains Tax
Capital reorganisation 27 September 2004

If you acquired your shareholding on or before 24 September 2004, in order to calculate any chargeable gains or losses arising on the disposal of shares after 24 September, the original tax base cost of your ordinary shares of $55\frac{5}{9}$p (adjusted if you held your shares as at 22 May 1998 to take into account the capital reorganisation of 26 May 1998 (see below)) will have to be apportioned between the shareholdings of ordinary shares of $2\frac{13}{81}$p and 'C' shares resulting from the capital reorganisation.

The cost of your shareholding of ordinary shares of $2\frac{13}{81}$p is calculated by multiplying the original base cost of your ordinary shares of $55\frac{5}{9}$p (adjusted where necessary to take into account the capital reorganisation of 26 May 1998 referred to above) by 0.73979.

The cost of the 'C' shares is calculated by multiplying the original base cost of your ordinary shares of $55\frac{5}{9}$p (again adjusted where necessary, to take into account the capital reorganisation of 26 May 1998 referred to above) by 0.26021.

Capital reorganisation 26 May 1998

If you acquired your shareholding on or before 22 May 1998, in order to calculate any chargeable gains or losses arising on the disposal of shares after 22 May 1998, the original tax base cost of your ordinary shares of 50p will have to be apportioned between the shareholdings of ordinary shares of $55\frac{5}{9}$p and redeemable 'B' shares resulting from the capital reorganisation.

The cost of your shareholding of ordinary shares of $55\frac{5}{9}$p is calculated by multiplying the original cost of your ordinary shares of 50p by 0.90714.

The cost of the 'B' shares is calculated by multiplying the original cost of your ordinary shares of 50p by 0.09286.

March 1982 values

31 March 1982 base values per share:

	'A' ordinary shares	Arising from an original shareholding of 'B' ordinary shares
Ordinary shares of $2\frac{13}{81}$p	88.55p	73.17p
'B' shares	7.94p	6.56p
'C' shares	22.42p	18.53p
$5\frac{3}{4}$ per cent cumulative preference shares of £1 each		42.50p
$5\frac{1}{8}$ per cent redeemable unsecured loan stock		£33.25

Notice of Annual General Meeting

This Notice and the explanatory statements which follow it are important. If you are in any doubt about their contents or the action you should take, you should consult your stockbroker, bank manager, solicitor, accountant or other professional adviser authorised pursuant to the Financial Services and Markets Act 2000. If you have sold or transferred all your shares in WH Smith PLC you should pass this Notice and other enclosures to the person through whom the sale or transfer was effected for transmission to the purchaser or transferee.

Notice is hereby given that the fifty-seventh Annual General Meeting ('AGM') of WH Smith PLC (the 'Company') will be held at the CBI Conference Centre, Centre Point, 103 New Oxford Street, London WC1A 1DU on Thursday 2 February 2006 at 11.30am for the following purposes:

Ordinary business – ordinary resolutions
Report and accounts

Resolution 1: to receive the accounts and reports of the directors and auditors for the year ended 31 August 2005.

Remuneration report

Resolution 2: to approve the directors' remuneration report for the year ended 31 August 2005.

Dividend

Resolution 3: to declare a final dividend of 9.2p per share on the ordinary shares.

Directors

Resolution 4: To elect Mike Ellis as a director of the Company.

Mike Ellis joined the Board in March 2005 and is Chairman of the Audit Committee. He has extensive financial experience, having been the Group Finance Director of HBOS plc from 2001 to 2004.

Resolution 5: To elect Luke Mayhew as a director of the Company.

Luke Mayhew joined the Board in July 2005 and is a member of the Audit and Remuneration Committees. He has extensive retail and services experience, having been the Managing Director of John Lewis from 2000 to 2004.

Resolution 6: To elect Alan Stewart as a director of the Company.

Alan Stewart joined the Board in March 2005 and is Group Finance Director. He has extensive financial experience and strong operational skills, having previously held a number of senior positions with Thomas Cook, most recently as Chief Executive of Thomas Cook UK Ltd.

Auditors

Resolution 7: to re-appoint Deloitte & Touche LLP as auditors and authorise the Board to determine their remuneration.

Special business – ordinary resolutions
Authority to make political donations

Resolution 8: to resolve that the Company be and is hereby generally and unconditionally authorised to make donations to EU political organisations and to incur EU political expenditure (each as defined in Part XA of the Companies Act 1985 (as amended) ('CA 1985')) in an aggregate amount not exceeding £50,000. The authority conferred by this resolution will expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier.

Resolution 9: to resolve that WH Smith Retail Limited be and is hereby generally and unconditionally authorised to make donations to EU political organisations and to incur EU political expenditure (each as defined in Part XA of CA 1985) in an aggregate amount not exceeding £50,000. The authority conferred by this resolution will expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier.

Resolution 10: to resolve that WH Smith Trading Limited be and is hereby generally and unconditionally authorised to make donations to EU political organisations and to incur EU political expenditure (each as defined in Part XA of CA 1985) in an aggregate amount not exceeding £50,000. The authority conferred by this resolution will expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier.

WH Smith 2004 L-TIP

Resolution 11: to resolve that the directors be and are hereby authorised to amend the rules of the WH Smith 2004 L-TIP (the 'L-TIP') so as to increase, from 100 to 200 per cent of a participant's basic annual salary, the limit which, save in exceptional circumstances, shall apply to the value of shares in the Company over which awards may be made to a participant in any year (taking into account the value of shares over which any options may be granted to such participant in that year under the WH Smith Executive Share Option Scheme 1999).

Authority to allot shares

Resolution 12: to resolve that the directors be and are hereby generally and unconditionally authorised, pursuant to Section 80 of CA 1985, to exercise all powers of the Company to allot relevant securities (within the meaning of Section 80(2) of CA 1985) up to an aggregate nominal amount of £1,303,149. This authority will expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier, save that the Company may before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the directors may allot relevant securities in pursuance of such offer or agreement as if the authority conferred hereby had not expired.

Special business – special resolutions
Disapplication of pre-emption rights

Resolution 13: to resolve that, subject to the passing of Resolution 12, the directors be and are hereby granted power pursuant to Section 95(2) of CA 1985 to allot equity securities (within the meaning of Section 94(2) of CA 1985) for cash pursuant to the general authority conferred by Resolution 12 as if Section 89(1) of CA 1985 did not apply to such allotment, provided that the power conferred by this resolution:

a) is limited to:
   i) the allotment of equity securities in connection with a rights issue in favour of ordinary shareholders where the equity securities are offered to the ordinary shareholders in the proportions (as nearly as may be) in which they hold ordinary shares but subject to such exclusions or other arrangements as the directors may deem necessary or expedient in relation to fractional entitlements or legal or practical problems arising under the laws or requirements of any regulatory body or any stock exchange or otherwise in any territory; and
   ii) the allotment of equity securities for cash otherwise than pursuant to paragraph i) up to an aggregate nominal amount of £195,472; and
b) will expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier, save that the Company may before such expiry make an offer or agreement which would or might require equity securities to be allotted after such expiry and the directors may allot such equity securities in pursuance of such offer or agreement as if the power hereby conferred had not expired.

Market purchases of ordinary shares

Resolution 14: to resolve that in accordance with Article 42 of the Company's Articles of Association and Section 166 of CA 1985, the Company be and is hereby generally and unconditionally authorised to make market purchases (within the meaning of Section 163(3) of CA 1985) of any of its own ordinary shares in such manner and on such terms as the directors may from time to time determine provided that:

a) the maximum aggregate number of ordinary shares authorised to be purchased is 18,095,163;
b) the minimum price which may be paid for each ordinary share is $2\frac{13}{81}$p (exclusive of all expenses);
c) the maximum price which may be paid for each ordinary share is an amount (exclusive of all expenses) equal to the higher of:
   i) 105 per cent of the average of the middle market quotations for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the ordinary share is contracted to be purchased;
   ii) the price of the last independent trade in the Company's ordinary shares on the London Stock Exchange; and
   iii) the highest current independent bid for the Company's ordinary shares on the London Stock Exchange at the time of the purchase; and
d) the authority shall, unless previously varied, revoked or renewed, expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier, save that the Company shall be entitled under such authority to make at any time before such expiry any contract to purchase its own shares which will or might be executed wholly or partly after such expiry.

Market purchases of 'C' shares
Resolution 15: to resolve that in accordance with Article 3B(D)(a) of the Company's Articles of Association and Section 166 of CA 1985, the Company be and is hereby generally and unconditionally authorised to make market purchases (within the meaning of Section 163(3) of CA 1985) of non-cumulative preference shares of 85p each in the capital of the Company ('C' shares) in such manner and on such terms as the directors may from time to time determine provided that:
a) the maximum number of 'C' shares authorised to be purchased is 9,693,148;
b) the minimum price which may be paid for each 'C' share is 5p (exclusive of all expenses);
c) the maximum price which may be paid for each 'C' share is the amount (exclusive of all expenses) to which the holder of such 'C' share would be entitled were the Company to be wound up on the date of purchase; and
d) the authority shall, unless previously varied, revoked or renewed, expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier, save that the Company shall be entitled under such authority to make at any time before such expiry any contract to purchase its own shares which will or might be executed wholly or partly after such expiry.

Off-market purchase of deferred shares
Resolution 16: to resolve that the terms of the proposed contract between (1) Ian Houghton acting on behalf of all holders of deferred shares of 85p each in the capital of the Company ('deferred shares') pursuant to Article 3B(G)(f)(i) of the Company's Articles of Association and (2) the Company providing for the purchase by the Company of all of its deferred shares (a draft of which has been produced to this meeting and signed for identification by the Chairman thereof) be and are hereby approved and authorised for the purposes of Section 164 of CA 1985 and otherwise but so that such approval and authority shall expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier.

Indemnification of directors
Resolution 17: to resolve that the Articles of Association of the Company be and are hereby amended by the deletion of the existing Article 137 and its replacement with the following:
'137(a) Subject to the provisions of, and so far as may be permitted by and consistent with, the Act, every director of the Company may be indemnified by the Company out of its own funds against (a) any liability incurred by or attaching to him in connection with any negligence, default, breach of duty or breach of trust by him in relation to the Company other than (i) any liability to the Company or any associated company (as defined in Section 309A(6) of the Act) and (ii) any liability of the kind referred to in Sections 309B(3) or (4) of the Act; and (b) any other liability incurred by or attaching to him in the actual or purported execution and/or discharge of his duties and/or the exercise or purported exercise of his powers and/or otherwise in relation to or in connection with his duties, powers or office. Where a director is indemnified against any liability in accordance with this Article 137(a), such indemnity shall extend to all costs, charges, losses, expenses and liabilities incurred by him in relation thereto.
137(b) Without prejudice to paragraph 137(a) above, the directors shall have power to purchase and maintain insurance for or for the benefit of (i) any person who is or was at any time a director of any Relevant Company (as defined in paragraph 137(c) below), or (ii) any person who is or was at any time a trustee of any pension fund or employees' share scheme in which employees of any Relevant Company are interested, including (without prejudice to the generality of the foregoing) insurance against any liability incurred by or attaching to him in respect of any act or omission in the actual or purported execution and/or discharge of his duties and/or in the exercise or purported exercise of his powers and/or otherwise in relation to his duties, powers or offices in relation to any Relevant Company, or any such pension fund or employees' share scheme (and all costs, charges, losses, expenses and liabilities incurred by him in relation thereto).
137(c) For the purpose of paragraph 137(b) above "Relevant Company" shall mean the Company, any holding company of the Company or any other body, whether or not incorporated, in which the Company or such holding company or any of the predecessors of the Company or of such holding company has or had any interest whether direct or indirect or which is in any way allied to or associated with the Company, or any subsidiary undertaking of the Company or of such other body.
137(d) Subject to the provisions of and so far as may be permitted by the Act, the Company (i) may provide a director with funds to meet expenditure incurred or to be incurred by him in defending any criminal or civil proceedings or in connection with any application under the provisions mentioned in Section 337A(2) of the Act and (ii) may do anything to enable a director to avoid incurring such expenditure, but so that the terms set out in Section 337A(4) of the Act shall apply to any such provision of funds or other things done.'

By Order of the Board
Ian Houghton
Company Secretary
13 October 2005

Registered Office:
Greenbridge Road, Swindon, Wiltshire SN3 3RX

Special business – explanatory notes
Authority to make political donations: Resolutions 8–10
Part XA of CA 1985, amongst other things, prohibits the Company and its subsidiaries making donations to EU political organisations of more than £5,000 in any 12 month period unless they have been authorised to make donations by the Company's shareholders. The Company has no intention of making donations to political parties.

However, CA 1985 defines EU political organisations widely. It includes organisations which carry on activities which are capable of being reasonably regarded as intended to affect public support for a political party in any EU Member State or to influence voters in relation to any referendum in any EU Member State. As a result, it is possible that the definition may include bodies, such as those concerned with policy review and law reform or with the representation of the business community or sections of it, which the Company may see benefit in supporting.

Accordingly, the Company wishes to ensure that neither it nor its principal trading subsidiary companies inadvertently commits any breaches of CA 1985 through the undertaking of routine activities, which would not normally be considered to result in the making of political donations. The Resolutions authorise donations and political expenditure up to an aggregate amount not exceeding £50,000 for each company in the period up to the Company's next AGM or 1 May 2007, whichever is the earlier. As required by CA 1985, the resolutions are in general terms and do not purport to authorise particular donations.

WH Smith 2004 L-TIP: Resolution 11
This Resolution seeks your approval to authorise the Remuneration Committee of the directors of the Company (the 'Committee') to amend the WH Smith 2004 L-TIP (the 'L-TIP'). The Company presently operates three distinct long term executive share incentive plans: the WH Smith Executive Share Option Scheme 1999 (the 'ESOS'), the L-TIP and the WH Smith 2004 Management Investment Plan (the 'MIP'). No further awards will be made under the MIP. The initial market value of shares over which awards may be made to a participant each year under the ESOS and the L-TIP is limited by reference to a percentage of the rate of basic annual salary payable to that participant at the time of the award. Presently, this is 200 per cent in the case of an option under the ESOS and 100 per cent in the case of an award under the L-TIP. This Resolution, if passed, will authorise the directors to increase that limit to 200 per cent in the case of an L-TIP award. Awards may be made under the L-TIP in excess of these limits, but only if the Committee considers the circumstances to be exceptional.

The Committee undertook a review of senior executive long term incentive arrangements during 2005 and concluded that its existing policy is no longer appropriate. In reaching this conclusion, it took into consideration the need to continue to provide senior executives with long term incentive opportunities that are strongly linked to ongoing business strategy and competitive with the marketplace. In addition, it recognised the need to retain the key executives following the expiration of the MIP.

To meet these goals in the current year, the Committee intends to make awards to executive directors and other key senior executives only under the L-TIP. After the current year it retains the discretion to make awards under both the L-TIP and ESOS provided that, except in exceptional circumstances, it will not make awards under either or both plans that exceed an expected value of 200 per cent of base salary in any year without the prior approval of shareholders.

Performance targets
Award shares under the L-TIP will vest in full only if the Company achieves stretching performance conditions relating to a fixed three year period (the Performance Period). Following extensive consultation with shareholders, the Committee adopted a combination of financial and market based measures for the purposes of the MIP and, in relation to awards under the L-TIP, is likewise of the view that such a combination of targets is best suited to the needs of the Company and its shareholders.

Accordingly, the performance conditions for L-TIP awards made in the financial year ending 31 August 2006 will be as follows:

The performance condition applying to half of the award shares will be based on a range of stretching targets relating to real growth in the adjusted earnings per share of the Company over the Performance Period (the 'Earnings Tranche'). The performance condition applying to the remaining half of such an award will be based on the Company's Total Shareholder Return ('TSR') performance against those other companies which comprise the General Retailers Sector of the FTSE All Share Index over the Performance Period (the 'TSR Tranche').

Award shares in the Earnings Tranche will vest if the following targets are achieved, as set out in the table below:

Annual rate of growth in Adjusted Earnings per Share (compounded annually) in excess of growth in RPI over the Performance Period	Proportion exercisable
Below 3%	Zero
3%	30%
9% or more	100%
Between the above points	Pro rata between 30% and 100%

For these purposes Adjusted Earnings per Share will be determined by reference to fully diluted earnings per share before goodwill amortisation, exceptional items and FRS 17 pension interest adjusted as considered appropriate by the Committee to ensure that a consistent approach is taken to such measurement of earnings per share, particularly in the transition period to international accounting standards.

The half of the award based on TSR will vest as set out in the table below:

TSR performance ranking at end of Performance Period	Proportion exercisable
Below median	Zero
Median	30%
Upper quartile	100%
Between the above points	Pro rata between 30% and 100%

The TSR of the comparator companies will be measured over a fixed three year period. The TSR figures for each company will be averaged over a three month period preceding the beginning and the end of the Performance Period.

The Committee will review these conditions each year and, if appropriate, consult with major shareholders before changing the performance targets to be set in relation to awards made in that year, to ensure that the targets are both realistic and stretching, and will afford real incentives to enhanced performance of the Company and growth in shareholder value.

It is intended that, in this year only, awards under the L-TIP will also be made within the period of 42 days immediately following the conclusion of the 2006 AGM.

A copy of the L-TIP rules marked to show the amendment proposed to be made is available for inspection at the registered office of the Company during normal business hours on any weekday, except Saturdays and public holidays, until 2 February 2006 and will also be available for inspection at the place of the AGM on 2 February 2006 for at least 15 minutes prior to and during the meeting.

Authority to allot shares: Resolution 12
Under Section 80 of CA 1985 the directors of a company may only allot unissued shares if authorised to do so by the shareholders in general meeting. This Resolution, if passed, will authorise the directors to allot unissued shares up to an aggregate nominal amount of £1,303,149, representing approximately one-third of the Company's issued ordinary share capital as at 13 October 2005. The authority will expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier. Although the directors have no present intention of exercising this authority, except for the purposes of allotting shares under the Company's employee share schemes, it is considered prudent to maintain the flexibility it provides.

Disapplication of pre-emption rights: Resolution 13
If shares are allotted for cash using the authority given by Resolution 12, Section 89 of CA 1985 requires that those shares are offered first to existing shareholders in proportion to the number of shares they already hold. This Resolution would renew for a further year, pursuant to Section 95 of CA 1985, the authority of the directors to allot equity securities for cash without first offering them to existing shareholders. The authority (other than in relation to a rights issue) would be limited to the issue of equity securities up to a maximum nominal amount of £195,472, which is equal to approximately 5 per cent of the Company's issued ordinary share capital as at 13 October 2005, and will expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier.

Market purchases of ordinary shares: Resolution 14
The Board considers that it would be in the best interests of the Company and its shareholders to renew for a further year the existing authority granted at the Annual General Meeting on 27 January 2005 to allow the Company to purchase its own ordinary shares in the market.

In considering the purchase by the Company of its own ordinary shares, the directors will follow the procedures laid down in CA 1985 and will take into account cash resources, capital requirements and the effect of any purchase on appropriate gearing levels. They will only exercise the authority when satisfied that it is in the best interests of the Company to do so and when it would result in an increase in earnings per share.

The proposed authority would be limited to purchases of up to 18,095,163 ordinary shares, which is equal to approximately 10 per cent of the Company's issued ordinary share capital as at 13 October 2005, made through the London Stock Exchange at prices not exceeding the higher of 105 per cent of the average of the middle market quotations as derived from the London Stock Exchange Daily Official List for the five business days before each purchase, the price of the last independent trade in the shares on the London Stock Exchange at the time of the purchase and the highest current independent bid for the Company's ordinary shares on the London Stock Exchange at the time of the purchase.

The directors wish to emphasise that the maximum number of ordinary shares and the price range are stated merely for the purposes of compliance with statutory and the UK Listing Authority requirements in seeking this authority and should not be taken as any representation of the terms upon which the Company may make purchases.

As at 30 September 2005, being the last practicable date prior to publication of this Notice, there were outstanding 13,845,907 options to subscribe for ordinary shares, representing 7.7 per cent of the Company's issued ordinary share capital. If the authority was exercised in full, the options would represent 8.5 per cent of the Company's issued ordinary share capital.

Prior to 1 December 2003, any shares purchased in this way would have been cancelled and the number of shares in issue reduced accordingly. However, the Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 have altered the position to permit shares purchased by the Company out of distributable profits to be held as Treasury Shares which may be cancelled, sold for cash or transferred for the purposes of the Company's employee share schemes. The Company currently holds no Treasury Shares, and it is not intended that any shares purchased pursuant to this authority will be held in treasury.

The authority will expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier.

Market purchases of 'C' shares: Resolution 15
At the time of the disposal of Hodder Headline Limited by the Company in September 2004, the Company created the 'C' shares as a means of returning capital to its shareholders. Most of these 'C' shares were either repurchased by the Company or converted into deferred shares following a bonus dividend payment (the 'Initial 'C' Share Dividend') on 27 October 2004. However, some 'C' shares remain in issue as a number of shareholders did not elect to have them repurchased or to receive the Initial 'C' Share Dividend.

The Board considers that it would be in the best interests of the Company and its shareholders to renew for a further year the existing authority granted at the Extraordinary General Meeting on 23 September 2004 to allow the Company to purchase its own 'C' shares in the market.

In considering any such purchase by the Company of its own 'C' shares, the directors will take into account cash resources, capital requirements and the effect of any purchase on appropriate gearing levels. They will only exercise the authority when satisfied that it is in the best interests of the Company to do so.

The proposed authority would permit purchases of any or all of the 'C' shares at prices not exceeding the amount to which the holder of a 'C' share would be entitled were the Company to be wound up on the date of purchase (being the nominal value of 85p plus any accrued dividend).

The directors wish to emphasise that the maximum number of 'C' shares and the price range are stated merely for the purposes of compliance with statutory requirements in seeking this authority and should not be taken as any representation of the terms upon which the Company may make purchases.

The authority will expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier.

Off-market purchase of deferred shares: Resolution 16
On 27 October 2004, those 'C' shares in respect of which the Initial 'C' Share Dividend was paid were converted into deferred shares. Under Article 3B(G)(f) of the Company's Articles of Association, the Company has authority to appoint any person to execute on behalf of the holders of the deferred shares a transfer to the Company of all the deferred shares for a total of 1p. However, this Article is subject to CA 1985, and Section 164 CA 1985 requires that the terms of the contract, which provides for the purchase of the entire class of deferred shares for a total of 1p by the Company, be approved by special resolution.

The Company has decided that it will appoint Ian Houghton, the Company Secretary, to execute this transfer on behalf of the holders of all the deferred shares.

A copy of this contract is available for inspection at the registered office of the Company during normal business hours on any weekday, except Saturdays and public holidays, until 2 February 2006 and will also be available for inspection at the place of the AGM on 2 February 2006 for at least 15 minutes prior to and during the meeting.

The authority to enter into this contract will expire at the conclusion of the next AGM of the Company or on 1 May 2007, whichever is the earlier, although it is the Company's intention to exercise this authority at the earliest possible opportunity.

Indemnification of directors: Resolution 17
In 2004, the Companies (Audit, Investigations and Community Enterprise) Act 2004 was passed by Parliament. This Act, among other things, extended the range of the indemnity which companies are permitted to give to directors. The proposed amendments to the Articles of Association of the Company bring the Articles up to date with this new law. It is the Company's intention to indemnify its directors subject to these provisions.

Recommendation
The directors consider that each of the proposals detailed in this Notice of Meeting will be of benefit to and in the best interests of the Company and the shareholders as a whole. The directors intend to vote in favour of all Resolutions in respect of their own beneficial holdings of ordinary shares in the Company and unanimously recommend other shareholders to do likewise.

Notes
1. Ordinary shareholders who are unable to attend the AGM are entitled to appoint one or more proxies to attend and, on a poll, vote on their behalf.
2. A Form of Proxy is enclosed for the use of ordinary shareholders unable to attend the meeting. Before completing the form shareholders should read the guidance notes below.
3. Any member with more than one ordinary shareholding registered in his/her name should receive only one copy of the annual report and one Form of Proxy. The Form of Proxy will be valid in respect of all his/her holdings.
4. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001, the Company specifies that only those ordinary shareholders registered in the register of members of the Company as at 6.00pm on 31 January 2006 shall be entitled to attend and vote at the meeting in respect of the number of shares registered in their names at that time. Changes to the register of members after 6.00pm on 31 January 2006 shall be disregarded in determining the right of any person to attend and vote at the AGM. Holders of preference shares, loan stock and loan notes are not entitled to attend and vote at the meeting unless they also hold ordinary shares.

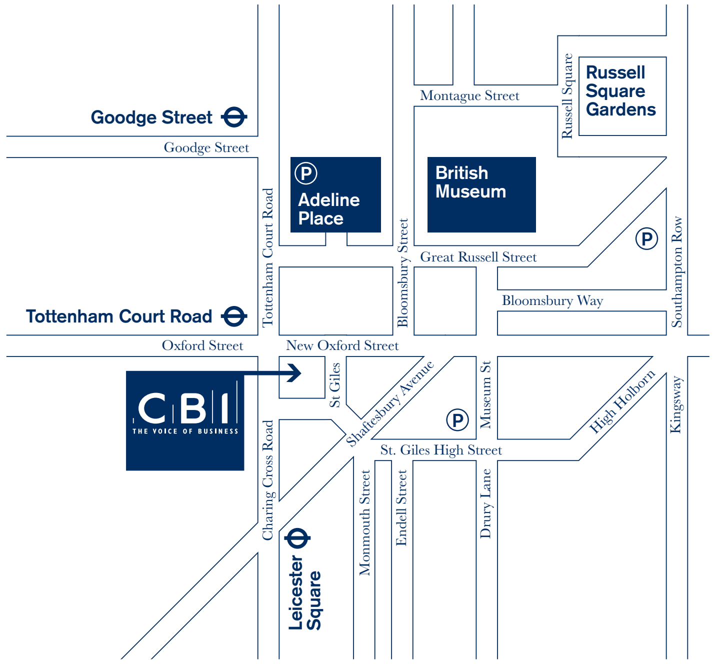
Notice of Annual General Meeting continued

5. The register of directors' interests in the share capital of the Company, a copy of the L-TIP rules marked to show the amendment proposed by Resolution 11 and the draft contract referred to in Resolution 16 are available for inspection at the registered office of the Company during normal business hours on any weekday, except Saturdays and public holidays, until 2 February 2006 and at the place of the AGM on 2 February 2006 for at least 15 minutes prior to and during the meeting.
6. Shareholders (and any proxies or representatives they appoint) agree, by attending the meeting, that they are expressly requesting and that they are willing to receive any communications (including communications relating to the Company's securities) made at the meeting.

Guidance notes for completion of Form of Proxy and electronic proxy voting

1. If you are unable to attend the AGM and wish to appoint a proxy to attend and, on a poll, vote on your behalf, please complete the enclosed Form of Proxy and return it, together with any power of attorney or other authority (or a duly certified copy of such power or authority) under which it is executed, to the Company's Registrar, Lloyds TSB Registrars, so as to be received no later than 11.30am on Tuesday 31 January 2006. A proxy need not be a shareholder of the Company and the appointment of a proxy will not prevent you from attending and voting in person.
2. You can appoint the Chairman of the Meeting, or any other person, as your proxy. If you wish to appoint someone other than the Chairman, cross out the words 'the Chairman of the Meeting or' on the Form of Proxy and insert the name of your proxy in the box provided.
3. You can instruct your proxy how to vote on each resolution on which a poll is taken by placing an 'X' in the For, Against or Vote withheld boxes, as appropriate. If you do not indicate on the Form of Proxy how your proxy should vote, he/she can exercise his/her discretion as to whether, and if so how, he/she votes on each resolution, as he/she will do in respect of any other business which may properly come before the meeting.
4. You must sign and date the Form of Proxy in the boxes provided. In the case of joint shareholders, only one need sign the Form of Proxy. The vote of the senior joint shareholder will be accepted to the exclusion of the votes of the other joint shareholders. For this purpose, seniority will be determined by the order in which the names of the shareholders appear in the register of members in respect of the joint shareholding. If the Form of Proxy is signed by someone else on behalf of the registered holder(s), the appropriate power of attorney or other authority (or a duly certified copy of such power or authority) under which it is executed must be returned with the Form of Proxy.
5. A corporation should execute the Form of Proxy under its common seal or otherwise in accordance with Section 36A of CA 1985 or by signature on its behalf by a duly authorised officer or attorney whose power of attorney or other authority should be returned with the Form of Proxy.
6. Alternatively, you can register the appointment of a proxy electronically by logging onto the website www.sharevote.co.uk, where full details of the procedure are given. You will need to have your Form of Proxy to hand when you log on as it has information required in the process. Electronic proxy voting instructions must be received no later than 11.30am on Tuesday 31 January 2006.
7. CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so by using the procedures described in the CREST manual. All messages relating to the appointment of a proxy or an instruction to a previously appointed proxy, which are to be transmitted through CREST, must be received by Lloyds TSB Registrars (CREST participant ID 7RA01) no later than 11.30am on 31 January 2006, or, if the meeting is adjourned, not less than 48 hours before the time fixed for the adjourned meeting.

A map of the location of the CBI Conference Centre, the venue for the AGM, is shown below. Please note that coffee and tea will be served before the meeting.



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