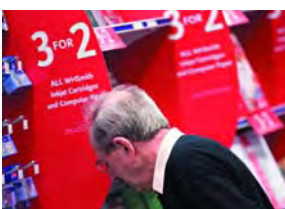
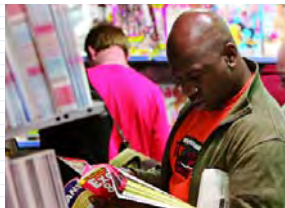
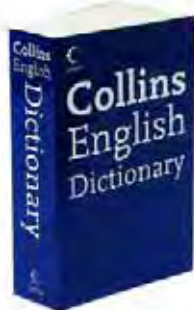
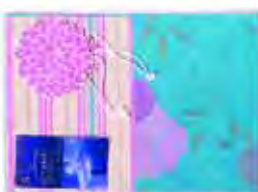
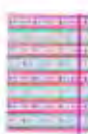


WH Smith PLC Annual Report and Accounts 2006





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The following definitions apply throughout this report unless the context requires otherwise:

'Company' means WH Smith PLC, a public limited company incorporated in England and Wales with registered number 5202036.

'Group' means the Company and its subsidiaries and subsidiary undertakings;

'Old WH Smith' means the Company formerly known as WH Smith PLC, a public limited company incorporated in England and Wales with registered number 471941 and which was the holding company of the WH Smith Group prior to the demerger;

'Smiths News' means Smiths News PLC, a public limited company incorporated in England and Wales with registered number 5195191 and which became the holding company of the WH Smith News business following the demerger;

'WH Smith Group' means Old WH Smith and its subsidiaries and subsidiary undertakings;

'WH Smith News' means the business carried on by Old WH Smith prior to the demerger and by Smiths News following the demerger of wholesaling and distributing newspapers and magazines to retailers and supplying other services to publishers and retailers; and

'WH Smith Retail business' means the business carried on by Old WH Smith prior to the demerger and by the Company following the demerger of retailing through High Street and Travel Retail outlets.

WH Smith PLC

WH Smith PLC, one of the UK's leading retail groups, is made up of two core businesses – High Street Retail and Travel Retail. Overall WHSmith employs approximately 17,000 staff across the UK. WH Smith PLC is listed on the London Stock Exchange (SMWH) and is part of the FTSE mid 250 Index. More information is available at www.whsmithplc.com.

High Street

Sales: £1,021m (2005: £1,112m)

Stores: 543 (2005: 542)

Selling Space: 3.0msf*

The High Street Retail business sells a wide range of newspapers, magazines, stationery, books and entertainment products. In addition, WHSmith Direct – www.whsmith.co.uk – serves customers on the internet 24 hours a day.

Travel

Sales: £319m (2005: £311m)

Stores: 129 (2005: 127)

Selling Space: 0.2msf*

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

* Million square feet

focused on...

shareholder value



We have made another year of good progress as we continued to focus on shareholder value creation, improving our profitability and customer offer.

Robert Walker, Chairman

I am pleased to report another year of good progress as we continued to focus on shareholder value creation, improving our profitability and customer offer. Although Group revenues were down 6 per cent at £1.3 billion, Group profit before tax and exceptional items was 31 per cent ahead of last year at £51m. The profitability¹ of our Retail business increased by 18 per cent year on year. As a result the Board is recommending a final dividend of 6.2p, reflecting the Board's confidence in the business's future prospects. This is a very creditable result in light of the retail consumer spending climate in our markets, which has remained very challenging in 2005/06.

In April, we announced our intention to separate our Retail and News businesses to allow them to benefit from greater focus on their respective strategies as independent businesses.

Full details of the demerger proposals were posted to shareholders in early July. At the shareholder meetings held at the beginning of August, all the resolutions approving the separation of our Retail and News businesses via a demerger and the share plans proposals were passed. The final stages of the demerger were completed at the end of the financial year with Smiths News PLC (formerly WHSmith News) and WH Smith PLC (formerly WHSmith Retail) beginning trading as two separate companies listed on the London Stock Exchange from 30 August 2006 and 1 September 2006 respectively.

Each separate business has in place a strong Board and management team to continue to deliver their strategies and plans. The existing Board remains with the Retail business, bringing a balance of retail, consumer and financial skills. The new Board of Smiths News PLC collectively have extensive news industry and management experience from both the sector and the wider commercial world.

Brendan Fitzmaurice, formerly Managing Director of WHSmith News, was appointed non-executive Chairman and Mark Cashmore, formerly Sales Director of WHSmith News, was appointed Chief Executive of Smiths News PLC. Non-executive directors are Dennis Millard (also Deputy non-executive Chairman and Senior Independent Director), Anthony Cann and John Worby. We wish the Smiths News Board and their colleagues every success for the future.

¹ Profit from trading operations is defined as operating profit after directly attributable share-based payment and pension service charges and before allocation of central costs, exceptional items, interest and taxation.

Chairman's Statement

Our High Street staff have maintained their focus on improving our customer offer by continuing to implement the plan we announced in July 2004, and our Travel staff have also worked hard to implement our plans to drive the growth of the Travel business.

In High Street our priorities remain unchanged – improving gross margins by building our authority in our core categories, managing the mix of products better, and tightly controlling our costs. This rigorous approach has enabled us to improve our profitability¹ by 14 per cent despite sales falling in a tough market.

In High Street we are also continuing to improve our customer offer by increasing our authority in our core categories of stationery, books, news and magazines. We have introduced new ranges and reviewed our existing ranges, particularly in stationery. We have also improved availability and we continue to change our offers and promotions so they are relevant and give customers better value.

Travel has had a strong year, delivering sales and profit¹ growth of 3 per cent and 24 per cent respectively. We have improved our ranges and managed space better, as well as developing new trial formats, such as two stationery-only stores in London's Charing Cross and London Bridge stations, and opening further stand-alone bookstores under the WHSmith Books brand. These new format stores are proving popular with customers as well as with landlords.

Our staff can be proud of these results. Over the past two years their hard work, loyalty and determination have increased WHSmith's Group profit¹ by 18 per cent from £62m to £73m. We are also proud of our improved ranking in *Business in the Community's* Corporate Responsibility Index. In two years we have moved from the fourth quartile, well outside the top 100, to a position within the top 50, confirming our view that improvements in financial performance and corporate responsibility performance can go hand in hand. We remain committed to managing our impact on society and the environment, whilst exploring the ways in which corporate responsibility can enhance our business performance.

The WHSmith Group Charitable Trust and the National Literacy Trust combined once again this year to support the Reading is Fundamental Summer Read initiative. Now in its second year, the Summer Read enabled over 2,700 children from summer play schemes in 15 locations across the UK to begin to build a love of reading and books. Children from play schemes around the country took part in a range of activities including storytelling, treasure hunts and sports activities, assisted by staff from our stores.

Looking ahead, and with the annual rate of growth in consumer spending in the UK having slowed markedly during 2005/06, we remain cautious about the outlook. On the one hand consumers' disposable incomes are being squeezed by higher interest rates and increases in utility bills and petrol prices, and on the other hand retailers continue to face higher cost inflation in areas such as business rates, rents, wages, utility and fuel bills. Inevitably, the combination of all these factors will continue to dampen the retail environment in the short to medium term.

Our plans continue to take the current downturn in consumer spending into account and I am confident that we will make good progress in implementing the initiatives we have planned to deliver further shareholder value. Thank you for your support.

Robert Walker
Chairman, WH Smith PLC
12 October 2006

focused on...

profitable growth



Following the separation of our Retail and News businesses, the WHSmith Retail business will benefit from greater focus, enabling High Street to continue the delivery of its recovery plan and Travel to continue on its growth path.

Kate Swann, Group Chief Executive

WH Smith PLC, one of the UK's leading retail groups, is made up of two core businesses – High Street and Travel. High Street sells a wide range of newspapers, magazines, stationery, books and entertainment products and Travel sells a tailored range of newspapers, magazines, books and confectionery products to meet the demands of travelling customers.

WHSmith Retail's outlets are frequently first choice for customers on the high street and we are a trusted convenience retailer for customers at travel locations. We have an extensive store portfolio spanning 543 High Street and 129 Travel locations and market-leading positions in three product categories, with market shares by value of approximately 15 per cent in books, 18 per cent in magazines and 13 per cent in stationery. Overall WHSmith Retail employs approximately 17,000 staff across the UK.

WHSmith also reaches customers via WHSmith Direct – www.whsmith.co.uk – serving customers on the internet 24 hours a day.

WH Smith PLC is listed on the London Stock Exchange (SMWH) and is part of the FTSE mid 250 Index. More information about the business is available at www.whsmithplc.com.

WH Smith PLC: corporate objectives

WHSmith intends to build on its position as the UK's most popular stationer, bookseller and newsagent by continuing to execute its High Street recovery plan and grow its strongly performing Travel business.

We aim to improve the profitability and cash flow generation of our business over a three to five year period, delivering sustainable returns. In addition we have sought to increase our dividends to shareholders annually. We believe that a concentration on these factors will be reflected in a total shareholder return that compares well with our peer group of equivalent listed companies.

We invest where we believe we will achieve a return on investment in excess of our cost of capital. While external economic and other factors might impact us in the short term, the markets we are focused on are growth sectors, which we believe will deliver sustainable returns.

To this end, in July 2004 we announced our plans to deliver value to shareholders by improving the performance of High Street. The High Street recovery plan focuses on rebuilding authority in core categories, optimising margins, controlling costs and ensuring we deliver the retail basics.

High Street is now two years into the plan and we have made good progress; in the year to 31 August 2005 trading profits¹ grew by 164 per cent to £37m, from £14m in the year to 31 August 2004. This year profits have grown further, by 14 per cent to £42m.

Travel is focused on delivering value to shareholders through organic growth in its existing outlets, securing new contracts and trialling new formats.

Travel has been performing strongly, with trading profits growing at approximately 18 per cent per annum since the 2003 financial year. In the year to 31 August 2005, Travel had revenues of £311m and trading profit of £25m. This year profits¹ have grown by 24 per cent to £31m.

We also aim to act responsibly towards all our stakeholders, including customers, suppliers, business partners, employees and the communities in which we operate. Our approach to corporate responsibility is summarised on page 19 of this report.

WH Smith PLC: progress in 2005/06

The year under review has seen further progress with the separation of our Retail and News businesses via a demerger. The separation, announced on 12 April 2006, allows both businesses to benefit from greater focus on their respective strategies as independent businesses.

Since 2003 WHSmith has undertaken a restructuring of the WHSmith Group by selling non-core assets including its Asia Pacific Retail operations, the US hotels and airports businesses and Hodder Headline Limited. Although the Retail and News businesses have operated within the WHSmith Group for a long time, because of limited operational synergies between the two businesses, the Board concluded that there was no continuing strategic logic for them to remain part of the same Group.

As a separate company, the News business will be more responsive to publisher needs and be capable of investing further in its services to publishers. Without the link to the WHSmith Retail business, the News business will also be able to work more effectively with other retailers who have previously viewed the News business as being part of a competitor's group. Furthermore, the Board concluded that the News business would be better placed to maximise its technological investments, win new business and develop new revenue streams.

As an independent listed UK retailer, the Board believes that the WHSmith Retail business will also benefit from greater focus, enabling High Street to continue the delivery of its recovery plan and Travel to continue on its growth path.

Full details of the demerger proposals were posted to shareholders on 7 July 2006 and at the shareholder meetings held on 2 August 2006, all the resolutions approving the separation of the Retail and News businesses via a demerger, and the share plans proposals, were passed by the requisite majorities. The final stages of the demerger were completed at the end of the financial year with Smiths News PLC (which holds the News business) and WH Smith PLC (which holds the Retail business) beginning trading as two separate companies listed on the London Stock Exchange from 30 August 2006 and 1 September 2006 respectively.

WHSmith High Street

Nature of business

High Street operates 543 stores. It is present in 85 per cent of the top 500 UK retailing locations and 95 per cent of its stores are in prime locations with high customer traffic.

With a presence on every significant high street in the UK, bar one, the High Street store portfolio has extensive reach across the UK. At 31 August 2006, High Street stores averaged 5,500 square feet in size, with total Retail space of over 3m square feet.

High Street sells a wide range of products, which are divided into four categories: News and Impulse (including newspapers, magazines, confectionery and other impulse products), Stationery (including greetings cards), Books, and Entertainment (including music, video and multimedia games). High Street is relatively seasonal with peaks at Christmas, Easter and in September for the 'Back to School' range.

The online retail business is operated by High Street and sells a range of books, magazines, stationery and entertainment products through its website at www.whsmith.co.uk. Books are the largest selling product, accounting for 65 per cent of all online revenue. The online business has access to 1.4m titles and is the UK's second largest online book retailer with an average of approximately 140,000 visits to the site per week.

In the year to 31 August 2006, High Street had revenues of £1.0bn, trading profit¹ of £42m and the number of employees averaged 14,221.

Markets in which we operate

The British Retail Consortium (BRC) categorises our operations (High Street and Travel) in its Other Non-Food sector. While this list is not exhaustive, Other Non-Food includes products such as books, newspapers and magazines, stationery, PC consumables, entertainment products, toys and games, DIY, gardening supplies, electrical appliances and sports and leisure equipment.

Growth drivers

High Street's performance is dependent upon overall growth in consumer spending, growth in the non-food, non-clothing market and High Street's ability to take share in its product markets.

High Street's management team believes that, following the current slowdown in consumer spending, High Street's product markets should return to more normal levels of growth over the longer term.

¹ Profit from trading operations is defined as operating profit after directly attributable share-based payment and pension service charges and before allocation of central costs, exceptional items, interest and taxation.

Competitive position

High Street faces competition in its product categories primarily from internet retailers, supermarkets and other high street specialists. Online retailers are able to offer customers access to our product categories via the internet from the convenience of their computers while supermarkets are able to offer customers access to our product categories as they do their regular food shopping.

Competitive strengths

High Street has significant competitive strengths and the Board believes it is well placed to deliver strong cash generation and long-term earnings growth to create shareholder value through its:

- Widely respected and recognised brand.
- Prime sites in key UK high street retail locations.
- High customer footfall.
- Market leading positions in its categories, allowing it to operate with scale.
- Purchasing and sourcing scale, driving value for the customer.
- Experienced senior management team.
- Integrated multi-channel offering, allowing customers to shop in-store or online as well as having products delivered to home or store.

High Street: risks and uncertainties

WHSmith's management team has identified the following factors as major potential risks to the successful performance of the business. Some, such as IT failures, are specific risks that require specific, identified actions to mitigate their effect. Others, such as the impact of competition, are areas addressed through strategic planning and operational management processes.

1) Competition in the retail industry

- High Street operates in highly competitive markets and its failure to compete effectively, in particular with internet retailers and supermarkets, may impact revenues obtained through our stores.

2) Poor economic conditions or slowdown

- As a UK retailer, High Street is sensitive to economic conditions and can be affected by conditions in the UK retail and travel markets. An outbreak of a pandemic disease (such as avian flu), an act of terrorism or war could reduce the number of customers visiting WHSmith outlets causing a decline in revenue and profit.

3) Inability to predict accurately or fulfil customer preference or demand

- The retail industry is subject to changing customer tastes. High Street's performance is dependent upon effectively predicting and responding quickly to changing consumer demands and translating market trends into saleable merchandise.

4) Seasonal fluctuations in sales

- High Street is exposed to seasonal demand for certain core categories. Christmas and Back to School are critical trading periods and therefore may be affected by depressed consumer footfall or spending, negatively impacting sales and profit.

5) Failure or interruption in product supply

- High Street has agreements with key suppliers in the UK, Europe and the Far East. The interruption or loss of supply of core category products from these suppliers to our stores may affect our ability to trade.

6) Failure or interruption of information technology systems

- In common with most retail businesses, High Street relies on a number of important IT systems. Any system performance problems could seriously affect our ability to trade.

7) Lack of new store growth opportunities

- High Street's stores are already present in most of the major high street locations across the UK. Our ability to grow through expansion of this portfolio may be limited.

8) Reliance on the WHSmith brand name

- The WHSmith brand name is an important asset. Failure to protect the WHSmith brand name, an event that materially damaged the reputation of our brand name and/or the failure to sustain its appeal to customers could have an adverse impact on revenues.

9) Cost inflation and legislative change

- WHSmith's operational costs are affected by underlying cost inflation and legislative and fiscal changes in relation to, for example, paper, packaging, fuel, utilities, rates and wages.

10) Raw material costs

- The price of WHSmith's products may be significantly affected by the cost of the raw materials used to produce the products WHSmith sells.

11) Exposure to high level lease costs, giving it operational gearing and low fixed charge coverage

- The majority of the operating leases of the former WH Smith PLC Group remain with WHSmith as they relate principally to the leases of High Street's store portfolio. The tenure of almost all of High Street's outlets is short or long leasehold with an average lease length of seven years. These are predominantly standard commercial property terms including periodic upwards-only rent reviews.
- Future increases in rent may affect the economic viability of certain High Street stores. Consequently, WHSmith is exposed to high fixed charges relative to its profits, giving it a high level of operational gearing. In the event of a downturn in sales and gross margin, these high fixed charges could exacerbate the effects of such a downturn on profits.

12) Contingent liabilities relating to reversionary leases and other risks and obligations associated with High Street properties that may have a material effect on the business, financial conditions or results

- The News business had total contingent lease liabilities of £169m as at 28 February 2006 (£23m annually at that date and reducing over time) in respect of previous assignments of leases used by various businesses of the WHSmith Group whereby the lease liability would fall to the News business if the assignee defaulted. Following the demerger, if any such contingent liability becomes an actual liability, it will be apportioned between the News and Retail businesses in the ratio 35:65 (provided that the actual liability of the News business can not exceed £5m in any 12 month period, with the Retail business assuming the excess of such a liability over £5m.

High Street: objectives and strategy

WHSmith announced its plans for improving the performance of High Street in July 2004. The plan centres on three areas: rebuilding authority in core categories, optimising margins, controlling costs and retail basics.

Rebuilding authority in core categories

Key changes include:

- Re-engineering ranges to more profitable categories. This has contributed to a reduction in sales, but has had a beneficial mixed impact on overall margins.
- Introducing more price points and new ranges and improved pricing and promotions across all categories.
- Increasing choice and availability through higher density fixtures and changes to the supply chain.
- Rebalancing space towards higher growth and more profitable product categories.

Optimising margins

Margin optimisation measures include:

- A positive shift in product mix by switching sales from low margin categories such as entertainment to higher margin categories such as stationery and books.
- An improved promotions and buying strategy.
- A lower cost of goods sold, through improving supplier terms and Far East sourcing.
- A focus on reducing shrinkage.
- A reduction of the overall stock held and more effective management of stock markdowns.

Controlling costs and retail basics

Cost control measures include:

- Increased productivity across the business.
- Improved flexibility of staff hours.
- Rationalisation of logistics through the consolidation and reconfiguration of our distribution network.
- Creation of shared IT services to improve efficiency and move towards operating common IT services across all parts of the business.
- Successful and more efficient marketing communication package launched – ‘Think WHSmith’.

High Street: operational review 2005/06

We are making good progress in the implementation of our plan to deliver value to shareholders by building on our position as Britain’s most popular stationer, bookseller, and newsagent. High Street has improved its profitability¹ by 14 per cent year on year, as we have maintained our focus on rebuilding our authority in our core categories, tightly controlling costs, optimising margins and delivering the retailing basics.

From a sales perspective the trading environment continues to be tough, with consumer spending subdued. Like for like sales for the year were down 7 per cent. However, in line with our plan, we improved gross margins in the year by 290 basis points, benefiting the business’s overall profitability.

To remain on track in the delivery of the recovery plan, and mitigate cost inflation, it is critical that we keep focused on managing our costs. For 2005/06 we targeted cost savings of £12m, revised to £18m at the interim results in April. For the full year we delivered cost savings of £22m, from areas of the business including logistics, information systems, stores and marketing.

In logistics, we completed the consolidation of our distribution network from three centres to two, completely withdrawing from one warehouse. We also reconfigured our main distribution centre in Swindon to ensure the faster flow of product through the centre and increase storage and picking capacity for the extra product relocated from our closed site. The project was delivered on time and with no disruption of service to stores, saving £2m.

We made further changes this year to our information systems to improve efficiency and move towards operating common IT services across all parts of the business where practicable. During the year we completed our systems migration by implementing a new finance system, reducing the number of data centres we operate from four to three and by removing old applications from the mainframe.

From a procurement perspective, the team has focused on delivering savings in store from a range of areas. For instance, we changed the design of our carrier bags. Our bags now have a blue WHSmith logo on a white background as opposed to the other way around. Removal of the blue dye in the polythene and changes in the bag construction have reduced the overall amount of polythene we use – good news for our costs and for the environment.

¹ Profit from trading operations is defined as operating profit after directly attributable share-based payment and pension service charges and before allocation of central costs, exceptional items, interest and taxation.

We have also improved staff productivity by removing tasks so that store staff have more time to spend helping customers. These changes include introducing faster tills so transaction times are reduced and introducing promotional sticker guns so prices can be changed faster in store.

Finally, another cost saving was achieved via the launch of a new press and TV advertising campaign for the 2005 Christmas season, entitled 'Think WHSmith'. Individual products or promotions are the heroes of the strongly branded advertisements. The campaign not only doubled the level of customer recall about WHSmith and its Christmas offer, but also delivered cost savings.

Over the year, we have also improved margins again, as planned. A significant part of the improvement in gross margin was achieved by changing the mix of products we sell – removing low margin products, such as electronics and certain entertainment merchandise, and devoting the vacated space to higher margin products such as stationery and books, where we are working to rebuild our authority as a popular specialist. We expect further mix changes to be a key driver of overall profit growth in the years to come, without relying on top line sales growth in the short or medium term.

The remaining improvement in gross margin was delivered through better management of promotions, markdowns and buying, improving shrinkage and increasing Far East sourcing.

Over Christmas, we refined our promotional strategy to improve gross margins at the same time as ensuring we were price competitive. In books for example, we ran very competitive base promotions and enhanced these promotions by running separate special weekend events. We also actively chose not to discount prices to profit-destroying levels in the two weeks prior to Christmas. On the top three Christmas books, *Sharon Osbourne – Extreme*, *Jamie Oliver – Jamie's Italy* and *John Peel – Margrave of the Marshes*, we achieved excellent market shares, demonstrating the relevance of our promotions and value for our customers.

We have also lowered our cost of goods sold by improving our buying terms further and increasing our levels of Far East sourcing. In addition, we have maintained our rigorous focus on product shrinkage and markdown management. Prior to Christmas we boosted our loss prevention team with the recruitment of additional specialists to improve process compliance that will lead to a reduction in shrink and waste. We also introduced new ink jet fixtures and storage facilities in 100 stores to reduce a key item of shrink and 320 of our stores now have non-live entertainment departments. With the clear accountabilities for stock in place centrally and in store, we also managed stock well over Christmas with markdowns under control.

We have also made good operational progress in 2005/06. The complex changes we are making, particularly to our supply chain, are vital foundations, which will allow us to rebuild our authority as a specialist retailer in our core categories in the months to come.

During the year we examined the end-to-end supply chain to ascertain the most profitable place to hold stock and the level of stock to hold in all categories. Consequently, in both books and entertainment we have reduced the intake-to-sales ratio for both new and promotional titles and increased the efficiency of returning stock to suppliers. In addition, in stationery we have improved forecasting and replenishment methods to reduced our overall stock holding and in all stores we have reduced the level of stock in the stock room while improving on-shelf availability.

In books we have made further changes to the supply chain to allow stores to carry additional ranges at no additional stock holding cost. Each month the books team introduces approximately 1,000 new titles so we have invested £1.5m in new IT systems to manage our specialist book ranges more effectively. The new-line management system was implemented successfully in April. The aim is to reduce the number of late titles that arrive in store, thereby improving our inventory, space management for fast sellers and the exit of slow stock. The new-line system also enables us to be certain of having the right products for customers in store at the time they want to buy them.

We have also worked closely with publishers and distributors on the Industry Returns Initiative (IRI) to remove cost and inefficiency in the books return supply chain. Under the IRI, book return requests are now processed within 24 hours or less as opposed to non-IRI requests, which can take up to a month to be processed. 78 per cent of all High Street returns are now processed under the IRI, delivering improved planning and forecasting, as well as reducing costs.

With a stronger supply infrastructure in place, we have begun to carry out in-depth analysis at a sub-category level to improve performance and our authority. In Children's Books for example, we reviewed the entire range architecture, some 7,500 titles, to ensure our offer is completely relevant. Seasonality in the Children's Books category is also important so we now have more flexible space so we can expand or contract ranges between fiction and education, depending on the time of year. We have more work to do in this area but we are pleased with results so far and intend to replicate the work in Children's Books in other book sub-categories.

As mentioned earlier, during the year we also tested a number of space change options aimed at rebuilding our authority in our core categories. The changes we have tested reduce the size of the entertainment department and then reinvest the space created into high margin categories and store strengths. In a third of our stores we have implemented space changes whereby, based on individual store performances, we transferred some space from the entertainment category to our other three categories.

The stationery and books categories have benefited in two ways from this space change. Firstly, through the space increase itself and carrying more range and secondly, in order to make sure we have the right products in the local catchment, we have changed the products we sell within each category itself so that each store plays to its strengths and poorer performers are removed. In stationery for example, we have added ranges of art and craft, photo frames and albums and pens, and taken out underperforming ranges such as computer hardware, games and jigsaws. In books, ranges we have increased include chart, sport, biography and reference.

Following trials in our large stores, we have also added in new stationery ranges in 70 stores. The new ranges include products such as craft, scrap booking and card making. We have also given more space to core stationery ranges such as core essentials, filing and PC accessories, with more price points and with better promotions.

Finally, with a view to rebuilding our authority, in towns where we would like to test range extensions and expand our core offer but we do not have the space because larger sites are not available, we are testing our offer in second stores, while the existing stores in each town are refurbished. We opened these second stores in the first half of the year. They are either stationery-only stores (Barnet) or stores where the majority of products are books (Kidderminster, Brentwood, Beverley and Sudbury).

All these trial stores have received very positive customer feedback. Results between the stores have varied so we are doing two things to gather more data. Firstly we are making changes to refine the existing trials and secondly, where results have been particularly positive, such as in our stationery-only store in Barnet, we are testing different stationery-only environments. This includes a new edge of town, stationery-only store at Nugent Shopping Park in Orpington and stationery-only stores in Bangor and in Tonbridge, Kent.

We will continue to analyse the data we receive from these stores, particularly as they trade through the forthcoming Christmas period. The lessons we have learnt so far from this programme are already being incorporated into our existing stores and lessons from the implementation of the programme itself have been used to improve our approach to layout and space changes for the Back to School and Christmas seasons.

High Street sales fell by 8 per cent to £1,021m (2005: £1,112m) with like for like sales down 7 per cent. High Street delivered a profit¹ increase of 14 per cent to £42m (2005: £37m), as we focused on rebuilding our authority in our core categories, optimising margins, tight cost control and delivering the retail basics.

Books like for like sales declined as we focused on rebuilding our authority and maximising profitability. Like for like sales in the second half of the year were particularly impacted by the release of *Harry Potter and the Half-Blood Prince* in the prior year. Lower consumer spending in the stationery market has softened stationery sales. We have also removed unprofitable sub-categories such as electronics, which has had a negative effect on sales but a positive impact on profit. We held our market share in News and Impulse, with growth in snacking and newspapers offsetting declines in the monthly magazine market. The entertainment market was extremely competitive, with a weaker release schedule than in 2004/05 and ongoing price deflation leading to a decline in sales. Entertainment sales were also impacted by our planned implementation of selective space reduction in entertainment towards our core categories.

Gross margin improved during the year with the continued benefits of category mix management, lower cost of goods from improving our buying terms further and increasing our Far East sourcing, improved promotions management, reduced shrinkage and better markdown management.

High Street delivered £22m of cost savings during the year, which is £4m ahead of our expectations of £18m, set in April this year. Cost savings were delivered from a number of areas of the business including logistics, information systems, stores and marketing communications. We have identified a further £15m of incremental cost savings for future years.

As a result of these initiatives and the costs savings delivered in the year, net margin for High Street has increased by 80 basis points to 4 per cent.

The High Street business now operates from 543 stores, which occupy 3m square feet (2005: 3m square feet). We opened seven new stores in the year and closed six stores.

High Street: Financial Review 2005/06

£m	2006	2005	Growth %	LFL sales growth %
Revenue	1,021	1,112	(8%)	(7%)
Profit from trading operations ¹	42	37	14%	—

¹ Profit from trading operations is defined as operating profit after directly attributable share-based payment and pension service charges and before allocation of central costs, exceptional items, interest and taxation.

WHSmith Travel

Nature of business

The Travel business trades under the same brand as the High Street stores and operates in 129 airport and railway stations across the UK. Travel's stores sell a more tailored range of products than those of High Street to meet the demands of travelling customers.

Travel's typical customer has less time to browse than the High Street customer and is more interested in reading materials for a journey and quick purchases of food and drink, and confectionery. Consequently, there is a limited demand for entertainment and stationery products, and the stock and format of each Travel store reflects these customer preferences.

Due to their location and convenience nature, Travel stores are, on average, significantly smaller than those in the High Street portfolio, with an average store size of approximately 1,700 square feet. The total retail space for Travel is approximately 220,000 square feet. At 31 August 2006, of the 129 Travel stores, 23 are located in London and regional airports, 34 are in London railway stations (including six underground stations) and 71 are located in provincial railway stations. There is also one non-UK travel store located in Paris.

Travel has a separate operating structure and management team from High Street reflecting the different operational and strategic challenges of the two businesses. Travel stores are in higher footfall locations than High Street stores, resulting in higher average rents, and they are less affected by the Christmas trading period. However increased passenger traffic during the summer holiday season, particularly in airports, contributes to a summer peak in Travel's sales.

Markets in which Travel operates

Travel operates in the airport and railway environments in the UK, selling a range of newspapers, magazines, books, food, drink and confectionery products for customers on the move.

Growth drivers

The Travel business offers opportunity for growth, for example, it is in discussions for new airport contracts and two stores are currently being trialled at Moto roadside locations. Additionally Travel is trialling other store formats such as stationery-only stores (in airports and railway stations) and specialist bookstores (in railway stations). Travel has six specialist bookstores in airports and intends to expand this format.

Competitive position

Travel operates stores in high footfall locations that are highly dependent on commuter and travelling customer traffic. Passenger traffic continues to be forecast to grow in the coming year.

That said, geopolitical events, war and acts of terrorism such as the London bombings on 7 July 2005 have, from time to time, contributed to decreased levels of commuter and travelling customer traffic and a heightened apprehension of rail and air travel. Additionally closure of routes, both planned and unplanned can also impact the operating results of Travel.

Travel faces competition in its product categories from other convenience retailers in rail and competition from category specific retailers in airports. The growth of either retail format may take market share away from Travel and have a negative impact on sales and profit.

Competitive strengths

Travel has significant competitive strengths and the Board believes it is well placed to deliver strong cash generation and long-term earnings growth to create shareholder value through its:

- Widely respected and recognised brand.
- Prime locations within its operating environments of railway stations and airports.
- High levels of customer footfall.
- Market leading positions in its categories, allowing it to operate with scale.
- Purchasing and sourcing scale, driving value for the customer.
- Experienced senior management team.
- Strong relationships with landlords at travel locations.
- Wide reach across travel retail sector.

Travel: risks and uncertainties

WHSmith's management team has identified the following factors as major potential risks to the successful performance of the business. Some, such as IT failures, are specific risks that require specific, identified actions to mitigate their effect. Others, such as the impact of competition, are areas addressed through strategic planning and operational management processes.

1) Disruptions in travel

- Travel operates in high footfall locations, which are highly dependent on commuter and travelling customer traffic. In the past, geopolitical events, wars and acts of terrorism such as the 11 September 2001 and 7 July 2005 attacks have, from time to time, contributed to decreased levels of customer traffic. Additionally, closures in travel routes, both planned and unplanned, may have a material effect on the business as passengers may be diverted from key Travel stores.

2) Loss of tenancy contracts

- With the exception of Edinburgh, Travel has a presence in all the major UK airports and railway stations. There is no guarantee that licences will be renewed or that Travel will be able to bid successfully for new licences in new locations.

3) Change of control clauses

- The majority of Travel's airport and railway concession agreements contain change of control clauses, giving various rights to the grantor of the concession, such as termination of the contract, in the event of a successful takeover bid for WHSmith. These change of control clauses could impact on the appetite for third parties to make an offer for WH Smith PLC.

4) Poor economic conditions or slowdown

- As a UK retailer, Travel is sensitive to economic conditions and can be affected by conditions of the UK retail and travel markets such as the outbreak of pandemic disease (such as avian flu), an act of terrorism or war that could reduce the number of customers visiting WHSmith outlets causing a decline in revenue and profit.

5) Competition in the retail industry

- Travel operates in highly competitive markets and its failure to compete effectively, with convenience and category specific retailers, may impact revenues obtained through our stores.

6) Failure or interruption of information technology systems

- In common with most retail businesses, Travel relies on a number of important IT systems. Any system performance problems could seriously affect our ability to trade.

7) Reliance on the WHSmith brand name

- The 'WHSmith' brand name is an important asset. Failure to protect the WHSmith brand name, an event that materially damaged the reputation of our brand name and/or the failure to sustain its appeal to customers could have an adverse impact on revenues.

8) Cost inflation and legislative change

- WHSmith's operational costs are affected by underlying cost inflation and legislative and fiscal changes in relation to, for example paper, packaging, fuel, utilities, rates and wages.

Travel: objectives and strategy

Travel has focused on increasing average transaction value, trading efficiency improvements, securing new contracts and trialling new formats.

Increasing average transaction value

Average transaction value has increased through:

- Improved product ranges in higher margin categories such as confectionery and snacks.
- Increased promotional activity and improvements in product mix.
- More efficient use of space, from improved queuing systems and increased fixture densities.

Trading efficiency improvement

Measures include:

- Introducing sales-based replenishment.
- Extended opening hours and increased flexibility of staff hours.
- Improved buying and supplier terms.

Securing new contracts and trialling new formats

Initiatives include:

- Re-secured contract at Heathrow Terminal 4 and in negotiations for new contracts.
- Growth of specialist book stores in airports.
- Stationery-only and motorway service station store trials.

Travel: operational review 2005/06

Travel delivered another strong performance for the full year, with profit¹ up 24 per cent and like for like sales up 3 per cent, driven by airport sales that increased by 6 per cent, as we continued to improve our ranges, made better use of our space and kept costs under control. The rail market was tougher. Like for like sales in rail for the full year were flat, however rail sales increased by 2 per cent in the second half of the year, boosted by the very hot weather in July and some recovery in sales in London rail and other urban stores following the sales decline after the London bombings in July 2005.

In line with our plan to optimise our margins, Travel delivered an improvement in gross margin from good category mix management – delivering more sales in higher margin categories like drinks, snacking and confectionery – together with further buying improvements and reduced shrinkage.

Costs in the business were tightly controlled, for example we managed our store staff costs as a percentage of sales through re-profiling store working patterns. Costs and news waste were reduced as we expanded sales-based replenishment to more stores. Sales-based replenishment improves news product availability and reduces excess copy as products are replenished based on their rate of sale. 105 of our 129 Travel locations now have a sales-based replenishment capability and we plan to introduce it to a further 14 stores during the course of this financial year.

Over the course of the year, we successfully renewed a large number of contracts as well as winning some important new business. We also made good progress on store format developments with both our book and stationery stores progressing well.

Airport stores

In our airport stores we have delivered strong sales growth of 6 per cent, 2 percentage points ahead of passenger growth numbers on a like for like basis, driven by the changes we have made to improve our offer, to make better use of our space and to deliver better customer service.

During the year we extended our food range to a further 20 stores. We now offer a comprehensive range of sandwiches, pastries, salads and desserts in 100 stores. We also increased further the choice within our food range to include more desserts, yoghurts and breakfast options, as well as introducing a wider range of healthy snacks such as fruit, nuts, fresh juices, granary bars and other branded options such as Innocent Smoothies.

To increase customer choice in books, this year we extended our range of fiction airport exclusives from 100 to 200 lines. These books offer great value, a degree of exclusivity and this year we will begin selling non-fiction airport exclusive books.

We also continue to make better use of space in our airport stores. We have increased selling space in the same footage by increasing fixture densities further. We installed larger chillers in more stores; 75 per cent of our stores now have the larger chillers. These chillers hold 30 per cent more stock in the same space enabling us to meet customer demand and cut down on a store's workload, as they need to be replenished less frequently. We have also rolled out chilled dump bins to 100 stores. These refrigerated units are charged overnight off the shop floor, then put onto the shop floor in the morning and can be moved to wherever is suitable. For news product we have rolled out improved news cubes to 77 stores – these hold 20 per cent more news product so again maintain higher levels of availability to meet customer demand.

Of course customer service continues to be an area of focus. We are testing mobile tills in six airside units. These tills can be added onto the main bank of tills during times of high demand, such as during the peak summer trading period, and then removed when demand decreases. We have also rolled out new queuing systems to all airside stores this year and we received our best ever mystery shopper results of 86 per cent, compared with 82 per cent in the previous year.

Our new format books-only stores, WHSmith Books, are trading well and we now have five of these stores open at Gatwick's north terminal, Glasgow airport, London Luton airport, Bristol airport and Heathrow Terminal 1. We will be opening a further WHSmith Books at Birmingham International airport this year.

We also made good progress on other airport contracts. We have renewed four contracts for two units at Glasgow airport, and units at Heathrow Terminal 4 and Southampton airport. To make sure our stores are up to customer, landlord and our own brand standards, we completed nine refits and we are planning a further 20 refits this financial year for stores including Heathrow Terminals 1, 2 and 4.

Finally in airports, in 2005/06, we opened five new stores – a bookstore in Bristol, as previously mentioned, and new units at Blackpool International airport, and an additional airside unit at Glasgow, a new airside unit at Southampton airport and an additional airside unit at Manchester airport.

Rail stores

Trading in our rail stores has been challenging in 2005/06. Like for like sales were flat for the year, however like for like sales increased by 2 per cent in the second half of the year as the business benefited from very hot weather in July and our London and urban stores showed some signs of recovery from their first half performance when sales were impacted by reduced footfall following the London bombings in July 2005.

In the second half of the year we implemented our plan to improve performance in our eight key London locations and deliver better service for customers. Firstly we extended our opening hours by an hour, typically from 11pm until midnight. We then re-profiled all store roles, as we have done in our High Street business, to make sure that we have the right staff in the right place to suit the trading patterns in our stores. With the right staffing levels in place, we were able to increase the number of tills open at peak hours and deliver better customer service.

In regional rail like for like sales were up 2 per cent in the second half of the year. Again we focused on improving our customer offer and service. We continued to rollout space rebalances by category and increased the density of our fixtures. For instance in Nottingham, Derby and Stockport, we have delivered sales performance increases of between 5 per cent and 15 per cent. In terms of fixtures we introduced many of the changes we implemented in our airport stores such as high-density chillers and new high-density news cubes.

In rail we have also continued to improve our product ranges by rolling out categories such as the food range and our health and beauty range to a larger number of stores. We also introduced a hot coffee offer, under the Coffee Nation brand, in six regional rail stores. During the year we also began some new format trials such as stationery and book-only stores in rail environments. Although it is early days, so far these trials are performing well, in line with our expectations.

Finally in rail we have made good progress this year with contracts. We have renewed ten contracts in total, including a key contract with ScotRail that represents 12 sites across Scotland. We completed nine store refits during the year and we opened three new stores – a standalone bookstore at London Liverpool Street and two standalone stationery stores at London Charing Cross and London Bridge stations.

Travel has delivered a strong performance with revenue increasing by 3 per cent to £319m (2005: £311m) and like for like sales up 3 per cent. Increased sales, enhanced by the hot weather in July 2006, combined with mix and space changes, range improvements and tight cost controls have led to Travel profit¹ increasing by 24 per cent to £31m (2005: £25m).

Airport like for like sales were up 6 per cent, out-performing passenger growth, driven by product range improvements and more efficient use of space. Total rail like for like sales were flat, with a strong second half performance in London stores driving an improvement from the like for like sales decline of 1 per cent in the first half of the year.

Gross margin increased during the year through buying improvements and mix changes, resulting in more sales in higher margin categories such as snacking. We have improved average transaction value by focusing on mix changes and improved promotional activity.

The Travel business now operates from 129 stores, with two new stores being opened in the year.

Outlook

We have made good progress during the year in the implementation of our plan to deliver value to shareholders. In High Street, we are rebuilding our authority and increasing customer choice by increasing the space we devote to books, stationery, and news and magazines. In Travel we have delivered both sales and profit growth by changing our product mix and making better use of our space. We will continue to implement more of these changes, in line with our plan, in the year ahead.

Our staff have once again demonstrated their commitment to the business and worked extremely hard to deliver our plans. Over the course of the year consumer spending has remained subdued and we expect it to continue to be subdued in our categories in the coming year. This tough retail environment is likely to mean that Christmas 2006 will be very competitive and we have planned accordingly. We will continue to focus only on profitable activity and will not chase sales at the expense of profit while consistently delivering a solid operational performance and the retail basics.

Kate Swann
Group Chief Executive, WH Smith PLC
12 October 2006

Travel: Financial Review 2005/06

£m	2006	2005	Growth %	LFL sales growth %
Revenue	319	311	3%	3%
Profit from trading operations ¹	31	25	24%	

¹ Profit from trading operations is defined as operating profit after directly attributable share-based payment and pension service charges and before allocation of central costs, exceptional items, interest and taxation.

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adding value



The Group delivered a strong profit performance through continued focus on rebuilding authority in our core categories, improved ranges and delivering the retail basics, combined with continued tight cost control.

Alan Stewart, Group Finance Director

The Group's profitability¹ has increased by 31 per cent despite the challenging trading conditions in our markets. High Street growth in profitability has been delivered by our continued focus on rebuilding authority in our core categories, optimising margins, tight cost control and delivering the retail basics. Travel delivered a strong performance through sales and margin growth from improved ranges and more efficient use of space, combined with tight cost control.

The Group generated a profit before tax and exceptional items of £51m (2005: £39m), an increase of 31 per cent. Profit after tax and exceptional items was £32m (2005: £22m).

Headline earnings per share² from continuing operations increased by 43 per cent to 25.0p (2005: 17.5p) with basic earnings per share of 18.6p (2005: 12.4p).

The Board has proposed a dividend per share of 6.2p; combined with the dividend proposed by Smiths News PLC, this gives a full year proforma dividend up 12 per cent to 15.3p (2005: 13.7p).

Cash generation has strengthened driven by improved trading performances in both High Street and Travel and good stock and other working capital management. Group free cash flow was £68m (2005: £44m).

On 31 August 2006, the Retail and News businesses were separated via a demerger, allowing both businesses to benefit from greater focus on their respective strategies as independent businesses.

¹ Profit before tax and exceptional items on continuing operations.

² Profit before tax, exceptional items and IAS 19 pension interest – undiluted.

Group income statement

Revenue

Group revenue decreased from £1,423m to £1,340m over the year as we have focused on profitable sales in a tough trading environment. The like for like (LFL) sales decline over the period was 4 per cent.

£m	2006	2005	Growth %	LFL sales growth %
High Street	1,021	1,112	(8%)	(7%)
Travel	319	311	3%	3%
Total	1,340	1,423	(6%)	(4%)

High Street sales were down 8 per cent and on a LFL basis down 7 per cent. LFL sales in the second half were particularly affected by the release of *Harry Potter and the Half-Blood Prince* in the prior year.

Travel sales growth of 3 per cent (3 per cent on a LFL basis) has been driven by the airports business, up 6 per cent on a LFL basis and approximately 2 percentage points ahead of passenger growth, primarily through product range improvements and more efficient use of space.

Profit before exceptional items and taxation

£m	2006	2005	Profit growth %
High Street ¹	42	37	14%
Travel ¹	31	25	24%
Trading operations profit¹	73	62	18%
Central costs	(14)	(16)	
Internal rents	1	1	
Operating profit²	60	47	28%
Net finance charges	(9)	(8)	
Profit before taxation²	51	39	31%

1 Profit from trading operations stated after directly attributable share-based payment and pension service charges.

2 Stated before exceptional items.

The Group generated a profit before tax and exceptional items of £51m (2005: £39m), an increase of 31 per cent. Operating profit increased by 28 per cent from £47m to £60m with the main driver being strong improvements in trading operations.

The £11m increase in profit from trading operations is discussed in detail in the respective business reviews. High Street delivered a profit increase of £5m, up 14 per cent on prior year, as we focused on rebuilding authority in our core categories, optimising margins, tight cost control and delivering the retail basics. Travel delivered a profit increase of £6m from increased sales, boosted by the hot weather in July 2006, combined with mix and space changes, range improvements and tight cost control.

High Street delivered £22m of cost savings during the year, which is £4m ahead of our expectations of £18m, set in April this year. Cost savings were delivered from a number of areas of the business including logistics, information systems, stores and administration costs. We have identified a further £15m of cost savings over the next three years.

Central costs and internal rents

Central support costs were down £2m to £14m from £16m in the prior year. Internal rents on freehold property owned by the Group remained at the prior year level of £1m.

Net finance charges

Net finance charges have increased by £1m in the year with lower debt interest from the repayment of the term loan facility during the year being offset by higher IAS 19 pension interest costs of £3m (2005: £1m). Pension interest has increased due to the impact of the change in investment policy to a Liability Driven Investment ('LDI') policy.

Exceptional items

The Group has taken a £12m exceptional charge in relation to costs associated with the demerger. A £5m exceptional gain was also recognised in the year as a result of the settlement of post retirement medical benefit liabilities.

Taxation

The tax charge for the year before tax on exceptional items was £10m (2005: £9m). The effective tax rate on continuing activities, excluding exceptional items, was 20 per cent (2005: 23 per cent). We expect the effective tax rate to remain below the UK standard rate over the medium term. The exact tax rate achieved will depend on the underlying profitability of the Group and continued progress in closing off outstanding tax assessments.

Earnings per share

The Group generated basic earnings per share of 18.6p (2005: 12.4p) while headline basic earnings per share from continuing operations was 25.0p (2005: 17.5p). The growth has been generated by both improving profitability and a more favourable effective tax rate.

Dividends

The Board is proposing a dividend of 6.2p per ordinary share. Subject to shareholder approval the dividend will be paid on 6 February 2007 to shareholders registered at the close of business on 5 January 2007. The Board intends to have a progressive dividend policy, which over time would be broadly covered twice by earnings.

Fixed charges cover

Fixed charges, comprising property operating lease rentals and net finance charges, were covered 1.3 times by profit before fixed charges (2005: 1.3 times cover).

Group cash flow

The operating free cash flow amounted to £68m compared with £44m in the previous year.

£m	2006	2005
Operating profit ¹	60	47
Non-cash items	1	4
Depreciation and amounts written off tangible fixed assets	37	41
Cash profit	98	92
Working capital	9	(8)
Capital expenditure	(29)	(30)
Tax	(2)	(2)
Net interest paid	(5)	(2)
Net provisions	(3)	(6)
Free cash flow	68	44

1 Stated before exceptional items.

Cash generation has strengthened due to the improved trading performance in the businesses and good working capital control.

Non-cash items relate to share-based payment charges of £6m (2005: £4m) and profits on disposal of fixed assets of £5m (2005: £nil).

The movement in working capital for continuing businesses was £17m favourable to the previous year, principally as a result of the strong focus on stock levels and improved control of receivables.

Business Review

WH Smith PLC Financial Review

This can be further analysed as follows:

£m	2006	2005
Inventories	6	5
Receivables	7	(12)
Payables	(4)	(1)
Working capital movement	9	(8)

Capital expenditure

£m	2006	2005
New stores and store development	11	11
Refurbished stores	7	7
Systems	7	7
Other	4	5
Total	29	30

We have continued to invest in maintaining our Retail properties.

Net funds

The movement in the net funds position is as follows:

	£m
Opening net funds	(58)
Free cash flow	68
Equity dividends paid	(15)
Net purchase of own shares	(6)
Pension deficit funding	(12)
Corporate advisory and financing costs	(6)
Sale and leaseback and fixed asset disposal proceeds	9
Net disposals of subsidiaries	8
Other items	(3)
Settlement of intercompany account on demerger	57
Closing net debt¹	42

¹ Stated before £25m cash contribution to the defined benefit pension trust on 1 September 2006.

The amount shown for pension deficit funding of £12m represents £10m of additional pension deficit funding in line with our agreement with the Trustees and £2m in relation to the post retirement medical benefit liability settlement.

The net disposals of subsidiaries of £8m includes deferred consideration of £11m received in early settlement of loan notes received on the disposal of the USA Travel Airports business to Hudson Group in 2004.

Corporate advisory and financing costs of £6m includes fees paid in relation to the demerger.

After the year end an additional £25m cash was contributed to the defined benefit pension scheme as part of the demerger agreement with the WH Smith Pension Trust Trustees.

Group balance sheet

	£m	£m
Goodwill and other intangible assets		30
Property, plant and equipment		184
		214
Inventories	143	
Payables less receivables	(149)	
Working capital		(6)
Net deferred tax asset		16
Current tax liability		(20)
Provisions		(12)
Operating assets employed		192
Net debt ¹		42
Net assets excluding pension liabilities		234
Pension liability ¹		(66)
Total net assets		168

¹ Stated before £25m cash contribution to the defined benefit pension trust on 1 September 2006.

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

	£m	£m
Opening net assets		105
Profit before tax and exceptional items	51	
Tax on above	(10)	
		41
Share-based payments and employee share schemes		6
Dividends paid		(15)
Tax effected movement in pension scheme deficit		(16)
Movement of intercompany account on demerger		66
Purchase and issue of own shares		(6)
Other items		(4)
Net assets before exceptional items		177
Exceptional items (net of associated tax)		(9)
Closing net assets		168

The Group's net assets have increased from £105m at the end of 2005 to £168m 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	180	23%	13%
Travel	21	148%	47%
Retail	201	36%	18%
Central items and property	(29)	—	—
Operating assets employed	172	35%	17%

For the prior year, comparable average returns were 23 per cent (12 per cent after capitalised operating leases).

Pensions

At 31 August 2006, the gross defined benefit pension deficit is £66m (2005: £60m). The pension deficit has increased mainly due to actuarial adjustments in relation to the lengthening of mortality rates. The results include net finance costs of £3m (2005: £1m).

In September 2005, the Company and the Trustees of the WH Smith Pension Trust (the 'Pension Trust') agreed that they would adopt a new investment policy in order to substantially reduce the volatility in the underlying investment performance and the risk of a significant increase in the deficit in the defined benefit fund. The assets in the investment fund were restructured in order to adopt this policy. This involved the assets being invested such that they are expected to alter in value in line with changes in the pension liability caused by changes in interest and inflation (an '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.
- 6 per cent of the fund's assets are invested in 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 substantially reduce the volatility in the fund and the resultant risk of a significant increase in the overall deficit whilst enabling the fund to continue to benefit from any potential higher returns in the equity markets.

On the date of demerger, 31 August 2006, the assets and liabilities of the Pension Trust and the WH Smith Retirement Savings Plan (a defined contribution plan) were split between the News business and the Retail business by way of a 'sectionalisation'. Each section only contains the accounts of members who are or were employed by the relevant business. There will be no cross-subsidy or cross-guarantees between the sections of the Pension Trust.

The assets and liabilities of the defined benefit scheme were allocated to the News business section and the WHSmith Retail business section in proportions that reflected the related liabilities of active, deferred, pensioner and orphan members belonging to the respective News and Retail businesses.

On 1 September 2006, the Group made a £25m one-off cash contribution to the Pension Trust. The Group has agreed with the Pension Trust Trustees to make aggregate ongoing pension deficit funding payments of approximately £10m each year for the next five years.

Financing and capital structure

The Group is financed through a mixture of debt, comprising overdrafts and credit facilities, finance leases, loan notes and equity (ordinary and preference shares).

A five year multicurrency £90m revolving credit facility agreement was signed by the Group on 26 June 2006.

The agreement contains provisions, obligations and certain financial covenants, which are customary under such an agreement.

The pre-demerger Group had a three year £270m facility agreement, which was signed on 26 July 2004, 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 was available by way of a multicurrency revolving credit facility. The pre-demerger Group repaid all of its obligations under the term loan facility by March 2006.

In order to facilitate the demerger the Company issued 182,919,970 ordinary shares to the shareholders of Smiths News PLC on a 1:1 basis. On 7 September 2006, a capital reduction was undertaken with the nominal value of ordinary shares reduced from 195p to 20p each, which created £320m of distributable reserves.

Treasury and risk management

The Group's Treasury function endeavours to reduce exposures to interest rates, foreign exchange and other financial risks, to ensure sufficient liquidity is available to meet foreseeable needs and to invest cash assets safely and profitably. The Group does not engage in speculative trading in financial instruments and transacts only in relation to underlying business requirements. The Group's treasury policies and procedures are periodically reviewed and approved by the Audit Committee and are subject to regular Group Internal Audit review.

Business Review

WH Smith PLC Financial Review

Currency risk management

The Group's foreign currency exposures mainly relate to the purchase of products from outside the UK. 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. At 31 August 2006 the Group had no material currency exposure that would give rise to net currency gains and losses being recognised in the income statement.

Interest risk management

The Group's interest rate exposure is managed by the use of fixed and floating rate borrowings and by the use of interest rate swaps to adjust the balance of fixed and floating rate liabilities. The Group regularly monitors its exposure to interest rate risk 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.

Credit risk management

The Group's credit risk is managed by dealing only with banks and financial institutions with strong credit ratings and within prescribed limits set for the organisation and approved by the Board and Audit Committee.

Operating leases

The Group's stores are held mainly under operating leases that are not capitalised and therefore are not included as a debt for accounting purposes. The High Street leases are on standard 'institutional' lease terms, typically with a 15 year term subject to five year upwards-only rent reviews. The Travel 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 £124m (net of £8m of external rent receivable). The total future rental commitment at the balance sheet date amounted to £832m with the leases having an average life of seven years. The net present value of these commitments is approximately £558m. 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.

The Group has contingent liabilities relating to reversionary property leases. Pursuant to the terms of the Demerger Agreement, any such contingent liability will be apportioned between the Group and Smiths News PLC in the ratio 65:35 (provided that the Smiths News PLC liability is limited to £5m in any 12-month period). We have estimated the Group's 65 per cent share of the future cumulative rental commitment at approximately £102m (2005: £118m).

Basis of preparation and accounting policy changes

In accordance with IFRS 3 'Business Combinations' the financial statements of WH Smith PLC have been prepared as if the continuing operations of the Retail business were in existence for the whole of the period from 1 September 2004 through to 31 August 2006. Central costs of the pre-demerger Group have been mainly allocated to WH Smith PLC.

The Group adopted IAS 32 'Financial Instruments: Presentation and Disclosure' and IAS 39 'Financial Instruments: Recognition and Measurement' at 1 September 2005.

Alan Stewart

Group Finance Director, WH Smith PLC

12 October 2006

focused on...

the future

A commitment to the principles of corporate responsibility has always been at the heart of the WHSmith brand. During 2006, we have continued our work to address the environmental and social impacts of our business operations.

This year, we have also published our first stand-alone Corporate Responsibility (CR) Report which is available at www.whsmithplc.com/cr. It provides details of performance against the targets we published last year, together with those we have set for the year ahead.

We are delighted to have received external recognition of our achievements through our improved ranking in the Business in the Community Corporate Responsibility Index where we moved from 74th to 44th place. At the same time we have delivered increases in profitability, confirming our firmly held belief that improvements in financial performance and corporate responsibility performance can go hand in hand.

Marketplace

Marketplace issues are all about how we manage the environmental and social impacts of the products we sell and how we interact with our customers and our suppliers.

We have a responsibility to make sure that customers receive the level of service and the quality of product that they have come to expect from WHSmith. We also have a duty to ensure that the people making our products work in decent conditions and are treated fairly, and the impact of our products on the environment is minimised.

Ethical trading

We have been assessing labour standards in our own-brand Asian suppliers for several years to monitor compliance with our Supplier Code of Conduct. This year, we appointed a specialist WHSmith Audit team within our Far East sourcing office. This is enabling us to build closer relationships with our suppliers, giving us greater visibility of the risks and increasing our capacity to influence improvement.

During 2005/06, the Audit team completed 126 supplier factory audits, most of which were in China. This is up from 64 last year. After each Audit, we agree necessary improvements with the factory management and a timescale for implementing these changes.

Forest sourcing

WHSmith offers a wide range of wood and paper products that come from forests located all over the world. It is our ultimate objective that all virgin (i.e. non-recycled) material used in our products come from known, legal, well-managed and credibly certified forests.

We continue to be members of the WWF UK's Forest Trade Network (FTN). Members have committed to tracing timber and paper products back to the forest source and report this annually to the FTN. This year our report was audited by an independent third party appointed by the WWF FTN. In commenting on WHSmith's performance in this area the auditors noted that there was 'commitment at senior management level' and a 'proactive approach to providing information and training to buyers and suppliers'. They also recognised the value of our inclusion of forest sourcing requirements when we are tendering contracts with suppliers.



**WWF-UK
FOREST
& TRADE
NETWORK**

Engaging suppliers and buyers

As our main interface with suppliers, it is important that our buyers have a good understanding of ethical trading and forest sourcing issues and what we expect of our suppliers. We have followed up on last year's buyer training programme by incorporating ethical trading and forest sourcing within buyers' personal objectives.

During the year we held supplier workshops in the UK to raise awareness of our ethical trading and forest sourcing requirements. In this way we spoke directly with around 30 key suppliers, developing their understanding of our requirements, outlining the business case for action and helping them to put systems in place. We are following up these sessions with more detailed engagement as well as planning further workshops for own-brand suppliers in the Far East during 2006/07.

Product stewardship

As part of the implementation of our forest sourcing policy, and in response to increasing consumer interest in environmental issues, last year we set a target to pilot at least three new lines of recycled or Forest Stewardship Council-certified stationery. Our buying teams responded with trials of new recycled lines, including new correspondence stationery, copier paper and the 'I used to be...' fashion stationery range. We will continue to develop our range of recycled and FSC-certified products.

Responsible marketing

We take our responsibility for the products we sell seriously. We are committed to listening to our customers and acting responsibly in their interests. Customers often have strongly differing views about the products we sell, so we aim to strike the right balance to meet the needs of all our customers. We aim to offer our customers choice, whilst also respecting customer views and protecting the interests of vulnerable groups, particularly children.

We already operate according to internal guidelines regarding the responsible retailing and marketing of our products. This year, we agreed a formal Marketing Code of Practice, which has been signed off by the Board. The Code sets out the standards we will follow in all aspects of promotional activity, marketing and advertising. During the year ahead, we will ensure that buying and marketing teams understand the Code and what it means for them.

Customer service

Customer service continues to be one of our core business values which underpins everything we do.

A major High Street store focus this year has been on transactions, specifically the successful implementation of our Two in a Queue policy and providing prompt and efficient service, both at the till and during the refund/exchange process.

We have rolled out new queuing systems to all airside airport stores this year and we received our best ever, independent mystery shopper results: 86 per cent versus 82 per cent last year.

Environment

We recognise that we have responsibilities for managing the impact of our business on the environment. This is not only good for the environment but makes business sense too – the less fuel, electricity, water and raw materials we use, the lower our costs will be. We also have responsibility for the environmental impacts of the products we sell. Some of these issues are discussed under Marketplace.

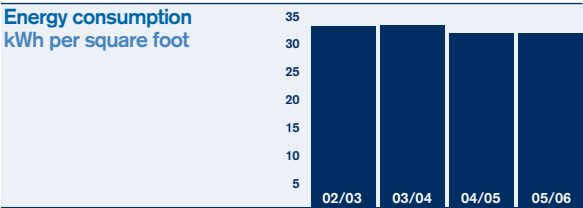
Environmental champions

This year we trialled a scheme in our Devon and Cornwall stores aimed at increasing awareness of environmental best practice and delivering reductions in energy consumption and waste. An Environmental Champion was appointed in each store and tasked with encouraging colleagues to make small changes in their behaviour which would improve our environmental performance.

The pilot demonstrated that there are opportunities to improve our environmental performance through small changes in staff behaviour. We concluded that it is not appropriate to appoint an Environmental Champion in each store. Instead, next year, we are planning an environmental awareness raising campaign targeting all staff in High Street and Travel stores and in our head office, to teach them about best practice.

Energy

We have continued to reduce energy consumption across the Group in line with our targets. Since September 2004, we have delivered a 4.3 per cent reduction in consumption.

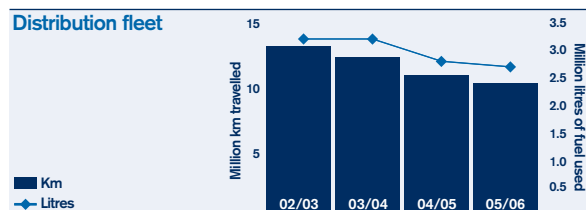


Raising staff awareness of energy efficiency remains a focus. This year we have created an Energy and Environment section on our intranet to provide staff with information on how they can help us save energy. Resources include a Virtual Shop, a fun tool for store teams to explore and see if they can find all the energy saving opportunities in a typical store.

Transport

Last year we set a target to reduce diesel use by 15 per cent compared to levels in 2004. This year we achieved a 4.4 per cent saving which, combined with our improvement last year, resulted in an overall reduction of 16.2 per cent from 2004 levels. During the same two year period we also managed to reduce distance travelled by 16.7 per cent.

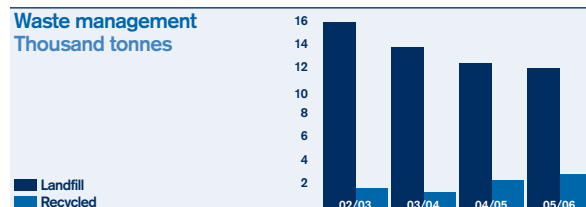
This year, reductions have been achieved through the introduction of double deck trailers on trunk routes and a restructuring of our distribution network.



Waste

For us there are two main areas of waste to consider: waste from our stores and distribution centres, (for example, cardboard boxes, plastic shrink wrap and damaged stock) and general waste from our offices (such as office paper, food and toner cartridges).

We have been working hard to increase the store recycling rate. We have a centralised waste management contract covering 370 of our High Street stores and during the year we have extended our cardboard recycling scheme to cover 153 of these sites. This has resulted in the recycling of 1,100 tonnes of cardboard. We plan to extend the scheme to further stores this year.



Packaging

With increasing pressure on both businesses and consumers to reduce waste, we are keen to find opportunities to reduce product packaging at source and to make our packaging easier to dispose of. As well as placing a burden on the environment, excessive packaging also increases costs for our business, with an over-packaged product costing more to transport and taking longer to unpack.

Transit packaging

This year we have continued our work with key Far East suppliers of own-brand products to eliminate unnecessary transit packaging. We trained merchandisers and product technologists in our Far East sourcing office on what best practice looks like in terms of product packaging. This was then followed by training for 25 suppliers where we explained the simple steps they can take to reduce packaging and also reduce cost.

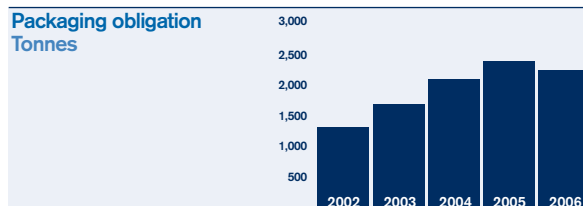
All the 25 suppliers trained have changed their processes in some way. The cumulative effect of many small changes is that at least 105 tonnes of cardboard has been taken out of our supply chain.

Carrier bags

A recent redesign of our carrier bags will deliver a significant saving in the amount of plastic used each year. The new carrier bag design has the same strength as before but uses around 30 per cent less plastic. Not only will the new bags save plastic, but the lighter design will also reduce costs.

Biodegradable sandwich packaging

The Foo Go sandwich range offered in our Travel stores features innovative packaging which is helping to reduce the waste from convenience food. The sandwich packaging is completely biodegradable.



Encouraging our customers to help the environment

Christmas card recycling

2006 saw our continued involvement in Woodland Trust's Christmas Card Recycling campaign – now in its ninth year. During January customers were able to recycle cards in WHSmith throughout England, Wales and Scotland. A staggering 82m cards were recycled by the scheme, an increase on the previous year of more than 40 per cent.



Toner cartridge recycling

We continue to 'complete the loop' with our own-brand toner cartridges. Customers buying a new printer cartridge can send off their old one to be recycled. This cartridge is then refurbished. In addition, Tommy's, the baby charity, receives donations based on the number of units recycled.

Workplace

Our employees are core to the success of our business. We aim to achieve a working environment in which our employees are respected, treated fairly, listened to and involved. We want all WHSmith employees to feel proud of the Company and responsible for its success.

Embedding our values

In 2004/05 we adopted four key business values: Customer Focus, Drive for Results, Value Our People and Accountability.

The values form a key part of every employee’s personal objectives and appraisals, as well as being incorporated into staff training and development programmes. This year, we have gone further in embedding the values within the business. In October we distributed Values postcards to managers to use with their teams. This enables them to send an immediate message to recognise staff demonstrating our values.

Communicating with and engaging our staff

As we work to deliver our turnaround plan, it is more important than ever that all employees are updated and informed on current business performance and progress in delivering key priorities throughout the year.

The executive directors carry out regular briefings to ensure that staff are informed about business strategy and performance and also have an opportunity to ask questions or raise any concerns they may have. We do not carry out formal employee surveys; instead we provide staff with frequent opportunities to ask questions of directors and to express their views, either face to face or anonymously.

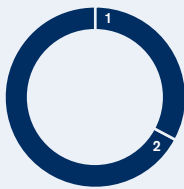
Valuing diversity

In February 2006 we established a diversity working group to develop initiatives and policies concerning gender, sexual orientation, ethnicity and disability. The working group carried out a review of WHSmith’s current diversity policies and benchmarked our policies and performance against our peers. This review helped us to identify areas requiring improvement, which will form the basis of our diversity action plan.

Developments already made this year include updating our suite of diversity policies to ensure they reflect new legislation, and the development of diversity awareness briefing sessions, due to be rolled out to all staff next year.

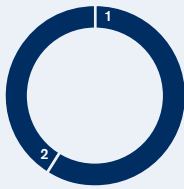
Diversity profile
All employees

1 Male
2 Female



Diversity profile
Senior management

1 Male
2 Female



This year, Kate Swann, Group Chief Executive, was invited to become a member of the National Employment Panel Business Commission on Race Equality in the Workplace. The Commission’s overall objective is to advise the Chancellor on policies and practical measures to increase the recruitment, retention and progression of ethnic minorities in the private sector. As a member of the Commission’s Executive Committee, Kate has taken responsibility for providing the strategic lead on the national levers for driving change in the private sector.

Disability discrimination

The business is continuing to work to improve the services that it provides to disabled customers. During the year, we have continued a rolling programme of capital improvements across our estate, including fitting hearing loops and installing automatic doors and lifts in some stores for those who are less mobile. We continue to provide training to staff so that they can better understand the needs of our disabled customers.

Training and developing our staff

We have continued to strengthen our training and development support to ensure that all employees, whether in head office, stores or distribution centres, can access the appropriate development tools.

For head office staff, we offer a variety of additional training programmes tailored to meet the needs of specific groups within the head office population. These include:

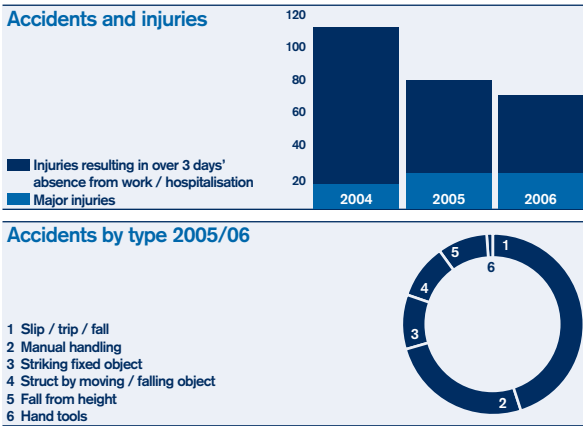
- Coaching and mentoring programme for the senior management team to develop their skills in this area; 40 senior managers took part in workshops last year.
- Fast-track Academy designed to prepare high-potential employees for future senior management roles.

Training and development for our store teams focuses on providing solutions which create a pipeline of talent to fulfil key roles within stores and retain talent within the business. At the core of this approach are development programmes designed to help staff in a specific role move on to the next level of seniority. These development programmes offer succession development for potential supervisors, potential store managers and potential area or district managers. 117 delegates attended the store manager development programme this year, with a running promotion rate upon completion of 69 per cent.

Health and safety

The Board is committed to maintaining high standards of health and safety in the business. The management team, supported by professional safety advisers, monitors key safety performance indicators and an annual report detailing trends, performance and recommendations is presented to the Board. The business also has a properly constituted Health and Safety Committee that comprises employee representatives, management, trade union representatives and officials.

This year the total number of reportable accidents reduced by a further 11 per cent although the number of major injuries remained stable. Whilst we are pleased with the overall reduction, in the coming year we will be focusing on making further improvements.



As the pie chart above shows, slips, trips and falls and manual handling account for over 70 per cent of our accidents. During the year we trained over 1,000 managers so that they can cascade safety training to their staff, with a particular emphasis on these two areas. Specific health and safety training has also been incorporated into our Management Development Programme for new store managers.

Community

Our community investment continues to focus on education and life-long learning. As a leading bookseller and stationer, this is an area where we can use our knowledge and resources to make a real difference.

During 2005/06, in line with our commitments to the Per Cent Club, we continued to invest over 1 per cent of our pre-tax profits in charities and community projects. The chart below gives a breakdown of our community contributions.



* Calculated using London Benchmarking Group reporting model.

Promoting literacy in partnership with the WHSmith Trust
July and August saw the second year of the Summer Read, a partnership between WH Smith PLC, the WHSmith Trust and the National Literacy Trust's Reading is Fundamental initiative. This is part of a three-year programme which encourages children across the UK to develop a love of reading and helps to maintain literacy levels during the long summer holidays.

More than 2,700 children in 15 locations around the country took part in the 2006 Summer Read events.

WHSmith Trust and WH Smith PLC will provide funding and support for a further Summer Read in 2007.

Employees making a difference in their local communities
This year, we launched the WHSmith Community Awards to recognise the excellent work our staff do in the local communities in which we operate. Awards were given to 20 teams who had set a leading example by building strong links in their local community.

Staff at our Gateshead Metro Centre store received a special award for outstanding achievement. The team has built a partnership with the Thomas Hepburn Community School which serves one of the most deprived inner city areas in the country. Support includes donating prizes to reward improvements in numeracy, literacy or attendance, and helping the school to promote educational events and encourage exam revision.

Products to promote and support charity and education
An increasingly popular way for our customers to support charity is through buying products with charity links. Our Adopt-an-Animal range, launched in autumn 2005, proved popular with our customers and we will be extending the range in 2006.

Our charity Christmas cards continue to raise significant amounts of money for our charity partners, as do the recycling schemes we offer to customers for used toner cartridges and for Christmas cards. More information can be found in the Environment section of this report.

focused on...

delivering strategic goals



1 Robert Walker
2 Kate Swann
3 Alan Stewart
4 John Barton
5 Mike Ellis
6 Luke Mayhew
7 MT Rainey



Board Committees

Audit Committee
Mike Ellis – Chairman
John Barton
Luke Mayhew

Nominations Committee
Robert Walker – Chairman
John Barton
MT Rainey
Kate Swann

Remuneration Committee
John Barton – Chairman
Luke Mayhew
MT Rainey

Robert Walker (Chairman), John Barton, Mike Ellis, Luke Mayhew, MT Rainey and Kate Swann were appointed directors of the Company on 26 June 2006 and Alan Stewart was appointed as a director of the Company on 21 June 2006. They were previously directors of the former listed parent company of the WH Smith Group.

1. Robert Walker is Chairman and joined the Board of Old WH Smith 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, for PepsiCo International. He is a non-executive director of Wolesey plc, Signet Group plc, Tate & Lyle plc and Williams Lea Group Limited. Aged 61.
2. Kate Swann is Group Chief Executive and joined the Board of Old WH Smith 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 The British Land Company plc. Aged 41.
3. Alan Stewart is Group Finance Director and joined the Board of Old WH Smith 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 and a trustee of the children's charity KidsOut. Aged 46.
4. John Barton is a non-executive director and Senior Independent Director and joined the Board of Old WH Smith 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 Next plc, and a non-executive director of Hammerson plc. Aged 62.
5. Mike Ellis is a non-executive director and joined the Board of Old WH Smith 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 its predecessor, Halifax Building Society) and was appointed Chief Operating Officer in 1999. Aged 55.
6. Luke Mayhew is a non-executive director and joined the Board of Old WH Smith in July 2005. He was Managing Director of John Lewis from 2000 to 2004, prior to which, from 1992 to 2000, he was Director of Research and Expansion of the John Lewis Partnership. He is Chairman of Pets at Home Group Limited and Bank Store Holdings Limited, and a non-executive director of Brambles Industries plc. Aged 53.
7. MT Rainey is a non-executive director and joined the Board of Old WH Smith in March 2002. She is the former Chairman of the Marketing Group of Great Britain. She is 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 innovative charity Timebank. Aged 51.

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 2006. The purpose of the annual report is to provide information to members of the Company. The annual report contains certain forward looking statements with respect to the operations, performance and financial condition of the Group. By their nature, these statements involve uncertainty since future events and circumstances can cause results to differ from those anticipated. Nothing in this annual report should be construed as a profit forecast. The following definitions apply throughout this report unless the context requires otherwise:

'Company' means WH Smith PLC, a public limited company incorporated in England and Wales with registered number 5202036;

'Group' means the Company and its subsidiaries and subsidiary undertakings;

'Old WH Smith' means the Company formerly known as WH Smith PLC, a public limited company incorporated in England and Wales with registered number 471941 and which was the holding company of the WH Smith Group prior to the demerger;

'Smiths News' means Smiths News PLC, a public limited company incorporated in England and Wales with registered number 5195191 and which became the holding company of the WH Smith News business following the demerger;

'WH Smith Group' means Old WH Smith and its subsidiaries and subsidiary undertakings;

'WH Smith News' means the business carried on by Old WH Smith prior to the demerger and by Smiths News following the demerger of wholesaling and distributing newspapers and magazines to retailers and supplying other services to publishers and retailers; and

'WH Smith Retail business' means the business carried on by Old WH Smith prior to the demerger and by the Company following the demerger of retailing through High Street and Travel retail outlets.

Principal activities and Business Review

The principal activities and future prospects of the Group, and a review of the development and performance of the businesses of the Group including a list of the principal risks and uncertainties facing the Group, are set out in the Business Review on pages 4 to 18.

Company results

The Group income statement for the year ended 31 August 2006 is shown on page 42.

Change of name

The Company was incorporated with the name Pollquote Limited on 10 August 2004, changed its name to New WH Smith PLC and became a public liability company on 23 June 2006, and changed its name to WH Smith PLC on 30 August 2006.

Share capital

The authorised and issued share capital of the Company, together with details of shares issued during the year, are shown in Note 29 to the Accounts.

In order to facilitate the demerger of the WH Smith Retail business the Company increased its authorised share capital on 23 June 2006 by the creation of one redeemable preference share of £50,000. On 6 July 2006 the shareholders of the Company resolved that the authorised share capital of the Company should be increased by the creation of 584,999,000 ordinary shares of £1 each. The share capital was then reorganised by consolidating and subdividing the issued and unissued ordinary share capital into 300,000,000 ordinary shares of 195p each. On 7 September 2006 the Company completed a reduction of its capital in order to create distributable reserves; and the nominal value of each ordinary share in the Company was reduced from 195p to 20p.

Demerger

At an Extraordinary General Meeting of Old WH Smith held on 2 August 2006, shareholders approved the demerger of the WH Smith Retail business from the WH Smith Group. The Board of Old WH Smith set up a sub-committee to ensure that the demerger process was carefully managed and completed in accordance with the agreed timetable for the demerger. The steps required to implement this proposal included the insertion of a new holding company, Smiths News, between Old WH Smith and its shareholders via a scheme of arrangement, a reduction of share capital of Smiths News, the demerger of the WH Smith Retail business by a dividend in specie of Old WH Smith and in exchange the issue to shareholders of shares in the Company and a subsequent reduction of capital of the Company.

The demerger became effective on 31 August 2006 with the the Company being admitted to the Official List of the UK Listing Authority and to trading on the London Stock Exchange on 1 September 2006.

As part of the demerger, the Company paid an additional contribution of £25m to the WH Smith Pension Trust on 1 September 2006.

Directors' Report

Major shareholders

At 12 October 2006, 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	19,470,192	10.75
Deutsche Bank AG	11,119,279	6.08
Standard Life Group PLC	10,563,237	5.78
Grantham, Mayo, Van Otterloo & Co LLC	6,328,566	3.50
Legal & General Group PLC	5,630,399	3.07

Dividends

The directors recommend the payment of a final dividend for the year of 6.2p per ordinary share on 6 February 2007 to members on the register at the close of business on 5 January 2007.

This final dividend, together with the final dividend of 4p recommended by Smiths News on 12 October 2006 and the interim dividend of 5.1p per ordinary share paid on 15 June 2006 by Old WH Smith, makes a total dividend paid to the shareholders of Old WH Smith (assuming they have retained the shares in Smiths News and the Company that they received pursuant to the demerger) of 15.3p per ordinary share for the year ended 31 August 2006.

Employees

The Group employs approximately 17,000 people throughout the United Kingdom and it is proud of its 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 an Inland Revenue Approved Save-As-You-Earn share option scheme (Sharesave Scheme) which provides employees with the opportunity to acquire shares in the Company.

The Board believes in creating throughout the Company a culture 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 disabled people whenever suitable vacancies arise. Should employees 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 Group'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 19 to 23 and on the Company's website www.whsmithplc.com.

Donations

The Company's support for charitable causes is mainly channelled through the work of the Company's Charitable Trust. Charitable donations during the year ended 31 August 2006 totalled £68,500 (2005: £50,000). In addition, the Company facilitated the sale of charitable products which gave rise to further donations of £334,529 (2005: £286,000) and also made donations in kind with an estimated value of £105,000 (2005: £180,000). Employees are encouraged to give their time and skills for the benefit of a variety of charitable causes. The Company also invests in the community in other ways. This is captured in the Community Contributions table on page 23.

It is the Company's policy not to make political donations and no political donations or EU political expenditure were made in the year (2005: £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 40 days (2005: 47 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 24. All the directors served throughout the period except as noted below:

SDG Registrars Limited were appointed as a director on 2 August 2004 and resigned on 21 June 2006.

Ian Houghton was appointed as a director on 21 June 2006 and resigned on 26 June 2006.

Alan Stewart was appointed as a director on 21 June 2006.

Robert Walker, John Barton, Mike Ellis, Luke Mayhew, MT Rainey and Kate Swann were appointed as directors on 26 June 2006.

Directors' Report

The Company's Articles of Association require that at the first three Annual General Meetings following the demerger, one-third or nearest to one-third of the directors shall retire from office but shall be eligible for re-appointment. At each Annual General Meeting thereafter any director then in office who has been appointed by the Board since the previous Annual General Meeting or has held office for three years or more since he was appointed or last re-appointed by the Company in general meeting shall be eligible for re-appointment.

John Barton was appointed to the Board as a non-executive director on 26 June 2006 and pursuant to the Company's Articles of Association retires and, being eligible, offers himself for election at the Annual General Meeting. John Barton has been appointed for a fixed term and does not have a contract of service.

Alan Stewart was appointed to the Board on 21 June 2006 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 the Company giving one year's notice or by Alan Stewart giving nine months' notice.

Details of the interests of the directors and their families in the share capital of the Company at 31 August 2006 are shown on page 39.

The Company has executed deeds of indemnity for the benefit of each director of the Company and each person who was a director of the Company during the year, in respect of liabilities which may attach to them in their capacity as directors of the Company or of associated companies. These provisions are qualifying third party indemnity provisions as defined by section 309B of the Companies Act 1985 and are currently in force. Old WH Smith gave similar indemnities which were in force throughout the year.

Annual General Meeting

The first Annual General Meeting of the Company will be held at the CBI Conference Centre, Centre Point, 103 New Oxford Street, London WC1A 1DU on 1 February 2007 at 11.30am.

The Notice of Annual General Meeting is set out on pages 90 to 95 and contains five items of special business. Explanatory notes relating to the special business are set out on pages 92 and 93.

Statement as to disclosure of information to auditors

Each of the directors at the date of approval of this report confirms that:

- 1) so far as the director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- 2) the director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 234ZA of the Companies Act 1985.

Auditors

A resolution to re-appoint 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 12 October 2006.

By Order of the Board

Ian Houghton

Company Secretary

12 October 2006

The Board of the Company is committed to high standards of corporate governance and confirms that the Company intends to apply the principles and comply with the provisions set out in the Combined Code on Corporate Governance 2003 (the 'Code') throughout the financial year. This report has been prepared following the demerger of the WH Smith Retail business from Smiths News on 31 August 2006 and includes information in respect of the period up to and including 31 August 2006 when Old WH Smith was the holding company of the WH Smith Group. The Board confirms that the Company has, except as described at the end of this report, applied the principles and complied with the provisions of the Code.

The Board

On 12 October 2006, 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 24. 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 (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.

Alan Stewart was appointed as a director of the Company on 21 June 2006, and Robert Walker (Chairman), John Barton, Mike Ellis, Luke Mayhew, MT Rainey and Kate Swann were appointed directors of the Company on 26 June 2006; having previously been directors of Old WH Smith. All of the non-executive directors who served during the year and up to the date of this report meet the independence criteria set out in the Code.

It is proposed that the Board will normally meet ten times a year. The Board manages the Company through a formal schedule of matters reserved for its decision. These include overall management of the Company; approval of strategic plans including acquisitions and disposals; approval of the Company'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 normally 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. The Board carried out a formal evaluation of its performance in September 2006. Each director completed an extensive questionnaire covering Board and committee 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 October 2006 and a number of actions agreed.

The Company's Articles of Association require that at the first three Annual General Meetings following the demerger, one-third or nearest to one-third of the directors shall retire from office but shall be eligible for re-appointment. At each Annual General Meeting thereafter, any director then in office who has been appointed by the Board since the previous Annual General Meeting or has held office for three years or more since he was appointed or last re-appointed by the Company in general meeting, shall retire and be eligible for re-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 Annual General Meeting on 1 February 2007 for 15 minutes prior to and during the meeting.

Board Committees Audit Committee

The Audit Committee, which intends to meet at least three times a year, comprises Mike Ellis (Chairman), John Barton and Luke Mayhew, all of whom are independent non-executive directors.

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, objectivity and effectiveness; 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').

Nominations Committee

The Nominations Committee, which will meet as required, comprises Robert Walker (Chairman), John Barton, MT Rainey and Kate Swann.

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.

Remuneration Committee

Details of the composition and terms of reference of the Remuneration Committee are contained in the Remuneration Report on pages 32 to 39.

Attendance at Board and Committee meetings

The following table shows the number of Board and Committee meetings of Old WH Smith held during the year ended 31 August 2006 and the attendance record of individual directors.

	Board meetings	Committee meetings		
		Audit	Nominations	Remuneration
No. of meetings	12	5	1	5
Robert Walker	12	–	1	–
Kate Swann	11	–	1	–
Alan Stewart	12	–	–	–
John Barton	10	5	1	5
Mike Ellis	12	5	–	–
Luke Mayhew	12	5	–	5
MT Rainey	10	–	–	4

Directors' remuneration

Full details of the Company's remuneration policy and individual directors' remuneration are contained in the Remuneration Report on pages 32 to 39.

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 provide assurance on compliance with these policies. Steps are being taken to embed internal control and risk management further into the operations of the business and to deal with areas of improvement which come to management's and the Board's attention. 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

The Board confirms that there is an ongoing process for identifying, evaluating and managing significant risks faced by the Company including those risks relating to social, environmental and ethical matters. This process was in place throughout the year under review and up to the date of approval of the annual report and meets the requirements of the revised guidance entitled 'Internal Control – Guidance for Directors on the Combined Code' issued in September 1999. The Audit Committee has kept under review the effectiveness of the system of internal control and has reported regularly to the Board.

The key features of the risk management process are as follows:

- The business conducts an annual risk assessment based on identified business objectives which are reviewed and agreed by the Executive Committee. 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 Group and business risk committees and are reported to the Executive Committee and the Audit Committee.
- A Company risk assessment is also undertaken by the 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 assessment forms the basis for determining the internal audit plan. Audit reports in relation to areas reviewed are discussed and agreed with the business risk committees and Audit Committee.
- The 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 business risk committees. Certificates are also provided by the business risk committees 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;
- 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 business 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 the 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 and Audit Committee 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 effectiveness of which is regularly reviewed by the executive management and the Board. The key elements are as follows:

- a corporate responsibility strategy was approved by the Board, including objectives and targets to address the impact our activities have on the environment, workplace, marketplace and community;
- clear accountability for corporate responsibility issues has been defined at Board and operational level;
- the Company has appointed a Corporate Responsibility Committee to take responsibility for reviewing performance in delivering corporate responsibility objectives;
- annual updates are submitted to the Board on each aspect 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 Risk Management team works with the business 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 the business to continue in the event of a disaster with minimal 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. The auditors may only provide such services provided that such advice does not conflict with their statutory responsibilities and ethical guidance. The Audit Committee Chairman's pre-approval is required before the Company uses non-audit services that exceed financial limits set out in the policy. The fees paid to the auditors in respect of non-audit services are shown in Note 3 to the Accounts.

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 review and summary financial statement the annual report and accounts and the Annual General Meeting. 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 Annual General Meeting is the principal forum for dialogue with private shareholders. All directors normally attend the Annual General Meeting 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 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 2006 the Company has complied with the Code, except as follows:

A.7.1 Re-appointment of directors

The Articles provide that at the first three Annual General Meetings following the demerger, one-third or nearest to one-third of the directors shall retire from office but shall be eligible for re-appointment. This provision was included in the Articles, as a result of the demerger, to provide an even spread of director re-appointments and hence not all directors are standing for re-appointment at the Annual General Meeting.

Remuneration Report

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 2006. This report has also been prepared following the demerger of the WH Smith Retail business from the WH Smith Group on 31 August 2006 and includes information in respect of the period up until 31 August 2006 that Old WH Smith was the holding company of the WH Smith Group.

Part A – Unaudited Remuneration Committee

The Remuneration Committee, which intends to meet at least three times a year, comprises three independent non-executive directors, John Barton (Chairman), Luke Mayhew and MT Rainey.

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; determining policy for and scope of pension arrangements for executive directors and other senior executives; 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.

During the year the Committee received external advice and services from its independent adviser, Mercer Human Resource Consulting ('Mercer'), and following the demerger the Committee will continue to receive advice from Mercer as its external independent adviser. During the year the Committee also received advice from an independent law firm, Allen & Overy LLP, who were appointed by the Company, in respect of share schemes. Mercer also provided the Company with actuarial advice in respect of the Company's pension schemes and Allen & Overy LLP 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 Combined Code on Corporate Governance.

The aims of the policy are achieved by providing a remuneration package, comprising salary and benefits, positioned at 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 future annual remuneration package for executive directors

Name	Fixed	Performance-related	
	Salary	Annual bonus	Long-term incentives
Kate Swann	22%	33%	45%
Alan Stewart	25%	32%	43%

- a) Kate Swann can earn up to 150 per cent of salary for maximum performance and Alan Stewart can earn up to 130 per cent of salary for maximum performance under the Annual Bonus Plan.
- b) The value placed on long-term incentives assumes maximum performance and comprises the value of shares awarded under the WH Smith LTIP.
- c) The above table does not include the value of other benefits and employer pension contributions.

At an Extraordinary General Meeting of Old WH Smith held on 2 August 2006, shareholders approved the demerger of the WHSmith Retail business from the WH Smith Group and also approved the adoption of three new employee share plans by the Company based on the existing Old WH Smith share plans. The new employee share plans are the WH Smith Sharesave Scheme, the WH Smith Executive Share Option Scheme and the WH Smith LTIP (together the 'New WH Smith Employee Share Plans'). The Company has also adopted the following Old WH Smith share plans in respect of options and awards which are outstanding under those plans held by participating employees of the Company, the WH Smith Executive Share Option Scheme 1999, the WH Smith 2004 L-TIP and the WH Smith 2004 Management Investment Plan (together the 'Old WH Smith Share Plans'). None of the Old WH Smith Share Plans will be operated again by the Company.

Participants in the Old WH Smith Share Plans will receive replacement options and awards for their existing options and awards over Old WH Smith shares which will have the same intrinsic value at the time of exchange. In calculating the intrinsic value of Old WH Smith prior to the demerger, the value of Old WH Smith's shares will be taken as that average of their prices on the London Stock Exchange over any five consecutive dealing days of trading over the 30 dealing days immediately before the demerger. In determining the

Remuneration Report

exercise price of an exchanged option for the Company's employees, the value of the Company's shares will be taken as that average of their prices on the London Stock Exchange over any five consecutive dealing days of trading over the 30 dealing days immediately after the demerger that most closely reflects the value of Old WH Smith prior to the demerger.

The performance criteria for exchanged options and awards will be the same as the old performance conditions but relate to the performance of the Company. The Remuneration Committee determined that the performance condition in respect of all options granted up to and including November 2003 would be satisfied as at the date they were due to be measured.

The fees paid to non-executive directors are determined by the Board on the recommendation of 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.

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 2006 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, the executive directors 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 profit before tax and after interest target and personal performance. No bonus is paid unless the minimum profit target is achieved.

For the year ending 31 August 2007, Kate Swann will be able to earn a bonus of up to 150 per cent of base salary and Alan Stewart will be able to earn a bonus of up to 130 per cent of base salary.

Long-term incentives

The New WH Smith Share Plans are as follows:

WH Smith LTIP

Under this plan, approved by shareholders of Old WH Smith in August 2006, 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 200 per cent of base salary. The vesting of awards will be subject to the satisfaction of performance conditions which will be determined by the Committee at the time of grant.

WH Smith share option schemes

The Company operates two types of share option scheme both of which were approved by shareholders of Old WH Smith in August 2006:

- a) an Executive Share Option Scheme which is used to grant options to executives up to an annual limit of 200 per cent of base salary. The exercise of options is conditional upon the achievement of a performance target which is determined by the Board at the time of grant; and
- b) an Inland Revenue Approved Save-As-You-Earn share option scheme (the 'Sharesave Scheme'). 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 Old WH Smith Share Plans are as follows:

WH Smith Deferred Bonus Plan

The Deferred Bonus Plan, under which executive directors and senior executives received 30 per cent of their annual bonus in ordinary shares of Old WH Smith and could invest a further 25 per cent of their annual bonus in ordinary shares of Old WH Smith 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 2006. This Scheme was not adopted by the Company as all awards were released to participants on 25 August 2006.

WH Smith 2004 Management Investment Plan

Participants in this plan who held Old WH Smith shares that they were required to hold to participate in the Management Investment Plan ('Investment Shares') have received both Company and Smiths News shares as a result of the demerger. Executive directors will be required to continue to hold both the Company and Smiths News shares whilst other participants employed by the Company will be required either to continue to hold both the Company and Smiths News shares or sell the shares of Smiths News and purchase with the proceeds of that sale (net of taxes and dealing costs) shares in the Company by 30 November 2006. If a participant does not continue to hold the relevant Investment Shares for the duration of the performance period, a matching award will only be capable of vesting on a pro rata basis, and will lapse if the minimum investment amount is not retained during the performance period.

The performance conditions to which matching awards are subject were adjusted by the Board to be equivalent to the performance conditions that attached to the matching awards prior to the demerger. The existing Earnings per Share ('EPS') performance condition requires that the EPS of Old WH Smith grows by RPI plus 20 per cent per annum over the performance period for vesting at threshold performance and growth of RPI plus 30 per cent per annum over the performance period for vesting at maximum performance. The EPS of Old WH Smith for the purposes of the performance condition in the base year was 18.5p. The EPS performance condition has been amended so that it relates to the performance of the Company and that, based on an assumed level of RPI for the performance period of 3 per cent per annum, the threshold EPS for the Company will be 23p and the maximum EPS will be 29p for the year ended 31 August 2007.

The existing Total Shareholder Return ('TSR') performance condition measures the TSR of Old WH Smith against the TSR on a notional investment in the FTSE All Share General Retailers Index over the TSR performance period. The TSR performance condition has been amended so that at the end of the performance period the market capitalisation of the Company and Smiths News plus reinvested dividends paid over the whole of the performance period (whether paid by Old WH Smith, Smiths News or the Company) are added together to determine the percentage of Matching Awards that vest. In this way, the value of the TSR of Old WH Smith over the period up to the demerger will be added to that of the combined Smiths News and the Company for the remainder of the performance period.

Matching Awards will normally vest on 31 January 2008. 75 per cent of a Matching Award that vests will become exercisable immediately on vesting and will remain exercisable for a period of 24 months. The remaining 25 per cent will become exercisable 12 months after vesting and will remain exercisable for a period of 12 months.

WH Smith 2004 L-TIP

All outstanding awards under the L-TIP held by the Company's employees will be exchanged for new awards over the Company's shares. The exchanged awards will be subject to performance conditions which are the same as the performance conditions in respect of Old WH Smith.

The performance condition for awards granted in the year ended 31 August 2005 was based on the relative TSR of Old WH Smith over a fixed three year period compared against the FTSE All Share General Retailers Sector, increasing on a straight-line basis from 40 per cent for median performance to full vesting if Old WH Smith was in the top decile.

Following extensive consultation with shareholders regarding the Management Investment Plan performance targets, the Committee adopted a combination of financial and market based measures for awards granted in the year ended 31 August 2006. It believed that such a combination of targets was best suited to the needs of Old WH Smith and its shareholders.

Accordingly, the performance conditions for awards granted in the year ended 31 August 2006 were as follows:

- a) the performance condition applying to one-half of the award shares was based on real growth in the adjusted earnings per share of Old WH Smith over the three years ending 31 August 2008 (the 'Performance Period') and would have vested if the following targets had been achieved:

Annual rate of growth in Adjusted EPS of Old WH Smith (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 EPS will be determined by reference to fully diluted EPS before goodwill amortisation and exceptional items adjusted as considered appropriate by the Committee to ensure that a consistent approach is taken to such measurement of EPS, particularly in the transition period to international accounting standards.

- b) the performance condition applying to the remaining half of such an award was based on Old WH Smith's TSR performance against a comparator group of other companies over the Performance Period and would have vested if the following targets had been achieved:

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%

Remuneration Report

WH Smith Executive Share Option Scheme 1999

All outstanding options under the approved part of the WH Smith Executive Share Option Scheme 1999 (the '1999 Scheme') became exercisable from 25 August 2006 to 29 August 2006 as a result of the demerger.

All outstanding options held by the Company's employees under the unapproved part of the 1999 Scheme will be exchanged for new options over the Company's shares. As soon as practicable after the demerger, the Company will grant replacement options ('Exchanged Options') under the unapproved part of the 1999 Scheme in exchange for the existing options ('Old Options') over Old WH Smith shares. In respect of each Old Option exchanged, the total value of the shares under an Exchanged Option and the total amount payable to exercise an Exchanged Option will remain the same.

In respect of all Old Options granted up to and including November 2003, the Remuneration Committee determined that the related performance conditions will be satisfied as at the date they are due to be measured. Therefore, Exchanged Options granted in respect of those Old Options will not be subject to further performance conditions. Any Exchanged Options granted in respect of Old Options which were granted after November 2003 will be subject to the same performance conditions but relate to the performance of the Company. This performance condition for outstanding options granted under the 1999 Scheme is measured over a fixed three year period and the proportion that will become 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 Committee believes that EPS growth is the most appropriate measure of the Company's underlying financial performance.

WH Smith Group Executive Option Scheme

All outstanding options under the WH Smith Group Executive Option Scheme became exercisable from 25 August 2006 to 24 February 2007 as a result of the demerger.

WH Smith Sharesave Scheme 1999

All outstanding options under the WH Smith Sharesave Scheme 1999 became exercisable from 25 August 2006 to 24 February 2007 as a result of the demerger.

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:

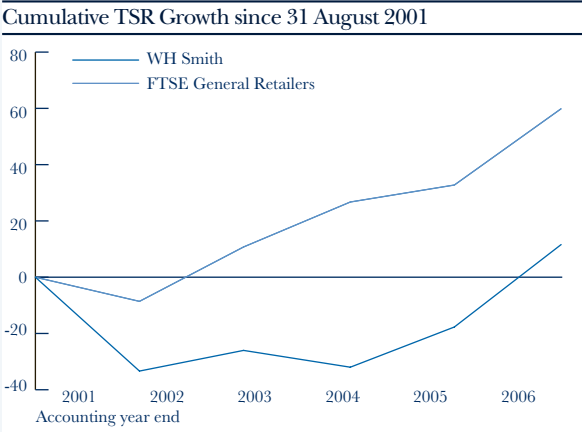
	Date of contract	Notice period by Company	Notice period by director
Kate Swann	2 July 2003	1 year	9 months
Alan Stewart	3 March 2005	1 year	9 months

It is the Company's policy to enter into contracts of employment with executive directors which may be terminated at any time by the Company upon 12 months' notice and upon 9 months' notice by the executive director. In accordance with the Company's policy 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 or by the Chairman.

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

Performance graph



- a) The graph illustrates the 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) Old WH Smith was a member of the FTSE General Retailers Sector and, as such, this sector was considered to be the most appropriate comparator group upon which a broad equity market index is calculated.

W H Smith Employees' Share Trust 1999 and the WH Smith Employee Benefit Trust

As part of the demerger the Old WH Smith Employees' Share Trust 1999 ('Old WH Smith Trust') will be split in proportion to the Trust's obligations to the Company and Smiths News as at the date of the demerger.

The WH Smith Employee Benefit Trust will be 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 plans including the Old WH Smith Share Plans. The Trust is a discretionary trust, the sole beneficiaries being employees (including executive directors) and former employees of the Company. The Trustee is Hill Samuel Offshore Trust Company Limited, an independent professional trustee company based in Jersey.

The number of shares held in the Old WH Smith Trust at 31 August 2006 was 7,712,263. The accounting treatment is described in Note 1 to the Accounts.

Pensions

The Company operates two types of pension scheme, a defined benefit pension scheme, WH Smith Pension Trust and a defined contribution pension scheme, WH Smith Pensionbuilder. No executive directors are members of the WH Smith Pension Trust.

The executive directors participate in WH Smith 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 the year ended 31 August 2006 the total contribution for Kate Swann was equivalent to 35 per cent of salary and for Alan Stewart was equivalent to 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 executive directors in respect of their non-executive directorships are shown in the table below:

	Directorship	Received £'000s	Retained £'000s
Kate Swann	The British Land Company plc	17	17
Alan Stewart	Games Workshop Group plc	30	30

Remuneration Report

Part B – Audited

Directors' remuneration

Following the demerger of the WH Smith Retail business from the WH Smith Group, the table below sets out the remuneration of the directors of Old WH Smith for the year ended 31 August 2006. The directors did not receive any remuneration from the Company in the year ended 31 August 2006.

	Salary/fees £'000s	Annual performance bonus £'000s	Benefits, pension supplement and other payments £'000s	Total £'000s	Year to 31 August 2005 £'000s
Robert Walker	200	–	–	200	119
Kate Swann	494	618	180	1,292	1,280
Alan Stewart	306	352	90	748	359
John Barton	49	–	–	49	45
Mike Ellis	42	–	–	42	18
Luke Mayhew	38	–	–	38	4
MT Rainey	38	–	–	38	33
Former directors	–	–	–	–	1,190
Total £'000s	1,167	970	270	2,407	3,048

- 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 a director of Old WH Smith on 1 September 2005 and was appointed as Chairman of the Company on 26 June 2006.
c) Kate Swann was a director of Old WH Smith on 1 September 2005 and was appointed as a director of the Company on 26 June 2006.
d) Alan Stewart was a director of Old WH Smith on 1 September 2005 and was appointed as a director of the Company on 21 June 2006.
e) John Barton was a director of Old WH Smith on 1 September 2005 and was appointed as a non-executive director of the Company on 26 June 2006.
f) Mike Ellis was a director of Old WH Smith on 1 September 2005 and was appointed as a non-executive director of the Company on 26 June 2006.
g) Luke Mayhew was a director of Old WH Smith on 1 September 2005 and was appointed as a non-executive director of the Company on 26 June 2006.
h) MT Rainey was a director of Old WH Smith on 1 September 2005 and was appointed as a non-executive director of the Company on 26 June 2006.
i) Ian Houghton was appointed as a director of the Company on 21 June 2006 and resigned on 26 June 2006. Ian Houghton did not receive a fee in respect of this appointment.

Directors' pensions

Defined contribution scheme

The following executive directors were members of a defined contribution scheme during the year ended 31 August 2006:

	Employee contribution		Employer contribution	
	% of salary	£'000s	% of salary	£'000s
Alan Stewart	5	15	5	15
Kate Swann	3.9	19	5	24

- a) 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.
b) 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.

Long-term incentives

Conditional share award

Kate Swann received an award of 141,315 ordinary shares on 4 November 2003. Following the capital reorganisation of Old WH Smith on 27 September 2004, this award increased to 142,415 Old WH Smith shares. Of these, 71,208 Old WH Smith shares with a market value of £260,265 were released and sold on 21 October 2005 and the balance of 71,207 Company and Smiths News shares will be released, subject to continued employment with the Company, in October 2006.

Remuneration Report

Old WH Smith Management Investment Plan

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

	31 August 2006	31 August 2005 or date of appointment	Date of grant	Market price on date of grant (pence)	Exercise period (see note b) below)
Alan Stewart	412,179	412,179	26.04.05	359	01.02.08 – 31.01.10
Kate Swann	717,778	717,778	03.11.04	343	01.02.08 – 31.01.10

- a) These awards will only vest to the extent that the performance targets are satisfied.
b) 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.

Old WH Smith 2004 L-TIP

Details of the conditional awards of ordinary shares of Old WH Smith granted to executive directors are as follows:

	31 August 2006	31 August 2005 or date of appointment	Share price at date of award (pence)	Date of award	Exercise period
Alan Stewart	83,265	83,265	367.50	02.11.05	October 2008 – 02.11.15
	56,319	56,319	407.50	09.02.06	February 2009 – 09.02.16
	139,584	139,584			
Kate Swann	134,476	134,476	367.50	02.11.05	October 2008 – 02.11.15
	90,957	90,957	407.50	09.02.06	February 2009 – 09.02.16
	225,433	225,433			

- a) These awards will only vest to the extent that the performance targets are satisfied.

Old WH Smith share option schemes

The interests of executive directors in options to acquire ordinary shares of Old WH Smith are as follows:

	Executive Share Option Scheme		Sharesave Scheme		Exercise price (pence)	Date of grant	Exercise period
	31 August 2006	31 August 2005 or date of appointment	31 August 2006	31 August 2005 or date of appointment			
Kate Swann	406,114	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
	406,114	414,847	–	3,491			

- a) The middle market price of an ordinary share at the close of business on 31 August 2006 was 475p (31 August 2005: 369p).
b) The high and low middle market prices of an Old WH Smith ordinary share during the year were 496.5p and 327p respectively.
c) Executive share options can only be exercised if the performance target is satisfied. The Remuneration Committee deemed that the performance condition set out on page 35 for options granted on or before 20 November 2003 was met for the three year period ended 31 August 2006.
d) Any Exchanged Options granted in respect of Old Options which were granted after November 2003 will be subject to a performance target that relates to the performance of the Company.
e) Kate Swann was granted an approved executive share option over 8,733 Old WH Smith shares on 20 November 2003 and exercised and sold them as a result of the demerger on 25 August 2006. The market price on 25 August was 479.8p and the gain, which was subject to tax, was £11,903.
f) Kate Swann was granted a sharesave option over 3,491 Old WH Smith shares, at an option price of 271.4p, on 1 June 2005 and exercised a reduced option over 1,209 Old WH Smith shares as a result of the demerger on 25 August 2006 (and the option lapsed in respect of the remaining 2,282 shares). The market price on 25 August was 479.8p and the gain, which was subject to tax, was £2,501.
g) The total gains made by directors on the exercise of share options under the Old WH Smith Executive Share Option Scheme was £11,903 and under the Old WH Smith Sharesave Scheme was £2,501.
h) Alan Stewart was not granted any options under the Old WH Smith share option schemes.
i) No options have been granted to or exercised by directors between 1 September 2006 and 12 October 2006.

Remuneration Report

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 2006	31 August 2005 (or date of appointment)
John Barton	16,000	16,000
Mike Ellis	5,000	5,000
Luke Mayhew	8,000	8,000
MT Rainey	—	—
Alan Stewart	82,194	82,194
Kate Swann	149,438	148,229
Robert Walker	13,476	13,476

There has been no change in the directors' interests shown above between 1 September 2006 and 12 October 2006.

Interest in shares under WH Smith Employees' Share Trust 1999

The executive directors, being potential beneficiaries of the WH Smith Employees' Share Trust, were each treated as at 31 August 2006 as being interested in 7,712,263 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 (including the Old WH Smith Share Plans).

By Order of the Board

John Barton

Chairman of the Remuneration Committee

12 October 2006

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 (formerly New WH Smith PLC; formerly Pollquote Limited)

We have audited the Group financial statements of WH Smith PLC for the year ended 31 August 2006 which comprise the Group income statement, the Group balance sheet, the Group cash flow statement, the Group statement of recognised income and expense, reconciliation of movements in equity and the related Notes 1 to 33. These Group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the directors' remuneration report that is described as having been audited.

We have reported separately on the individual company financial statements of WH Smith PLC for the year ended 31 August 2006.

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

The directors' responsibilities for preparing the annual report, the directors' remuneration report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted for use in the European Union are set out in the statement of directors' responsibilities.

Our responsibility is to audit the Group 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 International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view, in accordance with the relevant financial reporting framework, and whether the Group 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 and Article 4 of the IAS Regulation. We report to you whether in our opinion the information given in the directors' report is consistent with the Group financial statements. The information given in the directors' report includes that specific information presented in the Business Review and the Financial Review that is cross referred from the directors' report. We also report to you if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' transactions with the Company and other members of the Group is not disclosed.

Independent Auditors' Report to the Members of WH Smith PLC (formerly New WH Smith PLC; formerly Pollquote Limited)

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 details of any non-compliance.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the 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 statement on internal control covers 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 we consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group 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 Group financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, 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 Group 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 Group financial statements and the part of the directors' remuneration report described as having been audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted for use in the European Union, of the state of the Group's affairs as at 31 August 2006 and of its profit for the year then ended; and
- the Group 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 and Article 4 of the IAS Regulation; and
- the information given in the directors' report is consistent with the Group financial statements.

As explained in Note 1 of the Group financial statements, the Group, in addition to complying with its legal obligation to comply with IFRSs as adopted for use in the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board. Accordingly, in our opinion the financial statements give a true and fair view, in accordance with IFRSs, of the state of the Group's affairs as at 31 August 2006 and of its profit for the year then ended.

Deloitte & Touche LLP

Chartered Accountants and Registered Auditors

London

12 October 2006

Notes: An audit does not provide assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular whether any changes may have occurred to the financial information since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.

Group Income Statement for the year ended 31 August 2006

		2006			2005		
£m	Note	Before exceptional items	Exceptional items	Total	Before exceptional items	Exceptional items	Total
Continuing operations							
Revenue	2	1,340	–	1,340	1,423	–	1,423
Operating profit	2,3,4	60	(7)	53	47	–	47
Investment income	11	2	–	2	3	–	3
Finance costs	12	(11)	–	(11)	(11)	–	(11)
Profit before tax		51	(7)	44	39	–	39
Income tax expense	13	(10)	(2)	(12)	(9)	–	(9)
Profit after tax from continuing operations		41	(9)	32	30	–	30
Loss for the year from discontinued operations	5	–	–	–	–	(8)	(8)
Profit for the year		41	(9)	32	30	(8)	22
<i>Earnings per share¹</i>							
<i>Basic – continuing operations</i>	15			18.6p			16.9p
<i>Diluted – continuing operations</i>	15			18.2p			16.8p
<i>Basic</i>	15			18.6p			12.4p
<i>Diluted</i>	15			18.2p			12.3p
<i>Non GAAP measures</i>							
<i>Headline earnings per share²</i>							
<i>Basic – continuing operations</i>	15			25.0p			17.5p
<i>Diluted – continuing operations</i>	15			24.4p			17.3p
<i>Basic</i>	15			25.0p			17.5p
<i>Diluted</i>	15			24.4p			17.3p
<i>Equity dividends per share³</i>				6.2p			
<i>Fixed charges cover</i>	9			1.3x			1.3x

1 Earnings per share is calculated in accordance with IAS 33 'Earnings per Share'.

2 Headline earnings per share excludes exceptional items and IAS 19 pension interest.

3 Dividend per share is the final proposed dividend.

Group Balance Sheet as at 31 August 2006

£m	Note	2006	2005
Non-current assets			
Goodwill	16	15	15
Other intangible assets	17	15	14
Property, plant and equipment	18	184	197
Deferred tax assets	24	29	38
Trade and other receivables	19	5	16
		248	280
Current assets			
Inventories		143	148
Trade and other receivables	19	69	75
Cash and cash equivalents	25	66	39
		278	262
Total assets		526	542
Current liabilities			
Trade and other payables	20	(215)	(216)
Current tax liabilities		(20)	(26)
Obligations under finance leases	22,25	(3)	(4)
Bank overdrafts and other borrowings	25	(13)	(45)
Short-term provisions	23	(4)	(5)
		(255)	(296)
Non-current liabilities			
Bank loans and other borrowings	25	–	(37)
Retirement benefit obligation	6	(66)	(60)
Deferred tax liabilities	24	(13)	(14)
Long-term provisions	23	(8)	(11)
Obligations under finance leases	22,25	(8)	(11)
Other non-current liabilities	21	(8)	(8)
		(103)	(141)
Total liabilities		(358)	(437)
Total net assets		168	105
Total equity		168	105

£m	Note	2006	Proforma 2005
Total equity			
Called up share capital	29	357	353
'B' share reserve		–	2
'C' share reserve		–	8
ESOP reserve		(22)	(26)
Revaluation reserve		3	3
Hedging reserve		(2)	–
Translation reserve		(2)	–
Retained earnings		–	(1)
Other reserve		(166)	(234)
		168	105

These financial statements were approved by the Board of Directors and authorised on 12 October 2006 and were signed on its behalf by:

Kate Swann
Group Chief Executive

Alan Stewart CA (SA)
Group Finance Director

Group Cash Flow Statement for the year ended 31 August 2006

£m	Note	2006	2005
Net cash inflows / (outflows) from operating activities	27	82	(23)
Investing activities			
Interest received		2	4
Proceeds on disposal of property, plant and equipment		9	2
Proceeds on disposal of subsidiary		–	222
Proceeds on settlement of loan notes		11	–
Non-operating disposal costs		(3)	(10)
Purchase of property, plant and equipment		(24)	(29)
Purchase of intangible assets		(5)	(1)
Net cash (outflows) / inflows from investing activities		(10)	188
Financing activities			
Interest paid		(7)	(6)
Dividend paid		(15)	(11)
'C' share dividend paid on capital reorganisation		–	(143)
Purchase of shares for employee share schemes		–	(12)
Money returned to ESOP Trust after share capital reorganisation		–	5
Issue of shares to satisfy employee share schemes		4	2
Repurchase of 'C' shares equity portion		(3)	(62)
Repayments of borrowings		(76)	–
Repayments of obligations under finance leases		(4)	(3)
New bank loans raised (net of financing costs)		–	61
Derivative cash movements		(1)	–
Movement in funding balances with the News business		57	(8)
Net cash used in financing activities		(45)	(177)
Net increase / (decrease) in cash and cash equivalents – continuing operations		19	(2)
Net increase / (decrease) in cash and cash equivalents – discontinued operations		8	(10)
Net increase / (decrease) in cash and cash equivalents in year		27	(12)
Opening net cash and cash equivalents		39	51
Closing net cash and cash equivalents		66	39

Reconciliation of net cash flow to movement in net (debt) / funds

£m	Note	2006	2005
Net (debt) / funds at beginning of the year		(58)	26
IAS 39 – 'B' and 'C' shares classified as financial liabilities		(7)	–
Increase / (decrease) in cash and cash equivalents		27	(12)
Decrease / (increase) in debt		76	(63)
Net movement in finance leases		4	(9)
Net funds / (debt) at end of the year	25	42	(58)

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

£m	2006	2005
Exchange differences arising on translation of foreign operations	(2)	–
Loss on cash flow hedges	(2)	–
Actuarial losses on defined pension schemes (Note 6)	(24)	(27)
UK deferred tax attributable to pension scheme liabilities	5	(10)
UK current tax attributable to the additional pension scheme contributions	3	13
Net expense recognised directly in equity	(20)	(24)
Profit for the year	32	22
Total recognised income and expense for the year	12	(2)

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

Reconciliation of Movements in Equity for the year ended 31 August 2006

£m	Share capital	'B' and 'C' share reserves	Hedging and translation reserves	Revaluation reserve	ESOP reserve	Other reserve	Retained earnings	Total
Balance at 1 September 2004	–	2	–	–	–	–	–	2
Capital reorganisation and proforma restatement	352	70	–	3	(20)	(238)	151	318
Restated at 1 September 2004	352	72	–	3	(20)	(238)	151	320
Total recognised income and expense for the year	–	–	–	–	–	–	(2)	(2)
Recognition of share-based payments	–	–	–	–	–	–	4	4
Dividends paid	–	–	–	–	–	–	(154)	(154)
Repurchase of shares	–	–	–	–	(11)	–	–	(11)
Employee share schemes	1	–	–	–	–	1	–	2
Cancellation of shares	–	(62)	–	–	–	–	–	(62)
Money returned to ESOP Trust after share capital reorganisation	–	–	–	–	5	–	–	5
Movement in funding balances with the News business	–	–	–	–	–	3	–	3
Balance at 1 September 2005	353	10	–	3	(26)	(234)	(1)	105
Cumulative adjustment for implementation of IAS 39	–	(7)	–	–	–	–	–	(7)
Balance restated at 1 September 2005 for adoption of IAS 39	353	3	–	3	(26)	(234)	(1)	98
Total recognised income and expense for the year	–	–	(4)	–	–	–	16	12
Recognition of share-based payments	–	–	–	–	–	–	4	4
Dividends paid	–	–	–	–	–	–	(15)	(15)
Employee share schemes	4	–	–	–	4	2	(4)	6
Repurchase of shares	–	(3)	–	–	–	–	–	(3)
Movement in funding balances with the News business	–	–	–	–	–	66	–	66
Balance at 31 August 2006	357	–	(4)	3	(22)	(166)	–	168

1 Accounting policies
a) Basis of preparation

WH Smith PLC (formerly New WH Smith PLC; formerly Pollquote Limited) was incorporated on 10 August 2004. On 23 June 2006, the Company re-registered as a public limited company.

On 31 August 2006, the WHSmith Retail business was demerged from Smiths News PLC, effected by a dividend in specie.

The shareholders of Smiths News PLC received a dividend in specie in respect of the entire shareholding of New WH Smith PLC. The payment of the dividend was effected as follows:

- existing shares in WHSmith Retail Holdings Limited (formerly WH Smith PLC), which owned the Retail business were transferred by Smiths News PLC to New WH Smith PLC (now renamed WH Smith PLC) so that New WH Smith PLC became the holding company of the WHSmith Retail business; and
- in exchange for such transfer, New WH Smith PLC allotted and issued to Smiths News PLC shareholders one New WH Smith PLC share, credited as fully paid, for each Smiths News PLC share held.

On 30 August 2006 New WH Smith PLC changed its name to WH Smith PLC. The shares of WH Smith PLC were admitted to listing on the London Stock Exchange on 1 September 2006.

In accordance with the principles of reverse acquisition accounting in IFRS 3 ‘Business Combinations’, the accounts of WH Smith PLC have been prepared as if it had been in existence in its current Group form since 1 September 2004. The following summarises the accounting principles that have been applied in preparing the accounts on a reverse acquisition accounting basis:

- the income statement for WH Smith PLC has been prepared as if the continuing operations of the WH Smith PLC Group were in existence for the whole of the period from 1 September 2004 through to 31 August 2006;
- share capital and reserves for the prior year consolidated balance sheet have been restated on a proforma basis including the 2005 capital reorganisation. Differences between these amounts and the previously reported share capital and reserves have been reflected in the other reserve, as set out in the reconciliation of movements in equity. The proforma restated share capital for the prior year represents the nominal value of shares in issue as if WH Smith PLC had been in existence in its Group form since 1 September 2004;
- as well as costs borne directly by the Retail business, the results for the year ended 31 August 2006 and 31 August 2005 include £0.8m of corporate head office costs of the former ultimate parent company which have historically not been recharged by WH Smith PLC to its business divisions. Services provided by WH Smith PLC included, but were not limited to, treasury, cash management, human resources, accounting, legal and professional services, and IT services. These charges may not be representative of the costs that would have been incurred had the business been a standalone entity.

International Financial Reporting Standards

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

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

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

IFRIC 4	Determining whether an Arrangement Contains a Lease
IFRIC 8	Scope of IFRS 2
IFRIC 9	Reassessment of Embedded Derivatives
Amendment to IAS 39	Cash Flow Hedge Accounting of Forecast Intragroup Transactions

The directors anticipate that the adoption of these Standards and Interpretations in future years will have no material impact on the Group financial statements except for the additional disclosures on capital and financial instruments when the relevant standards come into effect for the financial year commencing on or after 1 September 2006.

Adoption of IAS 32 and IAS 39

The Group implemented IAS 32 ‘Financial Instruments: Disclosure and Presentation’ and IAS 39 ‘Financial Instruments: Recognition and Measurement’ in the year commencing 1 September 2005.

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

A summary of the Group’s accounting policies is given below.

Accounting convention

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

1 Accounting policies continued

Basis of consolidation

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

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

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

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

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

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

b) Revenue

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales related taxes. Sales of goods are recognised when goods are delivered and title has passed.

c) Retirement benefit costs

Payments to the WHSmith Group defined contribution pension scheme, the WH Smith Retirement Savings Plan, are recognised as an expense in the income statement as they fall due.

The cost of providing benefits for the main defined benefit scheme, WHSmith Pension Trust, is determined by the Projected Unit Credit Method, with actuarial calculations being carried out at the balance sheet date. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the income statement in the consolidated statement of recognised income and expense.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligation as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets. Any asset resulting from the calculation is limited to past service cost, plus the present value of available refunds and reductions in future contributions to the plan.

The WHSmith Group provides medical benefits to certain pensioners. The present value of estimated future benefit payments is included in the balance sheet under pension liabilities. Any differences arising from changes in assumptions in respect of the estimation of this liability are recognised in the consolidated statement of recognised income and expense.

d) Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are recognised as assets of the Group at their fair value determined at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and a reduction of the lease obligations so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are recognised directly in the income statement.

Rentals payable and receivable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

1 Accounting policies continued
e) Intangible assets
Goodwill

Goodwill represents the excess of the fair value of purchase consideration over the net fair value of identifiable assets and liabilities acquired.

Goodwill is recognised as an asset at cost and subsequently measured at cost less accumulated impairment. For the purposes of impairment testing, goodwill is allocated to those cash-generating units that have benefited from the acquisition. The carrying value of goodwill is reviewed for impairment at least annually or where there is an indication that goodwill may be impaired. If the recoverable amount of the cash-generating unit is less than its carrying amount, then the impairment loss is allocated first to reduce the carrying amount of the goodwill allocated to the unit and then to the other assets of the unit on a pro rata basis. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the profit and loss on disposal.

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1 June 1997 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

Other intangible assets

The costs of acquiring and developing software that is not integral to the related hardware is capitalised separately as an intangible asset. These intangibles are stated at cost less accumulated amortisation and impairment losses.

Amortisation is charged so as to write off the costs of assets over their estimated useful lives, using the straight-line method. The estimated lives are usually a period of up to five years. Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

All such intangible assets are reviewed for impairment in accordance with IAS 36 'Impairment of Assets', when there are indications that the carrying value may not be recoverable.

f) Property, plant and equipment

Property, plant and equipment assets are carried at cost less accumulated depreciation and any recognised impairment in value. The carrying values of tangible fixed assets previously revalued have been retained at their book amount.

Depreciation is charged so as to write off the costs of assets, other than land, over their estimated useful lives, using the straight-line method, with the annual rates applicable to the principal categories being:

Freehold and long leasehold properties	— over 20 years
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

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

All tangible fixed assets are reviewed for impairment in accordance with IAS 36 'Impairment of Assets', when there are indications that the carrying value may not be recoverable.

g) Non-current assets held for resale

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of the assets' previous carrying amount and fair value less costs to sell.

h) Inventories

Inventories comprise goods held for resale and are stated at the lower of cost or net realisable value. Inventories are valued using a weighted average cost method.

i) Provisions

Provisions are recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the balance sheet date. Where the effect is material, the provision is determined by discounting the expected future cash flows at the Group's weighted average cost of capital.

Onerous contracts – property provisions

The Group's property provisions represent 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 in the income statement as 'unwinding of discount on provisions'.

1 Accounting policies continued

j) Foreign currencies

Transactions denominated in foreign currencies are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in the income statement for the period.

In order to hedge its exposure to certain foreign exchange risks, the Group enters into forward contracts and options (see below for details of the Group's accounting policies in respect of such derivative financial instruments).

On consolidation the assets and liabilities of the Group's overseas operations are translated into sterling at exchange rates prevailing on the balance sheet date. Income and expense items are translated into sterling at the average exchange rates for the period. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve.

k) Taxation

The tax expense included in the income statement comprises current and deferred tax.

Current tax is the expected tax payable based on the taxable profit for the period, using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the accounts and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

l) Financial instruments

UK GAAP – to 31 August 2005

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 instrument's impact on profit deferred until the underlying transaction is recognised in the profit and loss account.

IFRS – from 1 September 2005

Trade receivables

Trade receivables are measured at initial recognition, do not carry any interest and are stated at their fair value and are subsequently measured at amortised costs using the effective interest rate method. Appropriate allowances for estimated irrecoverable amounts are recognised in the income statement when there is evidence that the asset is impaired.

Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

Bank borrowings

Interest bearing bank loans and overdrafts are initially measured at fair value (being proceeds received, net of direct issue costs), and are subsequently measured at amortised cost, using the effective interest rate method recorded as the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemptions and direct issue costs are accounted for on an accruals basis and taken to the income statement using the effective interest rate method and are added to the carrying value of the instrument to the extent that they are not settled in the period in which they arise.

Trade payables

Trade payables are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method.

1 Accounting policies continued

l) Financial instruments continued

Equity instruments

Equity instruments issued are recorded at the proceeds received, net of direct issue costs.

Derivative financial instruments and hedge accounting

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

Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and any ineffective portion is recognised immediately in the income statement. If the cash flow hedge of a firm commitment or forecasted transaction results in the recognition of an asset or liability, then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had previously been recognised in equity are included in the initial measurement of the asset or liability. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recognised in the income statement in the same period in which the hedged item affects the net income statement.

For an effective hedge of an exposure to changes in the fair value, the hedged item is adjusted for changes in fair value attributable to the risk being hedged with the corresponding entry in profit or loss. Gains or losses from remeasuring the derivative, or for non-derivatives the foreign currency component of its carrying amount, are recognised in the income statement.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the net profit or loss for the period.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not carried at fair value with unrealised gains or losses reported in the income statement.

m) Share schemes

WH Smith Employees' Share Trust 1999

The shares held by the WH Smith Employees' Share Trust 1999 are valued at the historical cost of the shares acquired. They are deducted in arriving at shareholders' funds and are presented as another reserve in line with IAS 32 'Financial Instruments: Disclosure and Presentation'.

As a result of the demerger, the WH Smith Employees' Share Trust 1999 was divided into two schemes, one for the Retail business and one for the News business. This involved segregating the assets of the Trust relating to each of the Retail group and the News group. From 1 September 2006, WH Smith PLC will account for the section of the Trust allocated from the segregation which will be called the WH Smith Employees' Share Trust.

Share-based payments

Employees of the Group receive part of their remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions).

Equity-settled share-based payments are measured at fair value at the date of grant. The fair value is calculated using an appropriate option pricing model. The fair value is expensed to the income statement on a straight-line basis over the vesting period, based on the Group's estimate of shares that will eventually vest.

n) Critical accounting judgements and key sources estimation uncertainty

Retirement benefit obligation

The Group recognises and discloses its retirement benefit obligation in accordance with the measurement and presentational requirement of IAS 19 'Employee Benefits'. The calculations include a number of judgements and estimations in respect of the expected rate of return on assets, the discount rate, inflation assumptions, the rate of increase in salaries, and life expectancy amongst others. Changes in these assumptions can have a significant effect on the value of the retirement benefit obligation.

In order to substantially reduce the volatility in the underlying investment performance and reduce the risk of a significant increase in the obligation, a new investment policy in respect of the assets of the WHSmith Pension Trust was adopted in September 2005. This is discussed in more detail in Note 6.

Notes to Accounts

2 Segmental analysis of results

For management purposes, the Group is currently organised into two operating divisions – High Street and Travel. These divisions are the basis on which the Group currently reports its primary business segment information. Prior to their disposal, the Publishing business, USA Travel Retail and Aspac Retail were separate business segments. The information for these businesses, which are presented as discontinued operations, can be found in Note 5.

i) Segmental analysis by business segments

a) Group revenue

£m	2006	2005
Continuing operations:		
High Street	1,021	1,112
Travel	319	311
Group revenue	1,340	1,423

b) Group results

£m	2006	2005
Continuing operations:		
High Street	42	37
Travel	31	25
Trading profit	73	62
Unallocated costs	(13)	(15)
Group operating profit before exceptional items	60	47
Exceptional items (Note 4)	(7)	–
Group operating profit	53	47
Investment income	2	3
Finance costs	(11)	(11)
Income tax expense	(12)	(9)
Loss for the year from discontinued operations	–	(8)
Profit for the year	32	22

c) Balance sheet

£m	2006					2005				
	High Street	Travel	Continuing operations	Discontinued operations	Group	High Street	Travel	Continuing operations	Discontinued operations	Group
Assets										
Segment assets	442	74	516	4	520	458	53	511	3	514
Unallocated assets	–	–	6	–	6	–	–	28	–	28
Consolidated total assets	442	74	522	4	526	458	53	539	3	542
Liabilities										
Segment liabilities	(213)	(38)	(251)	(4)	(255)	(224)	(31)	(255)	(6)	(261)
Unallocated liabilities	–	–	(103)	–	(103)	–	–	(176)	–	(176)
Consolidated total liabilities	(213)	(38)	(354)	(4)	(358)	(224)	(31)	(431)	(6)	(437)
Net assets			168	–	168			108	(3)	105

Notes to Accounts

2 Segmental analysis of results continued

d) Other segmental items

£m	2006					2005				
	High Street	Travel	Continuing operations	Discontinued operations	Group	High Street	Travel	Continuing operations	Discontinued operations	Group
Capital additions	24	5	29	–	29	26	4	30	–	30
Depreciation and amortisation of non-current assets	(29)	(5)	(34)	–	(34)	(36)	(5)	(41)	–	(41)
Impairment losses	(3)	–	(3)	–	(3)	–	–	–	–	–

Segment assets include intangible assets, property, plant and equipment, inventories, receivables and operating cash. Segment liabilities comprise of operating liabilities. Information on discontinued operations is shown in Note 5.

ii) Segmental analysis by geographical area

The total Group revenue and operating profits for these periods originate from the UK / Europe region. The directors consider this to be one segment.

3 Group operating profit

£m	2006	2005
Turnover	1,340	1,423
Cost of sales	(761)	(847)
Gross profit	579	576
Distribution costs	(434)	(437)
Administrative expenses	(97)	(92)
Pre-exceptional operating items	(90)	(92)
Exceptional operating items ¹	(7)	–
Other income ²	5	–
Group operating profit	53	47

1 The exceptional operating items are detailed in Note 4.

2 Other income is attributable to profit on sale of freehold property, plant and equipment. During the period there was a £3m impairment charge for property, plant and equipment included in distribution costs (2005: £nil).

£m	2006	2005
Cost of inventories recognised as an expense	786	854
Write-down of inventories in the period	12	17
Depreciation and amounts written off property, plant and equipment	33	37
Amortisation of intangible assets	4	4
Net operating lease charges		
– land and buildings	147	140
– equipment and vehicles	1	2
Other occupancy costs	50	45
Staff costs (Note 7)	192	199
Auditors' remuneration (see below)	2	1
Fees payable to Deloitte & Touche LLP, the Group's auditors, included in the income statement related to:		
Audit fees	0.2	0.2
Non-audit fees	1.9	0.2
	2.1	0.4

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

Notes to Accounts

4 Continuing operations exceptional items

Exceptional items are material items of income or expense that are disclosed separately due to their nature or amount. They are disclosed and described separately in the financial statements where it is necessary to do so to provide further understanding of the financial performance of the Group.

£m	2006	2005
Settlement of Post Retirement Medical Benefit Scheme	5	–
Costs of demerger from Smiths News PLC	(12)	–
	(7)	–

In September 2005, members of the Post Retirement Medical Benefits Scheme were offered the option to be bought out of the scheme, which was accepted by the majority of members. A gain of £5m (before tax) arose from the settlement of this scheme, which has been recognised in the income statement for the period. Further details are included in Note 6.

The Group has a £12m exceptional charge in relation to costs associated with the demerger from Smiths News PLC.

5 Discontinued operations

The results from discontinued operations were as follows:

i) Revenue from discontinued operations

£m	2006	2005
Publishing business		
Total revenue	–	14
Internal revenue	–	(3)
Total revenue	–	11
USA Travel Retail	–	–
Total revenue – discontinued operations	–	11

ii) Loss from discontinued operations

	2006			2005		
£m	Publishing business	USA Travel Retail	Total	Publishing business	USA Travel Retail	Total
Profit before tax and before exceptional items	–	–	–	–	–	–
Income tax expense	–	–	–	–	–	–
Profit after tax and before exceptional items and loss on sale	–	–	–	–	–	–
Exceptional trading items	–	–	–	–	–	–
Impairment on sale of discontinued operations	–	–	–	–	(8)	(8)
Income tax expense	–	–	–	–	–	–
Exceptional items after tax	–	–	–	–	(8)	(8)
Loss from discontinued operations	–	–	–	–	(8)	(8)

iii) Cash flows of discontinued operations

The cash flows of discontinued operations comprise:

£m	2006	2005
From operating activities	–	–
From investing activities	8	(10)
From financing activities	–	–
Net increase / (decrease) in cash and cash equivalents	8	(10)

Notes to Accounts

5 Discontinued operations continued

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	
Fixed assets	156
Inventories	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.

USA Travel Retail

£8m was charged to the income statement in the prior year relating to the disposal of discontinued businesses. Of this amount, £7m related to an impairment review of the loan notes received as deferred consideration on the previous disposal of the Group's USA business, and the balance related to disclosure and exit provisions.

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.

6 Retirement benefit obligation

The WHSmith Group has operated a number of defined benefit and defined contribution pension plans. The main pension arrangements for employees are operated through a defined benefit scheme, WHSmith Pension Trust, and a defined contribution scheme, WH Smith Retirement Savings Plan. The most significant is the defined benefit WHSmith Pension Trust for the Group's UK employees which is described in Note 6 a) (i). The scheme is independent of the Company and is administered by a Trustee. The Trustee of the Pension Trust has extensive powers over the pension plans' arrangements, including the ability to determine the levels of contribution.

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

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

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

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

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

Notes to Accounts

6 Retirement benefit obligation continued

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

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

£m	2006	2005
Continuing operations		
Present value of the obligations	(674)	(651)
Fair value of plan assets	608	598
Deficit	(66)	(53)
Retirement medical benefit liability	–	(7)
Retirement benefit obligation recognised in the balance sheet	(66)	(60)
Deferred taxation (Note 24)	20	18
Net retirement obligation	(46)	(42)

a) Defined benefit pension scheme

i) The WHSmith Pension Trust

A full actuarial valuation of the scheme is carried out every three years with interim reviews in the intervening years. The latest full actuarial valuation of the Pension Trust was carried out as at 31 March 2006 by independent actuaries, Mercer Human Resource Consulting, using the projected unit basis, and as with each such triennial valuation, the valuation currently remains subject to the formal approval of the Pension Trust Trustee. The scheme was closed in September 1995 and under the projected unit method the current service cost would be projected to increase as members approach retirement and the age profile of members increases. On an ongoing basis the gross actuarial defined benefit pension deficit for WHSmith PLC was approximately £96m (approximately £67m net of related deferred taxes) for the Pension Trust. The ongoing deficit is greater than the IAS 19 deficit primarily due to the different assumptions and calculation methodologies.

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

The key features of this new investment policy were that:

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

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

The valuation of the defined benefit pension scheme used for the IAS 19 disclosures is based upon the most recent valuation. Scheme assets are stated at their market value at the relevant reporting date.

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

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

The amounts recognised in the income statement were as follows:

£m	2006	2005
Current service cost	(6)	(6)
Interest cost	(32)	(31)
Expected return on scheme assets	29	30
	(9)	(7)

Notes to Accounts

6 Retirement benefit obligation continued

a) Defined benefit pension scheme continued

i) The WHSmith Pension Trust continued

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

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

£m	2006	2005
At 1 September	(651)	(559)
Current service cost	(6)	(6)
Interest cost	(32)	(31)
Actuarial gains and losses	(7)	(75)
Benefits paid	22	20
As at 31 August	(674)	(651)

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

£m	2006	2005
At 1 September	598	443
Expected return on scheme assets	29	30
Actuarial gains and losses	(17)	48
Contributions from the sponsoring companies	20	97
Benefits paid	(22)	(20)
As at 31 August	608	598

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

£m	2006	2005
Equities	–	265
Bonds	–	333
Cash	584	–
Inflation swaps	(14)	–
Equity call options	38	–
	608	598

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

	2006	2005
Equities	–	7.00%
Bonds	–	4.00%
Cash ¹	–	3.75%
Inflation swaps ¹	–	–
Equity call options ¹	–	–

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

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

Notes to Accounts

6 Retirement benefit obligation continued

a) Defined benefit pension scheme continued

i) The WHSmith Pension Trust continued

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

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

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

The four year history of experience adjustments is as follows:

£m	2006	2005	2004	2003
Present value of defined benefit obligations	(674)	(651)	(612)	(585)
Fair value of scheme assets	608	598	473	441
Deficit in the scheme	(66)	(53)	(139)	(144)
Experience adjustments on scheme liabilities				
Amount (£m)	(7)	(75)		
Percentage of scheme liabilities (%)	1	11		
Experience adjustments on scheme assets				
Amounts (£m)	(17)	48		
Percentage of scheme assets (%)	(3)	8		

ii) Post retirement medical benefits

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

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

b) Defined contribution pension scheme

The pension cost charged to income for the Group's defined contribution scheme, WH Smith Retirement Savings Plan, amounted to £2m for the year ended 31 August 2006 (31 August 2005: £2m).

c) Discontinued pension schemes

Year ended 31 August 2005

Publishing business

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

USA Travel Retail

The Group made a settlement of £3m in respect of the pension liabilities of this business.

Notes to Accounts

7 Staff costs and employees

a) Staff costs

The aggregate remuneration of employees was:

£m	2006	2005
Continuing:		
Wages and salaries	166	175
Social security	11	11
Net pension cost	9	9
Employee share schemes	6	4
Total continuing operations	192	199
Discontinued:		
Wages and salaries	–	2
Social security	–	–
Net pension cost	–	–
Employee share schemes	–	–
Total discontinued operations	–	2
Total Group	192	201

b) Employee numbers

The average total monthly number of employees (including executive directors) was:

Number	2006	2005
Continuing:		
High Street	14,221	15,981
Travel	2,851	2,809
Total Retailing	17,072	18,790
Support functions	44	55
Continuing operations	17,116	18,845
Discontinued:		
Publishing	–	67
Discontinued operations	–	67
Total Group	17,116	18,912

8 Operating lease commitments

£m	2006			2005		
	Land and buildings	Equipment and vehicles	Total	Land and buildings	Equipment and vehicles	Total
Minimum lease payments under non-cancellable operating leases are payable as follows:						
Within one year	124	–	124	85	1	86
Within two to five years	372	1	373	387	–	387
In more than five years	335	–	335	403	–	403
	831	1	832	875	1	876

The Group leases various properties and plant and equipment under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

Notes to Accounts

8 Operating lease commitments continued

	2006					2005
	Annual net lease commitment					Annual net lease commitment £m
	Land and buildings £m	Equipment and vehicles £m	Total commitment £m	Future cumulative net lease commitment £m	Average lease term (years)	
High Street	86	–	86	718	8	86
Travel	37	–	37	117	3	43
Total Retailing	123	–	123	835	7	129
Support functions	1	–	1	14	3	7
Property sublet to third parties	7	–	7	27	5	9
Gross rental commitment	131	–	131	876	7	145
Less – external rent receivable	(7)	–	(7)	(30)	4	(10)
– internal rent receivable	(1)	–	(1)	(16)	–	(2)
Total continuing operations	123	–	123	830	7	133
USA Travel Retail	2	–	2	7	4	2
Less – external rent receivable	(1)	–	(1)	(5)	4	(1)
Total discontinued operations	1	–	1	2	2	1
Total	124	–	124	832	7	134

- a) High Street lease commitments include internal rent of £2m (2005: £2m) 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 (2005: £1m) related to USA Travel Retail which sublet retail space in airports where it operated a master contract and £8m (2005: £10m) represents income on subletting other surplus Group property.
- c) Potential liabilities (not included above) that could crystallise under previous assignments of leases where the liability would revert to the Group if the lessee defaulted are estimated at £18m (2005: £19m) per year with a future cumulative rental commitment of approximately £102m (2005: £118m), and an average lease term of approximately seven years (2005: eight years) (see Note 26).
- 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 (2005: £43m) and relates to Travel stores.

9 Fixed charges cover

£m	2006	2005
Net finance charges	9	8
Net operating lease rentals	148	142
Total fixed charges	157	150
Profit before tax and exceptional items	51	39
Profit before tax, exceptional items and fixed charges	208	189
Fixed charges cover – times	1.3x	1.3x

Notes to Accounts

10 Segmental analysis of operating assets employed

	Operating assets as at 31 August 2006 £m	Return on capital employed %	ROCE % after capitalised net operating leases including internal rent %	Operating assets as at 31 August 2005 £m	Return on capital employed %	ROCE % after capitalised net operating leases including internal rent %
Continuing operations:						
High Street	180	23%	13%	189	20%	11%
Travel	21	148%	47%	25	99%	31%
Retailing	201	36%	18%	214	30%	14%
Freehold property	14			18		
Support functions	(32)			(12)		
Provisions for liabilities and charges	(7)			(9)		
Operating assets employed continuing operations	176	34%	17%	211	22%	13%
Discontinued operations:						
USA Travel Retail	1			1		
Provisions for liabilities and charges	(5)			(7)		
Operating assets employed discontinued operations	(4)			(6)		
Total operating assets employed	172	35%	17%	205	23%	12%
Net funds / (debt)	42			(58)		
Net assets excluding pension liabilities	214			147		
Net retirement obligation continuing operations	(46)			(42)		
Total net assets	168			105		

- a) Return on capital employed is calculated as the operating profit before exceptional items 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.

11 Investment income

£m	2006	2005
Interest on bank deposits	2	3

12 Finance costs

£m	2006	2005
Interest payable on bank loans and overdrafts	6	8
Net charge on pension schemes (Note 6)	3	1
Unwinding of discount on provisions	1	1
Interest on obligations under finance leases	1	1
	11	11

Notes to Accounts

13 Income tax expense

£m	2006	2005
Tax on profit before exceptional items	4	14
<i>Standard rate of UK corporation tax 30%</i>		
Adjustment in respect of prior year UK corporation tax	(7)	(3)
Total current tax charge before exceptional items	(3)	11
Deferred tax – current year	13	(2)
Tax on profit before exceptional items	10	9
Tax on exceptional items	2	–
Tax on profit after exceptional items	12	9
<i>Effective tax rate on continuing activities before exceptional items</i>	20%	23%

Reconciliation of the taxation charge

£m	2006	2005
Tax on profit before exceptional items at standard rate of UK corporation tax 30%	15	12
Tax effect of items that are not deductible or not taxable in determining taxable profit	2	1
Depreciation for which no tax relief is available	–	1
Utilisation of tax losses	(13)	–
Adjustment in respect of prior years	(7)	(3)
Current tax charge	(3)	11

14 Dividends

Amounts recognised as distributions to shareholders are as follows:

£m	2006	2005
Dividends		
Interim – paid	5	4
Final – paid	10	7
	15	11
‘C’ share dividends		
‘C’ share dividend paid on capital reorganisation	–	143
	15	154

The proposed dividend of 6.2p per share is not included as a liability in these financial statements and, subject to shareholder approval, will be paid on 6 February 2007 to shareholders on the register at the close of business on 5 January 2007.

In the prior year, the Group paid a ‘C’ share dividend of £142,533,945 to the holders of 167,686,994 ‘C’ shares in accordance with the terms of a capital reorganisation, and upon payment of this dividend, these ‘C’ shares were converted to deferred shares, which have now been cancelled in the year ended 31 August 2006.

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

Notes to Accounts

15 Earnings / (loss) per share

a) Earnings

£m	2006			2005		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
Headline earnings attributable to shareholders	43	–	43	31	–	31
Pension interest net of related taxation	(2)	–	(2)	(1)	–	(1)
Exceptional items net of related taxation	(9)	–	(9)	–	(8)	(8)
Profit / (loss) attributable to shareholders	32	–	32	30	(8)	22

b) Basic earnings / (loss) per share

£m	2006			2005		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
Headline earnings per share (Note a)	25.0	–	25.0	17.5	–	17.5
Pension interest net of related taxation	(1.2)	–	(1.2)	(0.6)	–	(0.6)
Exceptional items net of related taxation	(5.2)	–	(5.2)	–	(4.5)	(4.5)
Earnings / (loss) per share (Note b)	18.6	–	18.6	16.9	(4.5)	12.4

a) Headline earnings per share has been calculated using profit after tax but before exceptional items and IAS 19 net interest charges on the defined benefit pension scheme.

b) Basic earnings per share has been calculated using profit after tax and exceptional items.

c) Diluted earnings / (loss) per share

Pence	2006			2005		
	Continuing	Discontinued	Total	Continuing	Discontinued	Total
Headline earnings per share	24.4	–	24.4	17.3	–	17.3
Pension interest net of related taxation	(1.1)	–	(1.1)	(0.5)	–	(0.5)
Exceptional items net of related taxation	(5.1)	–	(5.1)	–	(4.5)	(4.5)
Earnings / (loss) per share	18.2	–	18.2	16.8	(4.5)	12.3

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

d) Weighted average share capital

£m	2006	2005
Weighted average shares in issue for earnings per share	172	177
Add weighted average number of ordinary shares under option	4	2
Weighted average ordinary shares for diluted earnings per share	176	179

Notes to Accounts

16 Goodwill

	£m
Cost	
At 1 September 2004, at 31 August 2005, and at 31 August 2006	15
Accumulated impairment	
At 1 September 2004, at 31 August 2005, and at 31 August 2006	–
Net book value at 31 August 2005, and at 31 August 2006	15

The carrying value of goodwill is allocated to the segmental businesses as follows:

£m	2006	2005
High Street	10	10
Travel	5	5
	15	15

Cash-generating units are comprised of the Group of retail stores purchased on acquisitions.

In undertaking reviews for impairments, the recoverable amount of the cash-generating units have been determined based on value in use calculations. These calculations are based on budgets prepared by management for a one year period, and projections over a further 15 years.

The growth rates are linked to RPI – a rate of between 2.25 per cent and 2.8 per cent. A discount rate of 10 per cent has been applied to the cash flows.

17 Other intangible assets

Other intangible assets comprise capitalised software costs that are not deemed to be an integral part of the related hardware which is classified within property, plant and equipment.

The amortisation period for these capitalised software costs is over a maximum period of five years.

	£m
Cost	
At 1 September 2005	22
Additions	5
At 31 August 2006	27
Accumulated amortisation	
At 1 September 2005	8
Amortisation charge	4
At 31 August 2006	12
Net book value at 31 August 2006	15
Cost	
At 1 September 2004	21
Additions	1
At 31 August 2005	22
Accumulated amortisation	
At 1 September 2004	4
Amortisation charge	4
At 31 August 2005	8
Net book value at 31 August 2005	14

Notes to Accounts

18 Property, plant and equipment

£m	Land and Buildings			Fixtures and fittings	Equipment and vehicles	Total
	Freehold properties	Long-term leasehold	Short-term leasehold			
Cost or valuation:						
At 1 September 2005	26	1	158	164	89	438
Additions	–	–	6	9	9	24
Disposals	(4)	–	(29)	(43)	(15)	(91)
At 31 August 2006	22	1	135	130	83	371
Accumulated depreciation:						
At 1 September 2005	8	1	94	96	42	241
Depreciation charge	1	–	8	10	11	30
Impairment charge	–	–	1	1	1	3
Disposals	(1)	–	(31)	(41)	(14)	(87)
At 31 August 2006	8	1	72	66	40	187
Net book value at 31 August 2006	14	–	63	64	43	184
Cost or valuation:						
At 1 September 2004	27	1	152	154	75	409
Additions	–	–	6	12	20	38
Disposals	(1)	–	–	(2)	(6)	(9)
At 31 August 2005	26	1	158	164	89	438
Accumulated depreciation:						
At 1 September 2004	7	1	85	83	39	215
Depreciation charge	1	–	9	16	11	37
Disposals	–	–	–	(2)	(7)	(9)
Currency translation differences	–	–	–	(1)	(1)	(2)
At 31 August 2005	8	1	94	96	42	241
Net book value at 31 August 2005	18	–	64	68	47	197

The net book value of finance leases contained within these balances are £12m at 31 August 2006 (31 August 2005: £15m).

19 Trade and other receivables

£m	2006	2005
Current debtors		
Trade debtors	16	8
Other debtors	32	39
Prepayments and accrued income	21	28
	69	75
Non-current debtors		
Other debtors	5	16
Total trade and other receivables	74	91

No interest is charged on the receivables balance. An allowance has been made for estimated irrecoverable amounts from the sale of goods at 31 August 2006: £1m (31 August 2005: £1m). This allowance has been determined by reference to past default experience.

The directors consider that the carrying amount of trade and other receivables approximates their fair value.

Notes to Accounts

19 Trade and other receivables continued

Credit risk

The Group's principal financial assets are bank balances and cash, and trade and other receivables.

The Group's credit risk is primarily attributable to its trade and other receivables. The amounts presented in the balance sheet are net of allowances for doubtful receivables. An allowance for impairment is made where there is an identified loss event which, based on previous experience, is evidence of a reduction in the recoverability of the cash flows.

The credit risk on liquid funds and derivative financial instruments is limited because the counterparties are banks with acceptable credit-ratings assigned by international credit-rating agencies.

The Group has no significant concentration of credit risk, with exposure spread over a large number of counterparties and customers.

20 Trade and other payables – current

£m	2006	2005
Trade payables	84	109
Other tax and social security	18	17
Other creditors	65	48
Accruals and deferred income	48	42
	215	216

Trade and other payables principally comprise amounts outstanding for trade purchases and ongoing costs. The average credit period taken for trade purchases is 40 days. The directors consider that the carrying amount of trade payables approximates to their fair value.

21 Other non-current liabilities

£m	2006	2005
Other creditors	8	8

22 Obligations under finance leases

£m	2006		2005	
	Minimum lease payments	Present value of minimum lease payments	Minimum lease payments	Present value of minimum lease payments
Amount payable under finance leases:				
Within one year	4	3	4	4
In the second to fifth years inclusive	9	8	13	11
After five years	–	–	–	–
Total	13	11	17	15
Less: future finance charges	(2)	–	(2)	–
Present value of lease obligations	11	11	15	15
Less: amount due for settlement within 12 months (shown under current liabilities)	(3)	(3)	(4)	(4)
Amount due for settlement after 12 months	8	8	11	11

It is the Group's policy to lease certain of its fixtures and equipment under finance leases. The average lease term is three to four years. Interest rates are fixed at the contract date. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments.

All lease obligations are denominated in sterling.

The fair value of the Group's lease obligations approximates their carrying amount.

Notes to Accounts

23 Provisions

£m	Property provision	Disposal provision	Total
Gross provision:			
At 1 September 2005	13	7	20
Credited to income statement	(1)	–	(1)
Utilised in year	(3)	(2)	(5)
At 31 August 2006	9	5	14
Discount:			
At 1 September 2005	(4)	–	(4)
Unwinding of discount utilisation	2	–	2
At 31 August 2006	(2)	–	(2)
Net book value at 31 August 2006	7	5	12

£m	Property provision	Disposal provision	Total
Gross provision:			
At 1 September 2004	16	10	26
Charged to income statement	1	1	2
Utilised in year	(4)	(4)	(8)
At 31 August 2005	13	7	20
Discount:			
At 1 September 2004	(5)	–	(5)
Unwinding of discount utilisation	1	–	1
At 31 August 2005	(4)	–	(4)
Net book value at 31 August 2005	9	7	16

Total provisions are split between current and non-current liabilities as follows:

£m	2006	2005
Included in current liabilities	4	5
Included in non-current liabilities	8	11
	12	16

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 provision 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 life of the leases.

The disposal provisions arose from commitments in respect of the disposal of the USA Travel Retail businesses. The provisions will be predominantly utilised over the next few years.

Notes to Accounts

24 Deferred tax

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting period.

£m	Accelerated tax depreciation	Property provision	Lease incentives	Share-based payments	Retirement benefit obligations	Total
At 1 September 2005	(14)	2	2	2	32	24
Charged to income	(1)	–	–	1	(15)	(15)
Charged to equity	–	–	–	–	5	5
Other movements	2	–	–	–	–	2
At 31 August 2006	(13)	2	2	3	22	16
At 1 September 2004	(14)	2	2	2	42	34
Charged to income	–	–	–	–	1	1
Charged to equity	–	–	–	–	(11)	(11)
At 31 August 2005	(14)	2	2	2	32	24

The Group has unused tax losses at 31 August 2006 of £5m available for offset against future profits (31 August 2005: £50m). A deferred tax asset of £2m has been recognised at 31 August 2006 to reflect these losses (31 August 2005: £14m) and a further deferred tax asset of £20m has been recognised at 31 August 2006 to reflect the deferred tax asset relating to the gross pension deficit (see Note 6) (31 August 2005: £18m). These assets have been included within the retirement benefit obligations caption disclosed above.

Certain deferred tax assets and liabilities have been offset. The following is an analysis of the deferred tax balances, after offset, for financial reporting purposes.

£m	2006	2005
Deferred tax liabilities (non-current liabilities)	(13)	(14)
Deferred tax assets	29	38
	16	24

25 Analysis of net funds / (debt)

Movements in net funds / (debt) can be analysed as follows:

£m	2005	IAS 32 and 39 reclassifications	Cash flow	Non-cash	2006
Cash and cash equivalents	39	–	27	–	66
Debt					
– Sterling floating rate	(50)	(7)	44	–	(13)
– Sterling fixed rate	(32)	–	32	–	–
Obligations under finance leases	(15)	–	4	–	(11)
Net (debt) / funds	(58)	(7)	107	–	42

£m	2004	Cash flow	Non-cash	2005
Cash and cash equivalents	51	(12)	–	39
Debt				
– Sterling floating rate	(17)	(33)	–	(50)
– Sterling fixed rate	(2)	(30)	–	(32)
Obligations under finance leases	(6)	(3)	(6)	(15)
Net funds / (debt)	26	(78)	(6)	(58)

Cash and cash equivalents comprise cash held by the Group and short-term bank deposits with an original maturity of three months or less. The carrying amount of these assets approximates their fair value.

Notes to Accounts

25 Analysis of net funds / (debt) continued

31 August 2006

On demerger, the existing three year syndicated borrowing facilities were replaced by a five year £90m Revolving Credit Facility.

At 31 August 2006 floating rate debt comprises of £13m of unsecured loan notes (redeemable at par on demand up until expiry on 28 February 2008) bearing an interest rate of 100 basis points below six month LIBOR (2005: £15m).

At 31 August 2006, there was no fixed rate debt.

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).

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).

26 Contingent liabilities and capital commitments

£m	2006	2005
Bank and other loans guaranteed	6	11

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. Pursuant to the terms of the Demerger Agreement, any such contingent liability which becomes an actual liability will be apportioned between the Group and Smiths News PLC in the ratio 65:35 (provided that the actual liability of Smiths News PLC in any 12 month period does not exceed £5m). The Group's 65 per cent share of these leases has an estimated future gross rental commitment at 31 August 2006 of £102m (31 August 2005: £118m).

Contracts placed for future capital expenditure approved by the directors but not provided for amount to £5m (31 August 2005: £4m).

27 Net cash inflow / (outflow) from operating activities

£m	2006	2005
Operating profit from continuing operations	53	47
Operating exceptional items	7	—
Adjustment for pension funding	(12)	(90)
Depreciation of property, plant and equipment	30	37
Profit on sale of property, plant and equipment	(5)	—
Impairment of property, plant and equipment	3	—
Amortisation of intangible assets	4	4
Share-based payments	6	4
Decrease in inventories	6	5
Decrease / (increase) in receivables	7	(12)
Decrease in payables	(4)	(1)
Income taxes paid	(2)	(2)
Cash spend against provisions	(3)	(6)
Net cash inflow / (outflow) from operating activities before exceptional items	90	(14)
Cash outflow relating to exceptional operating items	(8)	(9)
Net cash inflow / (outflow) from operating activities	82	(23)

28 Derivative financial instruments

Currency derivatives

The Group utilises currency derivatives to hedge significant future transactions and cash flows. The Group is a party to a variety of foreign currency forward contracts and options in the management of its exchange rate exposures. The instruments purchased are denominated in the currencies of the Group's principal markets. It is the Group's policy that no speculative trading in financial instruments shall be undertaken.

At 31 August 2006, the total notional amount of outstanding forward foreign exchange contracts that the Group has committed are US\$50m.

At 31 August 2006, the Group has options to purchase US\$25m as a hedge against exchange losses on future purchases of goods.

These arrangements are designed to address significant exchange exposures for the years ended 31 August 2007 and 31 August 2008 and are assessed on a revolving basis as required.

At 31 August 2006, the fair value loss of the Group's currency derivatives that are designated and effective as cash flow hedges amounts to £2m, which are deferred in equity as a hedging reserve.

Amounts of £1m have been transferred to both the income statement and inventories in respect of contracts that matured during the year ended 31 August 2006.

At the balance sheet date, the total notional amount of outstanding forward foreign exchange contracts that the Group has committed is a liability of £1m. The movement in derivative assets recognised on the balance sheet over the financial year is shown below:

	£m
Balance at 31 August 2005	–
Adoption of IAS 39	1
Balance at 1 September 2005	1
Movement	(2)
Balance as at 31 August 2006	(1)

Changes in the fair value of non-hedging currency derivatives amounting to £nil have been charged to income in the year to 31 August 2006.

Interest rate swaps

The Group periodically uses interest rate swaps to manage its exposure to interest rate movements on its bank borrowings and deposits. It regularly reviews this exposure and considers from time to time whether there would be a benefit in further hedging this risk.

At 31 August 2006 there are no outstanding interest rate swaps.

Notes to Accounts

29 Share capital

a) Authorised

	2006		2005	
	Number of shares (millions)	Nominal value £m	Number of shares (millions)	Nominal value £m
Equity:				
Ordinary shares of £1.00 each	–	–	–	–
Ordinary shares of £1.95 each	300	585	–	–
Redeemable preference share of £50,000 each	–	–	–	–
Total	300	585	–	–

b) Allotted and fully paid

	2006		2005	
	Number of shares (millions)	Nominal value £m	Number of shares (millions)	Nominal value £m
Equity:				
Ordinary shares of £1.00 each	–	–	–	–
Ordinary shares of £1.95 each	183	357	–	–
Redeemable preference share of £50,000 each	–	–	–	–
Total	183	357	–	–

At 31 August 2005, the authorised share capital of the Company was £1,000 divided into one thousand ordinary shares of £1.00 each with one share allotted and fully paid up.

On 23 June 2006, the authorised share capital was increased by the creation of one redeemable preference share of £50,000 which was issued as fully paid up. In accordance with IAS 32 'Financial Instruments: Disclosure and Presentation', this amount is presented within liabilities. On the same day the Company issued a second ordinary share which was fully paid.

On 6 July 2006, the authorised share capital was increased by £584,999,000 through the creation of a further 584,999,000 ordinary shares of £1.00 each. 76 ordinary shares were then issued fully paid to the existing shareholders. The issued and unissued ordinary shares were then consolidated on a 39:1 basis into ordinary shares of £39 each which were then subdivided on a 1:20 basis into ordinary shares of £1.95 each. Following this consolidation and subdivision, the authorised share capital was £585,050,000 divided into 300,000,000 ordinary shares of £1.95 each and one redeemable preference share of £50,000, of which 40 ordinary shares and the redeemable preference share were issued and fully paid up.

On 31 August 2006, the Company issued 182,919,970 ordinary shares to the shareholders of Smiths News PLC in exchange for acquiring WH Smith Retail Holdings Limited (formerly WH Smith PLC) and its subsidiary entities.

On 7 September 2006, the Company reduced its authorised share capital through the reduction of the nominal value of each ordinary share from £1.95 each to £0.20 each, creating £320m of distributable reserves.

Notes to Accounts

30 Share-based payments

Summary of movements in awards and options

Number of shares	Sharesave Schemes	Executive Share Option Schemes	MIP	L-TIP	Share award	Deferred bonus plan	Total
Balance at 1 September 2005	3,056,586	7,069,065	2,909,860	460,299	142,415	10,319	13,648,544
Options and awards granted	–	1,549,637	–	749,986	–	–	2,299,623
Options and awards exercised	(1,447,256)	(871,489)	–	–	(71,208)	(9,143)	(2,399,096)
Options and awards lapsed	(1,327,675)	(1,666,029)	(269,460)	(118,590)	–	(1,176)	(3,382,930)
Balance at 31 August 2006	281,655	6,081,184	2,640,400	1,091,695	71,207	–	10,166,141
Balance at 1 September 2004	3,723,154	8,010,938	–	–	141,315	12,380	11,887,787
Capital reorganisation adjustment	–	–	–	–	1,100	(210)	890
Options and awards granted	805,947	1,896,677	3,359,622	460,299	–	–	6,522,545
Options and awards exercised	(299,142)	(60,982)	–	–	–	–	(360,124)
Options and awards lapsed	(1,173,373)	(2,777,568)	(449,762)	–	–	(1,851)	(4,402,554)
Balance at 31 August 2005	3,056,586	7,069,065	2,909,860	460,299	142,415	10,319	13,648,544

Detail of movements in awards and options

Sharesave Scheme

Under the terms of the Old WH Smith Sharesave Scheme, approved by shareholders of Old WH Smith in 1999, the Board each year granted options to purchase ordinary shares in Old WH Smith to employees with at least one year's service who entered into an Inland Revenue approved Save-As-You-Earn (SAYE) savings contract for a term of three or five years. Options were 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.

As a result of the demerger, all outstanding options under the Old WH Smith Sharesave Scheme became exercisable.

Outstanding options granted under the Old WH Smith Sharesave Scheme at 31 August 2006 are as follows:

Date of grant	Number of shares		Exercise price (pence)	Exercise period
	2006	2005		
7 June 2000 (5 year)	–	68,523	293.40	01.08.05 – 31.01.06
6 June 2001 (5 year)	5,294	121,429	382.40	01.08.06 – 31.01.07
5 June 2002 (3 year)	–	277,814	356.80	01.08.05 – 31.01.06
5 June 2002 (5 year)	37,766	229,852	356.80	25.08.06 – 24.02.07
4 June 2003 (3 year)	7,266	616,469	251.20	01.08.06 – 31.01.07
4 June 2003 (5 year)	42,189	420,177	251.20	25.08.06 – 24.02.07
2 June 2004 (3 year)	47,560	337,960	284.40	25.08.06 – 24.02.07
2 June 2004 (5 year)	32,842	187,411	284.40	25.08.06 – 24.02.07
1 June 2005 (3 year)	73,084	505,305	271.40	25.08.06 – 24.02.07
1 June 2005 (5 year)	35,654	291,646	271.40	25.08.06 – 24.02.07
	281,655	3,056,586		

Notes to Accounts

30 Share-based payments continued

Old WH Smith Executive Share Option Schemes

Under the terms of the Old WH Smith Executive Share Option Schemes, the Board granted options to executives up to an annual limit of 200 per cent of basic annual salary. Since 1995, the exercise of options has been conditional on the achievement of a performance target, which was determined by the Board at the time of grant. Further details are set out in the Remuneration Report.

As a result of the demerger, all outstanding options under the WH Smith Group Executive Option Scheme and the approved part of the WH Smith Executive Share Option Scheme 1999 became exercisable. All outstanding options under the unapproved part of the WH Smith Executive Share Option Scheme 1999 will be exchanged for new options over the Company's shares. Further details are set out in the Remuneration Report.

Outstanding options granted under the Old WH Smith Executive Share Option Schemes as at 31 August 2006 are as follows:

Date of grant	Number of shares		Exercise price (pence)	Exercise period
	2006	2005		
19 September 1995	–	20,000	371.00	19.09.98 – 18.09.05
22 December 1998	–	22,960	473.50	22.12.01 – 21.12.08
25 February 1999	9,900	22,345	530.50	25.02.02 – 24.02.09
7 December 1999	123,709	232,211	387.00	07.12.02 – 06.12.09
11 May 2000	–	13,947	382.00	11.05.03 – 10.05.10
11 May 2000	–	5,714	385.00	11.05.03 – 10.05.10
31 October 2000	305,452	470,535	393.25	31.10.03 – 30.10.10
1 May 2001	–	18,595	488.00	01.05.04 – 30.04.11
1 May 2001	7,937	37,654	491.50	01.05.04 – 30.04.11
1 November 2001	329,576	553,852	438.00	01.11.04 – 31.10.11
5 November 2002	21,605	446,509	355.50	05.11.05 – 04.11.12
5 November 2002	586,038	1,663,039	361.50	05.11.05 – 04.11.12
20 November 2003	1,832,178	1,808,779	343.50	20.11.06 – 19.11.13
3 November 2004	1,322,987	1,545,547	340.00	03.11.07 – 02.11.14
26 April 2005	181,598	207,378	360.00	26.04.08 – 25.04.15
2 November 2005	1,341,299	–	369.00	02.11.08 – 02.11.15
20 April 2006	18,905	–	441.50	20.04.09 – 19.04.16
	6,081,184	7,069,065		

WH Smith 2004 Management Investment Plan

Under the terms of the WH Smith 2004 Management Investment Plan, approved by shareholders of Old WH Smith in September 2004, executive directors and key senior executives invested their own money to buy ordinary shares in Old WH Smith and were 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.

Outstanding awards granted under the WH Smith 2004 Management Investment Plan are as follows:

Date of grant	Number of shares		Exercise price (pence)	Exercise period
	2006	2005		
3 November 2004	2,182,761	2,316,883	Nil	01.02.08 – 31.01.10
24 February 2005	20,506	155,844	Nil	01.02.08 – 31.01.10
26 April 2005	412,179	412,179	Nil	01.02.08 – 31.01.10
3 June 2005	24,954	24,954	Nil	01.02.08 – 31.01.10
	2,640,400	2,909,860		

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.

Notes to Accounts

30 Share-based payments continued

WH Smith 2004 L-TIP

Under the terms of the WH Smith 2004 L-TIP, approved by shareholders of Old WH Smith in January 2004, executive directors and key senior executives were granted conditional awards to acquire ordinary shares in Old WH Smith (in the form of nil cost options) which will only vest and become exercisable to the extent that the related performance target is met.

Outstanding awards granted under the WH Smith 2004 L-TIP are as follows:

Date of grant	Number of shares		Exercise price (pence)	Exercise period
	2006	2005		
3 November 2004	371,991	399,846	Nil	October 2007 – 03.11.14
26 April 2005	–	60,453	Nil	April 2008 – 26.04.15
2 November 2005	496,900	–	Nil	October 2008 – 02.11.15
9 February 2006	222,804	–	Nil	February 2009 – 09.02.16
	1,091,695	460,299		

Awards will first become exercisable on the vesting date, which is the date (as soon as practicable after the announcement of the Company's and Smiths News's results for the final year of the performance period) that participants receive notification of the number of award shares that have vested.

WH Smith Deferred Bonus Plan

Under the terms of the WH Smith Deferred Bonus Plan, which was operated for annual bonuses earned in the financial year 2002/03, a number of senior executives received a part of their annual bonus in the form of ordinary shares of Old WH Smith which would have been released after three years, subject to continued employment. In addition, some participants opted to invest up to 25 per cent of their total annual bonus in ordinary shares of Old WH Smith which would have been 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.

As a result of the demerger the bonus shares and the matching shares (on a 1:2 basis) vested on 25 August 2006.

Outstanding awards granted under the WH Smith Deferred Bonus Plan at 31 August 2006 are as follows:

Date of award	Number of shares					
	2006			2005		
	Bonus	Matching (1:1)	Total	Bonus	Matching (1:1)	Total
20 November 2003	–	–	–	9,218	1,101	10,319

Fair value information

	2006	2005
Weighted average share price at date of exercise of share options exercised during period – pence	302.98	304.60
Weighted average share price of outstanding awards at end of period – pence	225.14	254.54
Weighted average remaining contractual life at end of period – years	6	6

Notes to Accounts

30 Share-based payments continued

Share options granted

The aggregate of the estimated fair value of the options and awards granted each period is:

£m	2006	2005
	3	17

The share options granted during each period have been valued using a Black-Scholes model.

The inputs to the Black-Scholes model are as follows:

	2006	2005
Share price – pence	438	296 – 362
Exercise price – pence	442	271 – 360
Expected volatility – per cent	33.2	34.7 – 37.1
Expected life – years	5	3.67 – 6.50
Risk free rate – per cent	4.48	4.12 – 4.73
Dividend yield – per cent	3.13	3.32 – 4.05

Expected volatility was determined by calculating the historical volatility of the Old WH Smith share price over the expected life of the option.

Awards

The fair values of the MIP and L-TIP awards granted were measured using a Monte Carlo simulation model.

The input range into the Monte Carlo models were as follows:

	2006	2005
Share price – pence	416	296 – 365
Exercise price – pence	Nil	Nil
Expected volatility – per cent	30.0	34.0 – 34.6
Expected life – years	3.0	2.88 – 3.47
Risk free rate – per cent	4.2	4.38 – 4.72
Dividend yield – per cent	4.0	3.29 – 4.05

Expected volatility was determined by calculating the historical volatility of the Old WH Smith share price over the expected life of the option.

The fair value of the Deferred Bonus Plan and the conditional share award was determined by reference to the share price at date of grant.

31 Related party transactions

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

Smiths News PLC

During the period, Group companies entered into the following transactions with Smiths News PLC. On 31 August 2006, the Group was demerged from Smiths News PLC.

Purchases were made on an arm's length basis.

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

£m	2006	2005
Purchase of goods from Smiths News PLC	115	113
Trading amounts owed to Smiths News PLC at end of year	6	10
Amounts owed by Smiths News PLC in respect of prior years' corporation tax	15	15

Prior to demerger on 31 August 2006, trading between the Retail and News businesses was not classified as a related party transaction as they were both part of the WHSmith Group.

31 Related party transactions continued

Transitional services agreement on demerger

On 7 July 2006, WH Smith PLC and Smiths News PLC entered into a transitional services agreement whereby WH Smith PLC has agreed, with effect from the demerger, to supply certain transitional services to Smiths News PLC. These services include, amongst other things, payroll, tax, and property administration. It is expected that the services will be provided for a transitional period of up to 12 months plus such time as is required to complete the 2005/06 year end tax computation, following which Smiths News PLC will make its own arrangements for the provision of these services. The consideration payable by Smiths News PLC to WH Smith PLC under this agreement for the 12 month period is likely to be approximately £800,000 although this could increase depending on the length of time that the services are provided to Smiths News PLC.

USA Travel Retail – Hotels

The CEO of Travel Traders LLC is Sean Anderson who was Chairman of WH Smith Airports Inc., WH Smith PLC's US subsidiary until September 2003 and he holds a 30 per cent stake in Travel Traders LLC. The total consideration of £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 also providing a loan facility of up to £4m to the new company, of which £3m is drawn down as at 31 August 2006 (31 August 2005: £3m).

Remuneration of key management personnel

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

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

Directors' transactions

There are no other transactions with directors.

32 Post balance sheet events

On 1 September 2006, the Group made a £25m one-off contribution to the WHSmith Pension Trust.

On 7 September 2006, the Company reduced its authorised share capital through the reduction of the nominal value of each ordinary share from £1.95 each to £0.20 each, creating £320m of distributable reserves.

33 Principal companies

The principal companies included within the financial statements are disclosed below:

Name	Country of incorporation / registration
WH Smith PLC	England and Wales
WH Smith Retail Holdings Limited	England and Wales
WH Smith (Holdings) Limited	England and Wales
WH Smith Retail Limited	England and Wales
WH Smith Group Holdings (USA) Inc.	USA
WH Smith France S.A	France

Independent Auditors' Report to the Members of WH Smith PLC (formerly New WH Smith PLC; formerly Pollquote Limited)

We have audited the individual company financial statements of WH Smith PLC for the year ended 31 August 2006 which comprise the balance sheet and the related Notes 1 to 4. These individual company financial statements have been prepared under the accounting policies set out therein.

The corporate governance statement and the directors' remuneration report are included in the Group annual report of WH Smith PLC for the year ended 31 August 2006. We have reported separately on the Group financial statements of WH Smith PLC for the year ended 31 August 2006 and on the information in 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

The directors' responsibilities for preparing the annual report and the individual company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of directors' responsibilities.

Our responsibility is to audit the individual company financial statements in accordance with relevant United Kingdom legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the individual company financial statements give a true and fair view, in accordance with the relevant financial reporting framework, and whether the individual company financial statements have been properly prepared in accordance with the Companies Act 1985. We report to you if, in our opinion, the directors' report is consistent with the individual company financial statements. We also report to you 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 other transactions is not disclosed.

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

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the individual company financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the individual company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, 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 individual company financial statements 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 individual company financial statements.

Opinion

In our opinion:

- the individual company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 August 2006;
- the individual company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

Deloitte & Touche LLP
Chartered Accountants and Registered Auditors
London

12 October 2006

Notes: An audit does not provide assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular whether any changes may have occurred to the financial information since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in the United Kingdom governing the preparation and dissemination of financial information differs from legislation in other jurisdictions.

Company Balance Sheet

£m	Notes	2006	2005
Fixed assets			
Investments	3	357	–
Total fixed assets		357	–
Current assets		–	–
Net current liabilities		–	–
Total assets less current liabilities		–	–
Total net assets		357	–
Capital and reserves			
Share capital	4	357	–
Profit and loss account		–	–
Total equity		357	–

Approved by the Board of Directors on 12 October 2006.

Kate Swann
Chief Executive

Alan Stewart CA (SA)
Finance Director

Notes to the Company Balance Sheet

1 Accounting policies

a) Basis of preparation

The financial statements are prepared in compliance with the Companies Act 1985 and in accordance with applicable United Kingdom law and accounting standards. The financial statements are prepared under the historical cost convention. The accounting policies have been applied consistently in the current and prior year.

b) Investment in subsidiary undertakings

Investment in equity and long-term loans in subsidiary undertakings are individually valued at historical cost less provision for impairment in value.

c) Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

2 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 £nil (2005: £nil). There were no other recognised gains or losses.

3 Investments in subsidiary undertakings

On 31 August 2006, the Company acquired the shares of WH Smith PLC (now renamed WH Smith Retail Holdings Limited) at a fair value of £357m. The Company had no subsidiaries in the prior year.

4 Called up share capital

a) Authorised

	2006		2005	
	Number of shares (millions)	Nominal value £m	Number of shares (millions)	Nominal value £m
Equity:				
Ordinary shares of £1.00 each	–	–	–	–
Ordinary shares of £1.95 each	300	585	–	–
Redeemable preference share of £50,000 each	–	–	–	–
Total	300	585	–	–

b) Allotted and fully paid

	2006		2005	
	Number of shares (millions)	Nominal value £m	Number of shares (millions)	Nominal value £m
Equity:				
Ordinary shares of £1.00 each	–	–	–	–
Ordinary shares of £1.95 each	183	357	–	–
Redeemable preference share of £50,000 each	–	–	–	–
Total	183	357	–	–

Notes to the Company Balance Sheet

4 Called up share capital continued

b) Allotted and fully paid continued

At 31 August 2005, the authorised share capital of the Company was £1,000 divided into one thousand ordinary shares of £1.00 each with one share allotted and fully paid up.

On 23 June 2006, the authorised share capital was increased by the creation of one redeemable preference share of £50,000 which was issued as fully paid up. In accordance with FRS 25 'Financial Instruments: Disclosure and Presentation', this amount is presented within liabilities. On the same day the Company issued a second ordinary share which was fully paid.

On 6 July 2006, the authorised share capital was increased by £584,999,000 through the creation of a further 584,999,000 ordinary shares of £1.00 each. 76 ordinary shares were then issued fully paid to the existing shareholders. The issued and unissued ordinary shares were then consolidated on a 39:1 basis into ordinary shares of £39 each which were then subdivided on a 1:20 basis into ordinary shares of £1.95 each. Following this consolidation and subdivision, the authorised share capital was £585,050,000 divided into 300,000,000 ordinary shares of £1.95 each and one redeemable preference share of £50,000, of which 40 ordinary shares and the redeemable preference share were issued and fully paid up.

On 31 August 2006, the Company issued 182,919,970 ordinary shares to the shareholders of Smiths News PLC in exchange for acquiring WH Smith Retail Holdings Limited (formerly WH Smith PLC) and its subsidiary entities.

On 7 September 2006, the Company reduced its authorised share capital through the reduction of the nominal value of each ordinary share from £1.95 each to £0.20 each, creating £320m of distributable reserves.

Analysis of Retail Stores and Selling Space

Number of stores

	1 September 2005	Opened	Closed	31 August 2006
High Street	542	7	(6)	543
Travel	127	2	–	129
Total	669	9	(6)	672

Retail selling square feet (000's)

	1 September 2005	Opened	Closed	Redeveloped	31 August 2006
High Street	3,035	21	(38)	(19)	2,999
Travel	216	1	–	3	220
Total	3,251	22	(38)	(16)	3,219

Four Year Financial Summary

Group income statement

£m	12 months			
	31 August 2006	31 August 2005	31 August 2004	31 August 2003
Continuing operations				
Revenue	1,340	1, 423	1, 453	1, 463
Group operating profit before exceptional items	60	47	20	70
Exceptional operating items	(7)	–	(92)	(12)
Group operating profit / (loss)	53	47	(72)	58
Net finance charges	(9)	(8)	(3)	(3)
Profit / (loss) before tax	44	39	(75)	55
Income tax expense	(12)	(9)	7	(20)
Profit / (loss) after tax from continuing operations	32	30	(68)	35
Loss from discontinued operations	–	(8)	(58)	(27)
Profit / (loss) for the period	32	22	(126)	8
Headline earnings per share				
– Basic – continuing operations	25.0p	17.5p	10.2p	19.7p
– Basic	25.0p	17.5p	15.2p	23.0p
– Diluted	24.4p	17.3p	15.2p	23.0p
Earnings per share				
Basic – continuing operations	18.6p	16.9p	(27.9)p	14.3p
Basic	18.6p	12.4p	(51.6)p	3.3p
Diluted	18.2p	12.3p	(51.6)p	3.3p
Tax rate* – continuing operations	20%	23%	25%	30%

* Before exceptional items.

Four Year Financial Summary

Segmental analysis of Group revenue

£m	31 August 2006	31 August 2005	31 August 2004	31 August 2003
Continuing operations:				
High Street	1,021	1,112	1,152	1,172
Travel	319	311	301	291
Group revenue	1,340	1,423	1,453	1,463

Segmental analysis of Group operating profit / (loss)

£m	31 August 2006	31 August 2005	31 August 2004	31 August 2003
Continuing operations:				
High Street	42	37	14	65
Travel	31	25	20	18
Trading profit	73	62	34	83
Unallocated costs	(13)	(15)	(14)	(13)
Group operating profit before exceptional items	60	47	20	70
Exceptional items	(7)	–	(92)	(12)
Group operating profit / (loss)	53	47	(72)	58

Four Year Financial Summary

Group balance sheet

£m	31 August 2006	31 August 2005	31 August 2004	31 August 2003
Non-current assets				
Goodwill and other intangible assets	30	29	32	249
Property, plant and equipment	184	197	194	216
Deferred tax assets	29	38	48	47
Trade and other receivables	5	16	25	5
Total non-current assets	248	280	299	517
Current assets	278	262	285	447
Assets in disposal groups held for sale	–	–	247	49
Total assets	526	542	831	1,013
Current liabilities	(255)	(296)	(286)	(324)
Non-current liabilities				
Retirement benefit obligation	(66)	(60)	(146)	(152)
Other non-current liabilities	(37)	(81)	(42)	(26)
Liabilities in disposal groups held for sale	–	–	(37)	(25)
Total liabilities	(358)	(437)	(511)	(527)
Total net assets	168	105	320	486

Four Year Financial Summary

Group cash flow statement

£m	12 months to			
	31 August 2006	31 August 2005	31 August 2004	31 August 2003
Cash flows from operating activities				
Generated from operating activities	84	(25)	18	100
Taxation paid	(2)	2	(5)	(25)
Cash flows from operating activities	82	(23)	13	75
Investing activities				
Interest received	2	4	1	1
Acquisitions and disposals of subsidiaries	8	212	31	–
Disposal of property, plant and equipment	9	2	5	27
Capital expenditure	(29)	(30)	(45)	(42)
Net cash from investing activities	(10)	188	(8)	(14)
Financing activities				
Interest paid	(7)	(6)	(4)	(4)
Dividend paid	(15)	(11)	(16)	(34)
Non-equity dividend paid	–	(143)	–	–
Purchase of shares for employee share schemes	4	(12)	–	(10)
Repurchase of own shares	(3)	(62)	–	–
Increase / (decrease) in debt	(80)	58	(6)	(33)
Derivative cash movements	(1)	–	–	–
Other financing	57	(1)	(10)	22
Cash flows from financing activities	(45)	(177)	(36)	(59)
Net increase / (decrease) in cash and cash equivalents – continuing operations	19	(2)	(58)	(27)
Net (decrease) / increase in cash and cash equivalents – discontinued operations	8	(10)	27	29
Net increase / (decrease) in cash and cash equivalents	27	(12)	(31)	2

Four Year Financial Summary

Group cash flow statement continued Analysis of net funds movement

£m	12 months to			
	31 August 2006	31 August 2005	31 August 2004	31 August 2003
Operating profit before exceptional items	60	47	41	78
Share-based payments	6	4	1	1
Profit on disposal of property, plant and equipment	(5)	–	(2)	(1)
Depreciation, amortisation and other amounts written off fixed assets	37	41	43	44
Movement in working capital	9	(8)	(30)	(11)
Net interest payable	(5)	(2)	(3)	(3)
Capital expenditure	(29)	(30)	(45)	(41)
Tax paid (before receipt of tax refund relating to exceptional items)	(2)	(2)	(5)	(25)
Provisions	(3)	(6)	(5)	(4)
Free cash flow (before dividends and investment activity)	68	44	(5)	38
Dividends	(15)	(11)	(16)	(34)
Adjustment for pension funding	(12)	(90)	(17)	(5)
Premium on issue of shares	4	2	–	2
Sale and leaseback and disposal of fixed asset proceeds	9	2	5	27
Net disposals proceeds of subsidiaries	8	212	42	–
Acquisitions	–	–	–	(1)
Purchase of own shares	(10)	(74)	–	(10)
Return of cash to shareholders	–	(138)	–	–
Corporate advisory costs	–	(9)	–	–
Cash outflow relating to exceptional operating items	(8)	–	(13)	(2)
(Cash) / debt in subsidiaries disposed / acquired	–	–	(11)	–
Bank fees	(1)	(2)	–	–
Net finance lease movements	–	(12)	(6)	(2)
Intercompany settlement on demerger	57	(8)	(10)	20
Net funds movement	100	(84)	(31)	33
Opening net funds	(58)	26	57	24
Closing net funds / (debt)	42	(58)	26	57

Extracts from the New WH Smith Prospectus

The following information was included in the New WH Smith PLC prospectus issued on 7 July 2006, and is repeated here in accordance with Listing Rule 9.2.18.

'Capitalisation and indebtedness

This statement of capitalisation and indebtedness has been prepared under IFRS using policies which are consistent with those used in preparing the historical financial information on the WH Smith Retail Group set out in Part VII (Historical Financial Information on the WH Smith Retail Group) in this prospectus.

Capitalisation

The following table has been extracted without material adjustment from the audited financial results for the 26 weeks ended 28 February 2006 and sets out the capitalisation of the WH Smith Retail Group as at 28 February 2006:

	£m
Total equity¹	143

1 Includes profit and loss reserve.

There has been no material change to the capitalisation of the WH Smith Retail Group since 28 February 2006.

Indebtedness

The following table is sourced from the underlying financial records of the WH Smith Retail Group and sets out the unaudited indebtedness and cash and cash equivalents of the WH Smith Retail Group as at 30 April 2006:

	£m
Cash	12
Cash equivalents	–
Trading securities	–
Total liquidity	12
Current financial receivable	1
Current bank debt	–
Current portion of non-current debt	–
Other current financial debt	(20)
Current financial debt	(20)
Net current financial indebtedness	(7)
Non-current bank loans	–
Bonds issued	–
Other non-current loans	(17)
Non-current financial indebtedness	(17)
Net financial indebtedness	(24)
Total current debt	
Guaranteed	–
Secured	(3)
Unguaranteed / unsecured	(17)
	(20)
Total non-current debt (excluding current portion of long-term debt)	
Guaranteed	–
Secured	(10)
Unguaranteed / unsecured	(7)
	(17)
Total indebtedness	(37)

Notes to the table

- This statement of indebtedness has been prepared under IFRS using policies which are consistent with those used in preparing the Group's audited non-statutory financial accounts for the six months to 28 February 2006.
- The Group's debt is shown gross of unamortised issue costs.
- The unsecured current debt at 30 April 2006 includes loan notes of £15m, redeemable at par on demand up until expiry on 28 February 2008 and bearing an interest rate of 100 basis points below six months' LIBOR and £2m of undated 5.125 per cent loan stock. The unsecured non-current debt includes £7m of reclassified 'B' and 'C' shares.
- The secured debt at 30 April 2006 above relates entirely to finance leases. Finance leases of £13m are secured upon the assets to which they relate. £3m of the finance lease obligations is within current debt and £10m is within non-current debt. There is no guaranteed debt shown in the tables above.

Extracts from the New WH Smith Prospectus

Indebtedness continued

The WH Smith Retail Group has various contractual obligations and commercial commitments, which are items for which it is contractually obligated or committed to pay a specific amount at a specific point in time. The aggregate contractual obligations as at 30 April 2006 were as follows:

£m	Total	Less than 1 year	1–3 years	4–5 years	After 5 years
Contractual obligations					
Loan notes and shares	24	17	7	–	–
Finance lease obligations	13	3	10	–	–
Operating lease obligations	129	15	29	15	70
Total contractual obligations	166	35	46	15	70

Following the demerger, the majority of the operating leases of WHSmith will remain with WHSmith Retail as they relate principally to the leases of WHSmith Retail's store portfolio. The tenure of almost all of WHSmith Retail's outlets are short or long leasehold with an average lease length of seven years and predominantly standard commercial property terms including periodic upwards-only reviews. It also has an annual minimum net rental commitment of £129m and a total future rental commitment at 31 August 2005 of £0.9bn.'

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 5202036).

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 1 February 2007 at 11.30am. The Notice of Annual General Meeting on pages 90 to 95 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 30 January 2007.

Electronic proxy voting

You may if you wish register the appointment of a proxy for the meeting electronically, by logging on to 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).

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 2006
Results announced	12 October 2006
Annual report posted	mid-December 2006
Final dividend ex-dividend date	3 January 2007
Final dividend record date	5 January 2007
Christmas trading statement	January 2007
Annual General Meeting	1 February 2007
Final dividend payment date	2 February 2007
Half-year end	28 February 2007
Interim results announced	April 2007
Interim dividend ex-dividend date	May 2007
Interim dividend record date	May 2007
Interim dividend payment date	June 2007
Financial year end	31 August 2007
Results announced	October 2007

The dividend dates shown above are in respect of the Company's ordinary shares of 20p.

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

UK Capital Gains Tax
Demerger 31 August 2006

Following the demerger of the Company on 31 August 2006, in order to calculate any chargeable gains or losses arising on the disposal of shares after 31 August 2006, the original tax base cost of your ordinary shares of 2½p (adjusted if you held your shares at 24 September 2004 and 22 May 1998 to take into account the capital reorganisations of 27 September 2004 and 26 May 1998 respectively (see below)) will be apportioned between the shareholdings of ordinary shares of 20p in the Company and ordinary shares of 5p in Smiths News in the ratio of 0.69585 and 0.30415 respectively.

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 55½p (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 2½p and ‘C’ shares resulting from the capital reorganisation.

The cost of your shareholding of ordinary shares of 2½p is calculated by multiplying the original base cost of your ordinary shares of 55½p (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 55½p (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 55½p and redeemable ‘B’ shares resulting from the capital reorganisation.

The cost of your shareholding of ordinary shares of 55½p 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 20p	61.62p	50.92p
Smiths News PLC ordinary shares of 5p	26.93p	22.25p
Old WH Smith ‘B’ shares	7.94p	6.56p
Old WH Smith ‘C’ shares	22.42p	18.53p
Old WH Smith 5% cumulative preference shares of £1 each		42.50p
Old WH Smith 5% 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 first Annual General Meeting 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 1 February 2007 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 2006.

Remuneration report

Resolution 2: to approve the directors' remuneration report for the year ended 31 August 2006.

Dividend

Resolution 3: to declare a final dividend of 6.2p per share recommended by the directors on the ordinary shares.

Directors

Resolution 4: to re-appoint John Barton as a director of the Company.

John Barton joined the Board on 26 June 2006. He joined the Board of Old WH Smith in November 1999 and is the Senior Independent Director and Chairman of the Remuneration Committee. He has extensive financial and retail experience. The Chairman confirms that, following the formal performance evaluation carried out in September 2006, John Barton continues to make an effective contribution and time commitment to Board and Committee meetings.

Resolution 5: to re-appoint Alan Stewart as a director of the Company.

Alan Stewart joined the Board on 21 June 2006 and is Group Finance Director. He joined the Board of Old WH Smith in March 2005 and 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 Limited.

Auditors

Resolution 6: 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 7: 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 Annual General Meeting of the Company or on 30 April 2008, whichever is the earlier.

Resolution 8: 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 Annual General Meeting of the Company or on 30 April 2008, whichever is the earlier.

Authority to allot shares

Resolution 9: to resolve that, pursuant to Article 6 of the Company's Articles of Association, the directors be and are hereby generally and unconditionally authorised, pursuant to section 80 of CA 1985, to exercise all the powers of the Company to allot relevant securities (as defined in section 80(2) of the said Act) up to an aggregate nominal value of £12,194,770. This authority will expire at the conclusion of the next Annual General Meeting of the Company or on 30 April 2008, 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.

Notice of Annual General Meeting

Special business – special resolutions

Disapplication of pre-emption rights

Resolution 10: to resolve that, pursuant to Article 7 of the Company's Articles of Association, but subject to the passing of Resolution 9 above, the directors be and are hereby empowered pursuant to section 95(2) of CA 1985 to allot equity securities (as defined in section 94(2) of CA 1985) for cash pursuant to the authority conferred by Resolution 9 above 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 value of £1,829,215; and
- b) will expire at the conclusion of the next Annual General Meeting of the Company or on 30 April 2008, 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 11: to resolve that, pursuant to Article 11 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 (as defined in 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 18,292,155;
- b) the minimum price which may be paid for each ordinary share is 20p (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 Annual General Meeting of the Company or on 30 April 2008, 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.

By Order of the Board

Ian Houghton

Company Secretary

12 October 2006

Registered Office:

Greenbridge Road, Swindon, Wiltshire SN3 3RX

Notice of Annual General Meeting

Special business – explanatory notes

Authority to make political donations: Resolutions 7 and 8

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 company 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 Annual General Meeting or 30 April 2008, whichever is the earlier. As required by CA 1985, the resolutions are in general terms and do not purport to authorise particular donations.

Authority to allot shares: Resolution 9

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 value of £12,194,770, representing approximately one-third of the Company's issued ordinary share capital as at 12 October 2006. The authority will expire at the conclusion of the next Annual General Meeting of the Company or on 30 April 2008, 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 10

If shares are allotted for cash using the authority given by Resolution 9, 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 authorise the directors, pursuant to section 95 of CA 1985, 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 value of £1,829,215, which is equal to approximately 5 per cent of the Company's issued ordinary share capital as at 12 October 2006, and will expire at the conclusion of the next Annual General Meeting of the Company or on 30 April 2008, whichever is the earlier.

Market purchases of ordinary shares: Resolution 11

With the authority of shareholders in general meeting, the Company is empowered by its Articles to purchase its own ordinary shares in the market subject to the provisions of CA 1985.

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 18,292,155 ordinary shares, which is equal to approximately 10 per cent of the Company's issued ordinary share capital as at 12 October 2006, 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.

Notice of Annual General Meeting

Market purchases of ordinary shares: Resolution 11 continued

As at 12 October 2006, being the last practicable date prior to publication of this Notice, there were outstanding 12,924,833 options to subscribe for ordinary shares, representing 7.1 per cent of the Company's issued ordinary share capital. If the authority was exercised in full, the options would represent 7.9 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 Annual General Meeting of the Company or on 30 April 2008, whichever is the earlier.

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 Annual General Meeting are entitled to appoint one or more proxies (who need not be shareholders) 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 either the annual review and summary financial statement or 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 and the Articles of Association of the Company, the Company specifies that only those ordinary shareholders registered in the register of members of the Company as at 6.00pm on 30 January 2007 shall be entitled to attend (either in person or by proxy) 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 30 January 2007 shall be disregarded in determining the right of any person to attend and vote at the Annual General Meeting.
5. Copies of directors' service contracts and non-executive directors' letters of appointment with the Company and any of its subsidiaries, and the register of directors' interests in the share capital of the Company 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 Annual General Meeting on 1 February 2007 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.

Notice of Annual General Meeting

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

1. If you are unable to attend the Annual General Meeting 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 30 January 2007. 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 on to 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 30 January 2007.
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 30 January 2007, or, if the meeting is adjourned, not less than 48 hours before the time fixed for the adjourned meeting.

Notice of Annual General Meeting

A map of the location of the CBI Conference Centre, Centre Point, 103 New Oxford Street, London WC1A 1DU, the venue for the Annual General Meeting, is shown below. Please note that coffee and tea will be served before the meeting.



Company Information

WH Smith PLC

Greenbridge Road
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United Kingdom

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01793 616161

Facsimile

01793 562560

Website

www.whsmithplc.com

High Street Retail

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Facsimile

01793 562560

Website

www.whsmith.co.uk

WHSmith Customer Service

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Telephone

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Email

[customer.relations](mailto:customer.relations@whsmith.co.uk)

@whsmith.co.uk

Investor Relations

Telephone

020 7851 8820

Media Relations

Telephone

020 7851 8850

Recruitment

Website

www.whsmithcareers.co.uk

Travel Retail

3rd Floor
180 Wardour Street
London, W1F 8FY
United Kingdom

Telephone

020 7851 8800

Facsimile

020 7851 8847

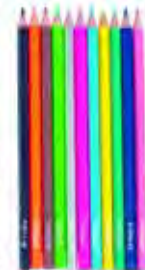
Website

www.whsmithplc.com

This annual report is printed on paper made using up to 50 per cent recovered fibre from pre and post consumer waste and the remaining pulp source is element chlorine free sourced from fully sustainable sources. The manufacturing mill has also been accredited with the internationally recognised standard ISO 14001.

Printed by a company accredited with ISO 9001 and utilising vegetable oil based inks.

Designed by greymatter williams and phoa.





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