

## Group performance

### Financial highlights

Following the disposal of HMV Japan during the period, the Group's results and comparatives shown below exclude HMV Japan to reflect continuing operations only, except where specified.

	2008 £m	2007 £m	Growth %
<b>Continuing operations:</b>			
Sales	<b>1,874.9</b>	1,684.8	11.3
Like for like sales – %	<b>7.3%</b>	(3.5%)	
Operating profit (before exceptional items)	<b>66.2</b>	54.0	22.6
Operating exceptional items	<b>(4.6)</b>	(26.5)	
Profit before tax (before exceptional items)	<b>56.6</b>	45.2	25.2
Profit before tax	<b>52.0</b>	18.7	
Discontinued activities – HMV Japan	<b>51.7</b>	1.9	
Adjusted basic earnings per share (continuing operations)	<b>10.1p</b>	8.2p	22.8
Basic earnings per share (continuing operations)	<b>9.2p</b>	3.5p	
Total dividend per share declared	<b>74p</b>	74p	
Underlying net borrowings	<b>0.2</b>	130.6	
Free cash flow	<b>874</b>	6.3	
Store numbers (continuing operations)	<b>692</b>	683	
Average trading square footage (continuing operations)	<b>3.68m</b>	3.59m	2.7

Total sales from the Group's continuing operations increased by £190.1m or 11.3% to £1,874.9m, including like for like sales growth of 7.3%.

At constant exchange rates, total sales grew by 10.3%. Beneficial exchange rate movements, primarily in the Euro and Canadian dollar, increased sales by £17.3m and operating profit by £0.9m.

Operating profit from continuing operations before exceptional charges increased by £12.2m or 22.6% to £66.2m. The improvement on last year reflects the strong sales performance of both UK businesses. Cost saving initiatives, particularly Group buying synergies and the consolidation of back office functions, contributed to the tight management of operating costs, which included an incremental bonus charge of £11.0m, reflecting the Group's profit growth and strong cash generation from management of working capital. Net finance charges before exceptional items rose from £8.8m to £9.6m, reflecting higher interest rates and the net impact on borrowings of the acquisition of Ottakar's and the disposal of HMV Japan.

The profit before tax and exceptional items for continuing operations was £56.6m, up 25.2% on the prior period.

Exceptional operating costs of £4.6m were incurred in connection with the continuing review of the combined Waterstone's store portfolio, following the acquisition of Ottakar's.

Discontinued operations, reflecting the trading and disposal of HMV Japan, generated a profit after tax of £51.7m.

Underlying net borrowings at £0.2m (2007: £130.6m) were broadly eliminated, reflecting the receipt of £70.6m gross proceeds from the sales of HMV Japan and the strong cash generation of the continuing operations.

The Board is proposing a final dividend of 5.6p, making a total dividend for the year of 7.4p.

Sales	2008	2007	Year on year	Constant	Like for like
	£m	£m	growth <sup>1</sup> %	exchange growth <sup>2</sup> %	sales growth (decline) <sup>3</sup> %
HMV UK & Ireland	<b>1,079.0</b>	932.2	15.8	15.4	11.4
HMV International <sup>4</sup>	<b>231.6</b>	215.1	7.6	1.7	(1.3)
Total HMV	<b>1,310.6</b>	1,147.3	14.2	12.9	9.2
Waterstone's <sup>5</sup>	<b>564.3</b>	537.5	5.0	4.7	3.3
<b>Total continuing operations</b>	<b>1,874.9</b>	1,684.8	11.3	10.3	7.3
<b>Discontinued operation – HMV Japan</b>	<b>61.2</b>	209.7			
<b>Total HMV Group</b>	<b>1,936.1</b>	1,894.5			

Operating profit (before exceptional items)	2008	2007	2008	2007	Year on year	Constant
	£m	£m	% of sales	% of sales	growth (decline) <sup>1</sup> %	exchange growth (decline) <sup>2</sup> %
HMV UK & Ireland	<b>41.4</b>	24.3	<b>3.8</b>	2.6	70.3	69.1
HMV International <sup>4</sup>	<b>8.5</b>	13.4	<b>3.7</b>	6.2	(36.2)	(39.6)
Total HMV	<b>49.9</b>	37.7	<b>3.8</b>	3.3	32.6	30.7
Waterstone's <sup>5</sup>	<b>16.3</b>	16.3	<b>2.9</b>	3.0	(0.6)	(1.5)
<b>Total continuing operations</b>	<b>66.2</b>	54.0	<b>3.5</b>	3.2	22.6	20.9
<b>Discontinued operation – HMV Japan</b>	<b>0.1</b>	3.3				
<b>Total HMV Group</b>	<b>66.3</b>	57.3				

1. Year on year growth for the 52 week period compared with the corresponding period last year is based on results translated at the actual exchange rates being the weighted average exchange rates for the year ended 26 April 2008 and year ended 28 April 2007 respectively.

2. Constant exchange growth for the 52 week period compared with the corresponding period last year is based on the weighted average exchange rates for the year ended 28 April 2007.

3. HMV Group's like for like sales performance is calculated at constant exchange rates and measures stores that were open at the beginning of the previous financial year (ie open at the beginning of May 2006) and that have not been resized, closed or re-sited during that time. It includes sales from internet sites and is only ever the net amount received.

4. HMV International comprises the results of HMV Canada, Hong Kong and Singapore.

5. Waterstone's results include Ottakar's, which was acquired on 3 July 2006.

### HMV UK & Ireland

HMV UK & Ireland, operating through 250 stores and online, had a very good year, with total sales up by 15.8%, driven by like for like sales growth of 11.4%. The result reflected strong store sales and the continuing growth of hmv.com. An excellent performance in music and DVD was complemented by an increased focus on higher growth games and technology categories, with like for like sales of these products increasing by 59% and 95% respectively. The increased mix of lower margin products contributed to a planned 50 basis point reduction in the gross margin rate, with this effect arising in the first half as underlying product margin gains increasingly offset the impact of growing games and technology sales. Operating costs were well managed, with like for like costs increasing by 2.2% exclusive of incremental staff bonuses. Overall, therefore, operating profit increased by 70.3% to £41.4m and the operating margin rose from 2.6% to 3.8%.

Although HMV UK & Ireland's markets remained highly competitive, market share gains were made across the board. In music, the market declined by almost 12% by volume, in line with our expectations, but in HMV UK & Ireland our unit sales of music marginally increased due to successful product campaigns and marketing. In DVD, HMV UK & Ireland increased unit sales by over 18%, significantly outperforming a market that grew by over 8% in volume. This performance was assisted by successful campaigns, including US TV, Valentine's and World Cinema, and a strong line-up of new releases, especially at Christmas. The games market continued to be an area of outstanding growth, with value growth in the year of 42%. Within this, HMV UK & Ireland increased its share of both the hardware and software markets, with total sales up over 64%.

Following enhancements made to the hmv.com website, including customer communication, service and functionality, online sales during the period increased by over 42%.

Seven new stores were opened in the period, and following the acquisition of seven stores and related trademarks from the administrator of Fopp, one further store was opened trading as Fopp.

### HMV International

HMV International now comprises 121 HMV stores in Canada and eight stores in Hong Kong and Singapore, with HMV's business in Japan sold during the period (see Discontinued operations).

Sales of HMV International were £231.6m, an increase of 1.7% on last year at constant exchange rates. Total reported growth was 7.6%, reflecting beneficial exchange rate movements. The growth reflected a like for like sales increase in HMV Hong Kong and Singapore, partially offset by like for like sales decline of 1.9% in HMV Canada, where the markets for both music and DVD were particularly challenging. Liquidation activity by HMV Canada's largest specialist competitor adversely impacted sales and market share during the Christmas period, but when these stores ceased to trade in January 2008 HMV Canada's sales and market share trends improved markedly. Games and technology sales grew rapidly to 7% of HMV Canada's sales mix following the roll-out of a games offer in the year and a range of new technology products in time for the peak Christmas period. However, the lower margins achieved on these products contributed to a 110 basis point dilution in gross margin.

In HMV Hong Kong and Singapore strong like for like sales growth was driven by continued success in DVD and, although a relatively low proportion of the mix, rapid games sales growth.

Six stores were opened in the period in HMV Canada and one in HMV Hong Kong.

Overall, the operating profit of HMV International fell to £8.5m, entirely reflecting HMV Canada's like for like sales decline and the impact of a higher mix of games and technology sales on gross margins. In HMV Hong Kong and Singapore, operating profit increased marginally.



## Waterstone's

In Waterstone's, which operates through 313 stores, total sales increased by 5.0% for the period, including like for like sales up 3.3%. This growth includes the annualisation of the Ottakar's acquisition and an estimated 0.9% impact from sales of Harry Potter and the Deathly Hallows. The book market continues to be highly competitive and promotional, which resulted in some Waterstone's market share dilution, although this can be mostly attributed to the closure of stores as part of the strategic initiative to rationalise dual catchments. New children's departments and an enhanced gift stationery offer were successfully rolled out to over 100 stores, enabling Waterstone's to maximise these growing product categories. Waterstones.com grew by 146% during the period, driven in part by the success of Waterstone's multi-channel loyalty card, which launched in September 2007, and has attracted 1.5m registered members to date.

Waterstone's operating profit for the year of £16.3m was level on last year after incurring £1.2m start-up costs of the book hub distribution centre. Better targeted discounting contributed to an underlying gross margin improvement of 30 basis points, although the total gross margin rate was down 10 basis points, due to the dilutory effect of Harry Potter and the Deathly Hallows. Costs were tightly controlled, with like for like operating costs, excluding incremental staff bonuses, up only 1.3%.

The result reflects a full annualisation of the impact of the Ottakar's acquisition in July 2006, with synergies, net of seasonal trading losses, contributing an additional £1.5m of operating profit. Exceptional store closure costs of £4.6m were incurred in connection with the continuing review of the combined store portfolio. As a result 11 stores closed in the period, while one new store was opened.

Above:

Strong brand promotions helped both UK businesses to deliver a successful Christmas.

### Net finance charges

Net finance costs before exceptional items increased from £8.8m to £9.6m. This reflected higher market rates and a higher interest margin as a result of amendments to the Group's Senior Facility agreed in June 2007, partially offset by reduced average net debt due to strong cash generation and the net effect of the acquisition of Ottakar's in July 2006 and the disposal of HMV Japan in August 2007.

### Taxation

The effective tax rate on continuing operations before exceptional items is 28% (2007: 27%). The total tax expense in the current year includes a credit of £1.1m (2007: £7.5m) in relation to the exceptional items from continuing operations of £4.6m (2007: £26.5m) and a charge of £0.9m in relation to the profit on disposal of HMV Japan.

### Earnings per share

Adjusted earnings per share from continuing operations, excluding the effect of exceptional items and discontinued operations was 10.1p, an increase of 22.8% on last year. Basic earnings per share was 22.1p, compared with 4.0p in 2007.

### Dividend

The Board is recommending a final dividend of 5.6p per share in addition to the 1.8p per share interim dividend already paid, bringing the total dividend for the year to 7.4p (2007: 7.4p). By maintaining the dividend level, dividend cover has increased to 1.4 times from 1.1 times, in line with the Board's policy of rebuilding dividend cover towards a target of 2.0 times by 2009/10.

Subject to shareholder approval at the Annual General Meeting on 5 September 2008, the final dividend will be paid on 10 October 2008 to shareholders on the register at the close of business on 29 August 2008. Shares will be quoted ex-dividend from 27 August 2008.

### Cash flow and net debt

Closing net debt of £0.2m was £130.4m lower than last year. This reflected the disposal of HMV Japan, as a result of which £80.0m of term debt was repaid and cancelled during the period, ahead of its maturity on 31 January 2008. Free cash inflow was £87.4m (2007: £6.3m).

	2008 £m	2007 £m
EBITDA	<b>108.1</b>	103.6
Capital expenditure	<b>(36.8)</b>	(46.6)
Working capital inflow (outflow)	<b>36.6</b>	(13.1)
Spend from exceptional charges and provision utilisation	<b>(6.1)</b>	(15.0)
Other	<b>4.2</b>	1.6
Net interest paid	<b>(9.3)</b>	(9.1)
Taxation	<b>(9.3)</b>	(15.1)
Free cash flow	<b>87.4</b>	6.3
Net proceeds from the disposal of HMV Japan	<b>65.9</b>	–
Dividends paid	<b>(29.8)</b>	(29.7)
Special pension contribution	<b>–</b>	(4.4)
Purchase of Ottakar's plc, repayment of debt and related costs	<b>–</b>	(90.2)
Other	<b>6.9</b>	3.0
Net cash inflow (outflow)	<b>130.4</b>	(115.0)
Underlying opening net debt	<b>(130.6)</b>	(15.6)
Underlying closing net debt	<b>(0.2)</b>	(130.6)

EBITDA – Earnings Before Interest, Taxation, Depreciation, Amortisation and exceptional items.  
 Free cash flow – Cash flow from operating activities after capital expenditure and net interest.  
 Underlying net debt – Underlying net debt is stated before unamortised deferred financing fees.

### **Working capital**

Working capital improvements resulted in a cash inflow of £36.6m (2007: outflow of £13.1m) reflecting the strong trading performance in the final quarter and tight management of stock and creditors. Group stock turn improved to 5.6 times (2007: 5.3 times).

### **Capital expenditure**

Capital expenditure in the period was £36.8m, compared with the £46.6m spent in the prior year, which included £7.7m in relation to the integration of Ottakar's. Capital expenditure in the year included £6.4m on new stores, £12.1m refitting the existing store portfolio and £9.0m on IT projects.

### **Discontinued operations**

The Group completed the disposal of its HMV Japan business on 25 August 2007 for £70.6m on a cash and debt free basis, giving rise to a post-tax profit on disposal of £51.8m. Prior to disposal, HMV Japan made a loss after tax of £0.1m, giving a total profit after tax for discontinued operations of £51.7m.

The results of HMV Japan have been presented in the income statement as a discontinued operation and the prior year comparatives restated accordingly.

### **Operating leases**

All the Group's stores are held under operating leases. In HMV UK and Waterstone's the majority of leases are on typical institutional lease terms, subject to five year upwards only rent reviews. The majority of the Group's international stores and a minority of UK leases operate through turnover related leases, usually with minimum rent guarantees, and lease terms of five to 10 years.

The Group's net operating lease rentals were £151.1m in the financial year (2007: £154.0m). The total future rental commitment at the balance sheet date amounted to £1.2 billion, or £0.8 billion at net present value, while the existing portfolio has an average remaining lease period of 10 years. Retaining a portfolio of good quality real estate, in prime retail areas, at commercially reasonable rates remains critical to the performance of the Group. Where a store location becomes surplus to requirements, the Group's policy of occupying prime, highly marketable locations serves to limit any lease exposure.

### **Pensions**

The Group has a number of pension schemes in operation. These primarily include defined benefit arrangements for approximately 600 employees almost entirely in the United Kingdom. The defined benefit scheme was generally closed to new joiners from 1 January 2002.

A valuation is undertaken on at least a triennial basis by a qualified actuary. The most recently completed actuarial valuation of the scheme, as at 30 June 2004, identified a deficit of £11.5m on assets of £43.9m. This deficit was funded through three contributions of £4.4m, the final amount of which was paid on 31 May 2006. Furthermore, the Group increased its contributions to a rate of 14.9% of pensionable pay from 1 July 2005 (from 12.9%), while the members' contribution rate increased to 5% of pensionable salaries from 4%. The actuarial valuation as at 30 June 2007 is now close to completion and following this, the next actuarial review will take place no later than 30 June 2010.

Under IAS 19 'Employee Benefits', the HMV defined benefit scheme had a deficit, net of deferred tax, of £11.8m (2007: £15.6m) at 26 April 2008.