

### A winning team

The heart of our business is our 53,000 colleagues, all of whom are focused on meeting the needs of our customers. At every level of our business, they share a common commitment to getting things right first time, being friendly and efficient and providing good customer service in our stores, over the telephone, online and in customers' homes.

The Group is led by a strong management team that combines long-term experience of the organisation with service in the wider retail sector. The high levels of retail expertise within our retail brands and Group operations contribute to the Group's consistently high levels of performance relative to the rest of the UK retail sector. We encourage professional skills and the career progress of our colleagues through targeted learning and development to ensure that the Group is always well equipped to deal with change.

### Our competitors

The Group faces competition from many sources. Our competitors include:

- Established national specialists, such as B&Q, Wickes and Focus in home improvement, Currys and Comet in consumer electronics and domestic appliances, MFI and IKEA in furniture, Woolworths and Toys R Us in toys, H. Samuel in jewellery and Woolworths and Wilkinsons across broader general merchandise
- Supermarkets, such as Tesco, J Sainsbury and ASDA, which have been growing share in certain parts of the non-food, non-clothing market, building on their regular footfall and the increased space given to these ranges
- Online retailers such as Amazon.co.uk, who represent a small but growing share of the non-food, non-clothing market
- Specialist independents, such as regional and local chains selling single product ranges such as toys and jewellery.

We expect our markets to remain highly competitive in the future. Yet the barriers to entry for new market entrants are high, particularly in relation to establishing sourcing and distribution operations on the scale required to be competitive in the long term. As we have demonstrated at Argos and Homebase, economies of scale are key to generating attractive customer propositions, as well as operational cost benefits for the Group.

Product markets	Argos	Homebase	Group position	Market size
<b>Home enhancement</b>				
Housewares	✓	✓	1	£9.1bn
Furniture	✓	✓	1	£8.6bn
Home improvement (DIY/fitted kitchens/bathrooms)	✓	✓	2	£11.5bn
Horticulture, garden furniture and outdoor living	✓	✓	2	£3.2bn
<b>General merchandise</b>				
Small domestic appliances	✓	✓	1	£1.4bn
Consumer electronics	✓	✓	2	£15.5bn
Large domestic appliances	✓	✓	3	£4.0bn
Toys	✓	✗	1	£1.9bn
Jewellery	✓	✗	1	£3.4bn
Sports and leisure equipment	✓	✗	1	£1.2bn

Note: All market positions are for calendar year 2007 and by retail sales except for jewellery, which is measured by volume.

## Group growth strategy

The Group has a clear agenda to deliver long-term growth. We will leverage our purchasing scale, retail brands and multi-channel approach to grow market share in key growth categories within the general merchandise market.

### Growth through leveraging purchasing scale

- Building upon market-leading positions by enhancing and developing the product range and offering in core areas
- Using shared scale and expertise in sourcing and logistics and joint product ranges to provide value for money and wider choice.

Purchasing scale continues to be leveraged with particular benefit from the Group-wide overseas buying operations. Buying directly from overseas has grown to 31% of Group sales, of which 18%, or over £1bn, is directly sourced from manufacturers, with the balance being purchased via overseas agents. Over 7,500 product lines are sourced directly via our overseas buying offices, and these are spread across the majority of the Group's product categories. While cost pressures may build, such as from raw material prices or from foreign exchange rates, this will impact the market generally and Home Retail Group will utilise its substantial scale, skills and direct control over its supply chain to continue to extend advantage over its competitors and provide further benefit to its customers.

A continuing programme is driving wider cost synergies across the combined Group. Areas of focus include corporate procurement, media buying, IT services and property management. There has also been increased focus on the distribution infrastructure across the Group. Examples of benefits include combined fleet purchasing, shared backhaul (vehicles returning from store deliveries with collections from nearby suppliers) and relocating certain Argos Direct outbases to other Group facilities.

### Growth through increasing market share in targeted large product markets

- Capitalising upon the strength of our retail brands to identify opportunities in product markets, particularly large, fragmented markets
- Utilising the inherent flexibility of the Argos and Homebase retail formats
- Using shared infrastructure efficiently to make products available to customers quickly and easily.

The Group has become the number two in the growth market of consumer electronics, with Argos clearly demonstrating the strength of its customer offer with excellent sales in areas such as video games systems, LCD TVs and 'satnav'. 'Big ticket' categories such as furniture and white goods are likely to exhibit more difficult conditions due to the weakening in the housing market and general consumer confidence; however, the Group will capitalise on the combined buying scale, a market-leading home delivery infrastructure, new product presentations and its in-house financial services operation to continue to drive market share growth. Homebase also expects to continue its market share progress in kitchens, and Argos in the sports and leisure market.

At the same time as targeting share growth in 'big ticket' categories, emphasis will still be placed on maintaining strong positions in 'smaller ticket' categories. Such categories remain key to the overall performance of the Group, given that in both businesses average basket values are approximately £20 to £30.

# No.1

**Market position** in furniture, housewares, small domestic appliances, toys, jewellery, and sports and leisure equipment.

# 31%

**Overseas buying** as a percentage of Group sales.

### Growth through extending and exploiting multi-channel leadership

- Driving incremental sales growth over and above that achieved through new store openings
- Applying a customer-focused, fully-integrated approach to ensure that whether customers shop with Argos in-store, online or over the phone, they are able to find, order and receive goods seamlessly across the different channels
- Leveraging Group skills, scale and infrastructure to support the Homebase proposition.

The leadership of Argos in fully integrated multi-channel convenience continues to build, demonstrated by 37% of its sales now being transacted across more than one channel. In particular, Argos Check & Reserve is unique in its functionality, scale and efficiency. With its online presence being well established, well invested and generating £900m of sales in the last year, Argos sees the internet as a further key growth opportunity and one that is significantly enhanced by its physical store presence for additional customer convenience.

Homebase has embarked on further multi-channel opportunities and continues to benefit from the scale and expertise of Argos. Homebase utilises the in-house cost advantage of Argos Direct, the UK's largest home deliverer of bulky products. Its recently relaunched website will also provide customers with expanded choice and improved information and functionality, while the 'Furniture and Home' catalogue, which brings together many of the key elements of the Homebase customer proposition, was rolled out to all stores in January 2008.

### Growth through expanding the store networks

- Opening approximately 30 Argos stores per year
- Opening approximately 10 Homebase stores per year.

Both Argos and Homebase regularly review their 'extent of chain' across the UK and Irish markets and will continue their new store opening programmes of around 30 Argos stores and 10 Homebase stores a year. Confidence in the Argos opening programme comes, in particular, because of its increased product choice that captures a wider share of customer spend in a catchment and its success in both high street and out-of-town locations. Confidence in the Homebase opening programme comes from its now broader home enhancement offer and its successful smaller store format which allows it to enter smaller catchments and frequently be the leading customer offer in categories including core DIY, garden and showroom. Growth is also expected to be achieved from continuing to develop formats and store presentations to meet the changing needs of customers.

**'Both Argos and Homebase will continue to extend their multi-channel routes to market by increasing sales via the internet and catalogues.'**

## Factors affecting performance

### Consumer spending

The biggest factor affecting the Group's short-term performance is likely to be UK consumer spending.

Retail market conditions are likely to be challenging in the short term. The rising costs of essential household bills, driven by inflationary pressures, mean that discretionary spending will be squeezed. The current instability in the credit markets is also likely to constrain consumer spending and confidence, which may affect bigger ticket, home-related purchases in particular.

However, while volume and value growth rates are likely to be impacted in most product markets, consumers will still want new products as tastes and technology change, or they need to replace many existing household items.

### Market growth

Although retail conditions are likely to be challenging in the short term, the longer-term outlook for market growth is positive. We expect continued growth in the general merchandise and home enhancement market due to the following factors:

- Population growth and an increasing number of households
- Rising overall household disposable income
- Technology change and new product development.

### Market consolidation

The UK retail market is undergoing significant change. This is in part driven by the slowdown in consumer spending but is underpinned by an overall structural shift in favour of more general and large scale retailers like Home Retail Group.

The market remains competitive. In the current trading conditions, factors such as scale, value and cost management are likely to be some of the key determinants of long-term success.

Where product markets are fragmented, an element of consolidation is inevitable. The most successful retailers will be those who can offer the consumer a differentiated service or shopping experience at a competitive price.

### Home Retail Group's position

The Group's key strengths mean we are well equipped for the future.

Our strong retail brands, multi-channel and multi-format offering, extensive product choice and competitive pricing, mean we are well positioned to trade through any downturn and benefit from renewed consumer confidence through the cycle.

We have leading positions in multiple product markets yet with substantial headroom for growth in many categories. Fragmented markets provide growth opportunities and we expect to take market share from weaker competitors and to benefit from any market consolidation that ensues.

Our retail brands are well established but continue to evolve to meet changing customer preferences. Our product range is constantly expanding. Our supply chain is highly efficient and cost effective.

With all the key determinants for success in place, we expect to emerge in the long run as a stronger competitor in a more consolidated market.

#### Group's key strengths:

1. The market leader
2. Two strong retail brands
3. Great choice and value
4. Integrated multi-channel capability
5. Purchasing, sourcing and supply chain strength
6. Shared infrastructure and logistics expertise
7. A winning team