

Chairman's statement



HMV Group began a period of transition during 2005/06. In the UK market, to which the Group has an overwhelming exposure through HMV UK & Ireland and Waterstone's, retail conditions were highly demanding. The most popular entertainment and book titles were impacted by rapidly growing competition from supermarkets, while a pronounced shift in consumer preference to buying online put pressure on the deeper range of product.

As a result of these competitive inroads, statutory turnover for the 52 week period decreased 2.0% to £1,825.9m and profit before tax and exceptional items was £98.2m, down 20.7%. Basic earnings per share were 14.0p and adjusted earnings per share were 17.4p.

Despite these challenging conditions, the Group continues to be cash generative. Therefore, your Board is recommending that the total dividend be increased by 8.8% to 7.4p per share.

In responding to the competitive environment, it has been necessary to make operational and structural changes in our businesses. Throughout, the dedication and passion of our people has been conspicuous. On behalf of the Board, I would like to say how much we appreciate their unfailing commitment to our customers and to our business.

The past months have not been uneventful. In February, we received a conditional offer from Permira Advisers Ltd, valuing the Company at 210p per Ordinary Share. The Board fully explored this proposal on behalf of its shareholders, and was unanimously of the view that it undervalued prospects for the business in the medium and long term. We also received a proposal to buy Waterstone's from Lazard European Private Equity Partners, which was ultimately withdrawn.

The UK retail environment remains challenging. However, your Board is confident that initiatives undertaken by management to revitalise the performance of the UK businesses will ultimately generate greater value.

After a successful trial in six stores, we are now rolling out new lower prices throughout HMV UK. Sales from hmv.co.uk are running ahead of last year by over 100%, following improvements made to the competitiveness, functionality and marketing of the transactional website. During the new financial year, we will further develop this multi-channel approach by more closely integrating the Internet channel into our store-based business. Performance in games continues to be very encouraging; we prepared thoroughly for an upturn in the market and have been rewarded by increased market share.

The HMV businesses in Asia Pacific and Canada had an excellent year. In both, we have already demonstrated our ability to respond successfully to many of the challenges now faced by our UK business.

In Waterstone's, we are continuing to make progress on a number of initiatives to improve the operating and financial performance of the business, including the launch of waterstones.com in autumn 2006.

The acquisition of Ottakar's plc was completed on 3 July 2006, and as a result the Waterstone's business is being enlarged to over 330 stores. This scale will enable us to respond better to competitive challenges. I would like to welcome Ottakar's employees to the Group. Their excellent bookselling skills are highly complementary to our own, and will ensure that we continue to offer customers the best book buying experience on the high street. The acquisition for £62.9m on a fully diluted basis is being financed from existing cash resources. Although this will increase the Group's leverage, your Board believes the Group can operate on a higher level of financial gearing, and during the new financial year we plan to resume a programme of on-market share buy-backs. We believe this will enhance value for shareholders, and still enable the Group to pursue opportunities for organic growth.

I am delighted to be the Group's new Non-Executive Chairman, following my appointment to the Board on 1 February 2006. The new financial year sees further changes to your Board. David Kappler, who has been a member since the IPO and last year became Chairman for an interim period, retires on 6 July. We have benefited greatly from David's extensive business experience, and will miss him.

The Group's Chief Executive, Alan Giles, will retire at the end of 2006 after almost nine years. He successfully led the Group's formation in 1998, its stock market flotation in 2002 and, most recently, the acquisition of Ottakar's plc. The Board would like to express our appreciation to Alan for his many contributions.

The lead-time on Alan's departure allows us to plan thoughtfully for succession. While this process was somewhat slowed by earlier events, we are confident of appointing in due course a high-calibre Chief Executive to lead the Group and the experienced and proven retail management teams in our businesses.

Competitive pressures will persist in the new financial year. However, with a robust balance sheet, two powerful retail brands, and highly-skilled and committed people, I am confident that we can successfully extend our excellence in store-based retailing to become a truly world class, integrated multi-channel retailer.

Carl Symon **Chairman**
5 July 2006