Reed Elsevier plc (LSE:REL)

Earnings Call Transcript

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Call Participants

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Presentation

Anthony Habgood

Chairman, Member of Remuneration Committee and Chairman of Reed Elsevier NV

So ladies and gentlemen, thank you all very much for coming in, and for those of you who are with us on the web, thank you for listening in.

In my mind, there is no doubt that Reed Elsevier has continued its positive momentum through 2011. For the first time in 4 years, all 5 business areas contributed to the underlying revenue growth, excluding the effect of biennial cycling in exhibitions.

Underlying operating profits grew well, and we delivered a good increase in earnings per share in both PLC and NV. Our cash flow generation has allowed us to invest in our business while maintaining a strong balance sheet, and we're recommending around a 6% increase in final dividend, very slightly below the EPS growth of the 2 parent companies.

In addition to positive financial progress, Erik has continued to reshape and build his management team. As we explained this time last year, Erik's earlier priority was to renew the leadership of the business areas, and 4 out of 5 are now under new management.

In the past 12 months, his focus has been on the central functions, and he has appointed a new group general counsel, dedicated heads of investor relations and corporate M&A and new heads of strategy, business analytics and corporate communications.

Mark Armour, as you know, our long-standing CFO, announced in October that he will retire at the end of the year. We are conducting a search, both internally and externally, to fill Mark's very substantial shoes.

In addition, we announced today that David Brennan, CEO of AstraZeneca, will be joining our boards later in the year as a nonexecutive director and member of the supervisory board, subject, of course, to shareholder approval in our AGMs in April.

As a truly international executive with deep knowledge, both of medical research and of the world's health care markets, David will bring highly relevant experience to our board discussions, and I'm looking forward to him joining us later in the year.

As you can see, we are continuing to evolve both our boards and our management team.

We will now follow the usual format. Mark will take us through the financial results, and then Erik will go into the business areas in more detail and discuss our strategy and outlook for 2012. Thank you very much.

Mark Armour

Chief Financial Officer, Member of Executive Council, Member of Executive Board and Executive Director

Thank you, Chairman, and good morning. I'm very pleased to report on a year of good financial progress in 2011. Underlying revenue growth was 2% and underlying operating profits were up 5%. Margins increased by 140 basis points to 27.1%, and adjusted earnings per share were up 8% for Reed Elsevier PLC at 46.7p and up 6% for Reed Elsevier NV at EUR 0.83. At constant currencies, adjusted earnings per share were up 6%.

The growth in reported EPS -- and that is including amortization of intangible assets, disposal gains and losses and all other items -- was 19% for Reed Elsevier PLC and 16% for Reed Elsevier NV.

Cash flow was strong with a 93% conversion of adjusted operating profits into cash, and the full year dividends proposed are up 6% for both Reed Elsevier PLC and Reed Elsevier NV at 21.55p and EUR 0.436, respectively.

Our balance sheet is in good shape with net debt to EBITDA at 2.3x on a pension and lease adjusted basis. And our post-tax return on invested capital increased 60 basis points to 11.2%.

I'm presenting the figures today in sterling. The same charts with the euro figures can be found in the appendices to this presentation. Reported revenues were down 1% in sterling, including acquisitions and disposals and currency translation effect, and flat at constant currencies. Adjusted operating profits were up 5% in sterling and up 4% in constant currencies.

Reconciliations of the year-to-year movements in revenues and adjusted operating profits are included in the appendices.

Interest expense was lower, principally reflecting the strong free cash flow, term debt redemptions and expiry of interest rate swaps.

Adjusted pretax profits were up 9% in sterling and up 7% at constant currencies. The effective tax rate was up 60 basis points, with proportionately higher profits in the U.S. than in the prior year, giving adjusted net profit up 8% in sterling and up 6% at constant currencies.

Focusing on revenue and adjusted operating profit. Underlying revenue growth was 2%, or 3% excluding the impact of biennial exhibitions cycling out this year. This reflect an improved market environment in 2011 as well as the impact of new product introduction, expanded sales and marketing and continued portfolio development.

The underlying adjusted operating profit growth was 5%, with costs flat despite business growth and additional spending on new product development.

Adjusted operating margin increased 140 basis points. This includes a 40-basis-point margin pickup between constant currencies and reported currencies, reflecting the impact of our multiyear journal subscription hedging program and other currency translation effects.

The next 2 charts summarize the constant currency growth rates across our businesses for revenue and adjusted operating profit, both in total and underlying.

Elsevier saw underlying growth of 2%; Risk Solutions was up 4%; Legal & Professional, up 1%; Reed Exhibitions, flat; and RBI, up 1%, giving the overall 2% revenue growth for Reed Elsevier.

Reed Exhibitions, excluding biennial show cycling, delivered underlying growth of 10%. Erik will go into more detail later on the performance of each business and outlook.

For adjusted operating profit, underlying profit growth was 4% at Elsevier and 12% at Risk Solutions. Legal & Professional was down 2%, with Exhibitions up 2% and RBI up 15%, to give the overall Reed Elsevier underlying profit growth of 5%.

This next chart sets out how the underlying operating profit performance is derived from changes in underlying revenues and cost base.

In Elsevier, underlying costs grew 1% against revenues up 2% to deliver the 4% profit growth. Cost increases from business growth and spending on new product marketing initiatives were largely offset by ongoing process efficiencies and procurement savings.

At Risk Solutions, underlying costs declined 1%, with business growth and continued investment in new product initiatives more than offset by further cost savings, particularly in technology integration as we completed the ChoicePoint integration.

In Legal & Professional, underlying profits were 2% lower on 1% revenue growth, with underlying cost growth of 1%, reflecting increased spending on new product initiatives and in sales and marketing, mitigated by continuing cost actions.

In Reed Exhibitions, our underlying costs were 1% lower, reflecting tight cost control while funding a record level of new exhibition launches and other initiatives to deliver the 2% profit growth.

At RBI, underlying costs were 2% lower, reflecting the cost actions taken in 2010 and 2011 to reposition the business and improve its profitability, with underlying profit growth of 15%. In total, underlying costs were flat to deliver the 5% operating profit growth.

This next chart shows how the Reed Elsevier net profit is divided between Reed Elsevier PLC and Reed Elsevier NV. While the average number of shares in issue is largely unchanged, the 8% increase in adjusted net profit expressed in sterling and the 6% increase expressed in euros flow through to the respective growth rates in adjusted earnings per share.

This next chart sets out the adjustments we've made to the reported IFRS pretax figures in arriving at the adjusted figures, which are used as key performance measures. Of particular note is that there are no exceptional restructuring costs in 2011. The 2010 costs related to RBI restructuring.

The acquisition integration costs principally relate to the final year of the 3-year ChoicePoint integration process. They also include costs of integrating other acquisitions, including CBI China, Ascend and Accuity.

Adjusted operating cash flow for the year represented 93% of operating profit after high levels of capital spending. This conversion rate is 5 percentage points lower than in the prior year due to the higher CapEx and lower depreciation than in 2010, which follows disposals, particularly in RBI, and accelerated depreciation in 2010.

The increase in capital expenditure in 2011 to GBP 350 million reflects increased CapEx in most of our businesses, supporting our electronic information solution strategy.

CapEx in the Legal & Professional business is particularly high at 12% of revenue as we build out the next generation of legal offerings and modernize the business systems infrastructure.

Overall CapEx averages 6% of Reed Elsevier revenues and is likely to remain at 6% this year, as the legal business moves through its peak investment period.

Free cash flow before dividends was GBP 46 million lower at GBP 977 million, principally due to the resumption in 2011 of more normal tax payment, although the tax paid in the year did benefit from the accelerated tax depreciation that's been available under the U.S. stimulus package. In 2010, we benefited from significant tax repayments from prior years related to crystallized tax losses on the retained U.S. assets of RBI.

I've included here our movement in net debt in both sterling and U.S. dollars as most of our debt is denominated in dollars, reflecting acquisition financing and also acting as a natural translation hedge for the operating profits and cash flow we generate in the U.S.

The net debt is largely unchanged year-on-year, with free cash flow and disposal proceeds used to finance acquisitions, most particularly CBI China, Ascend and the GBP 343 million acquisition of Accuity, which we completed in November.

Net debt to EBITDA was 2.3x on a pension and lease adjusted basis, down from 2.5x in 2011, reflecting the growth in EBITDA in U.S. dollars.

Turning to the balance sheet. There are no major changes in the sheet. Goodwill and intangible assets increased with the acquisitions made in the year, partly offset by amortization.

The net pension obligations increased by GBP 72 million, principally due to lower discount rates on liabilities, and negative working capital increased further to GBP 1.1 billion.

The 60-basis-point improvement in post-tax return on invested capital largely reflects the solid underlying profit growth, good cash generation and continued capital efficiency. Portfolio change had little impact on returns in the year.

Lastly, dividends. The equalized dividends, as the Chairman said, are up 6% -- sorry, the final dividends are up 6% at 15.9p for Reed Elsevier PLC and up 8% to EUR 0.326 for Reed Elsevier NV. This gives full year dividend growth of 6% for both Reed Elsevier PLC and Reed Elsevier NV at the 21.55p and EUR 0.436, respectively.

The difference in the growth rates in the final dividend reflects the slight weakening of the euro against sterling since February 2011, when last year's final dividends were proposed. This offsets an opposite effect in respect to the interim dividend, so that for the full year dividend, the growth rates are unusually the same for both Reed Elsevier PLC and Reed Elsevier NV.

The equalization calculation for the dividends are set out in appendix. On that note, I will hand over to Erik.

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Well, good morning. Thank you for coming and for taking the time to be here today. Now I stood up here for the first time as the brand-new CEO of Reed Elsevier almost exactly 2 years ago. And at that time, we reported on the results from what was a difficult 2009, and we expected to see late-cycle effects continuing in the near-term.

But we also said that we had fundamentally high quality assets with strong positions in long-term global growth markets and that we would focus on a set of clear priorities to drive value and improve our operating performance in each business at across Reed Elsevier.

And even though the macroeconomic environment is still uncertain today, I'm pleased to say that we have indeed improved our operating performance since then, and we have made significant strategic progress.

In terms of operating performance, you've already heard that the underlying revenue growth in 2011 was 2%, but if you exclude the effects of biennial exhibition cycling from each of the past 5 years, the like-for-like underlying revenue growth trajectory looks like this, recovering to 3% in 2011. And without adjusting for exhibition cycling, underlying operating profit growth recovered to 5%.

And despite increasing the organic investment in our business and completing a few acquisitions, we've improved our return on invested capital, up 60 basis points to 11.2% for the year.

And we've taken our net-debt-to-EBITDA ratio back into a range that we're very comfortable with, ending the year at 2.3x on a pension and lease adjusted basis.

In addition, we've continued to migrate our business online to the extent that only just over 20% was still in print during 2011, down from over 50% 5 years earlier.

And we're evolving our geographic footprint with revenues outside North America and Europe, having gone from 12% to 17% of our revenues over the past 5 years, and with Continental Europe now representing only about 20% of our total revenues.

Now going forward, in an environment where global professional employment will grow across industries, information sources and data volumes are multiplying and the use of technology is evolving, we want to be a company that sells improved outcomes to professional customers. And by that, we mean that we want to serve professional customers in information-intensive industries, the individuals as well as the institutions or businesses that they work for.

We want to deliver demonstrably improved outcomes to those customers, i.e., help them make better decisions, get better results and be more productive.

We want to do this with tools that leverage deep customer understanding, combine high-quality content and data with analytics and technology to build solutions that typically cost less than 1% of our customers' total cost base but can have a significant positive impact on the remaining 99%.

We want to build leading positions in long-term global growth markets, primarily through organic investment. And we want to move in this direction to this type of business across all of Reed Elsevier and, in doing so, leverage our institutional skills, assets and resources across the company, both to build solutions for our customers and to pursue cost efficiencies within the company.

And the institutional skills of Reed Elsevier are the skills needed to serve information-intensive professional customers, namely professional customer analytics, data collection, content management and electronic product and platform development pricing and distribution.

Now we leverage these skills by sharing methods, tools, data, software, infrastructure and people and sometimes by building out central groups to drive them forward. But let me walk through each one of our 5 major business areas to illustrate what we're doing in each one.

In Elsevier, our priorities are to improve research outcomes and productivity for researchers and their managers through expanded content and integrated analytics and technology platforms, to drive remaining P to E migration in health leveraging global platforms and to relentlessly pursue process innovation and efficiency through global shared services.

We made good progress on those priorities in 2011. Our author, editor, reviewer satisfaction and loyalty scores reached an all-time high, and this is not something we say lightly or take likely. Just to give you one illustration, we just received our 1 millionth survey response in one of our programs, the journal feedback program, where we measure and track what people in different communities around the world think of us at different times.

This was reflected in the double-digit growth in article submissions we saw during the year and continued growth in citation share, the primary measure of quality, to an all-time high. We also expanded our global platforms for both science and health content.

And the results in the year were: The S&T grew 4% with good growth in research and databases; Health Sciences was flat with double-digit growth in electronic revenues across all segments, offset by declines in print book sales to individuals and pharma promotion. Going forward, we expect continued modest underlying revenue growth in 2012.

In risk, our priorities are to drive growth in insurance through an active new product pipeline that improves carrier economics across their workflows and to leverage our leading database and technology platform to expand into adjacent risk markets and new geographies.

In 2011, our new insurance products were driving good growth. We launched new products, for example, in fraud, waste and abuse, and we rolled out international anti-money laundering, and we just brought on our first commercial U.K. insurance customer as a live commercial customer.

As a result, we saw good growth in insurance and business services, screening slowed down in the second half but grew 3% for the year, and we saw some declines in U.S. federal government revenue, with some contract wind-downs that we talked about earlier in the year.

Going forward, we expect continued good underlying revenue growth in Insurance and Business Services, while government and screening markets remain uncertain.

In Legal & Professional, our priorities are: To progressively introduce the next-generation legal products, to leverage the new platform globally to drive P to E migration and long-term international growth and to upgrade our operational infrastructure and gradually rebuild margins.

In 2011, we launched the second release of Lexis Advance in the U.S., we expanded our international solutions, and we divested one of our stand-alone discovery service businesses.

We returned to sight growth, both in the U.S. and in international, in research and litigation tools and in practice management. And we saw moderating declines in news and business to corporate customers and in electronic listings, and we stabilized the margin.

Now we will continue on this path in 2011, but at this point, the legal markets remain stable but subdued, limiting revenue growth and margin growth potential in the short term.

In Reed Exhibitions, our priorities are to drive organic growth by leveraging global sector groups and technology platforms and to prioritize faster growing geographies and sectors through launches and small acquisitions.

In 2011, we rolled out our Nova web platform to the vast majority of our shows. We launched 43 new shows. And in 2012 in January, we have now completed the buyout of the leading Brazilian organizer, Alcantara Machado, a former joint venture of ours, which will significantly increase our emerging markets presence and, as a side effect, slightly reduce the biennial cycling effects in exhibition.

For the year, we achieved good underlying revenue growth in all markets, and you can see here that North America did particularly well in new show launches.

In 2012, we will have a positive impact from biennial cycling, and we're currently seeing good momentum in annual shows but with some signs of market softness in Europe.

In Reed Business Information, our priorities are to drive expansion in global data services organically and through acquisition, to reshape the portfolio through organic transformation and selective disposals and to continue to realign the cost base.

In 2011, we built out data services organically and acquired Accuity and CBI China. We transformed one of our leading brands with the combination of Flight with Ascend, and we divested some magazines and services.

For the year, we saw a continued strong growth in data services, stabilizing leading brands and our margins were up 3.4 percentage points to a record 15.8%.

Going forward, we expect continued good growth in our core data services businesses, offset by softness in print advertising.

Now as you can see here, we're migrating towards a type of business across Reed Elsevier and within all 5 business areas, a business type that, as I said earlier, will deliver demonstrably improved outcomes to professional customers by combining content and data with technology in global platforms and by leveraging our institutional skills, assets and resources within Reed Elsevier across platforms and across markets.

Now we will continue to migrate our business mix towards this type of business across Reed Elsevier, and we will do this within all 5 umbrella business areas through organic investment in transforming our current core businesses; through organic build out of new products and solutions in adjacent markets and adjacent geographies; through selective acquisitions, where we are the natural owner and we can accelerate our strategy with good returns; and through continued divestments where we're not able to migrate an asset in this direction or we do not see significant future value creation.

Now in this situation, we'll manage an asset for value or exit pragmatically. In 2011, we completed 10 sale transactions for a combined annual revenue of over GBP 100 million, very similar to what we did in 2010, and we sold businesses from within every one of our 5 umbrella divisions.

So in summary, over the past 2 years and in particular in 2011, we've improved our operating performance and made significant strategic progress. Going forward, the macroeconomic outlook remains uncertain, but by delivering highly valued products and services to our professional customers and relentless focus on process efficiency, we expect to deliver another year of underlying revenue and profit growth in 2012.

And now, I think we're ready to move to questions. Yes, let's start over here. Sam?

Question and Answer

Sami Kassab
Exane BNP Paribas, Research Division
Sami at Exane BNP Paribas. May I ask -- first question on the legal division. You reported slight growth in the U.S. research business in '11. Your main competitor, slight decline. Should we think of a relatively very strong competitive performance or of diverging product mix is explaining the difference? Secondly, could you elaborate more on the sources of cost efficiency gains? How and where would these come from? And lastly, if you could comment a little bit more on the U.K. market for the Risk Solutions division. You've just said you won your first customers. Can you talk about the contribution you expect from the U.K. to that division performance in '12, please, Erik?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Yes. First question, yes, we did describe a slight -- return to slight growth in U.S. legal markets and in research. We, of course, try to understand what happens in our marketplace and with our competitors as well. But I think we have competed head to head with some of the other large competitors for a very long period of time, and you very rarely see significant differences in like-for-like growth rates. And I would not read anything into any one interpretation of a certain short time period, any one year, whether it swings one way or the other. And I think I said something similar over the past 2 years from what maybe might have looked slightly different. So I would not read anything particular into that. We have -- had very similar growth rates over a long period of time. You said sources of cost efficiency. The main driver of cost efficiency within Reed Elsevier in all our areas is basically process redesign. Process redesign, redefining the internal operating procedures for our own professional employees. We consider ourselves to be experts in understanding our professional customers, how they use the information, how they operate and how to make them more productive. We try to apply that same philosophy and approach to our own processes, to our own people and rebuild, constantly rebuild our own internal information tools to drive efficiency. U.K. risk, this...

Sami Kassab
Exane BNP Paribas, Research Division
Sorry, can I come back on that? You insisted particularly often today on the professionals, the word professionals. Does it mean that education and publishing assets have no longer their place in the group?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
What we look at as a professional, the definition of professional, is a professional employee in businesses, in industries, in academia. It's about professional type of employee within all industries, across industries and across employment environment. So it may be an interpretation of what you mean by the word.

Sami Kassab
Exane BNP Paribas, Research Division
U.K.?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Sorry, U.K. risk. Yes, we are just launching our first initial sort of data service in the U.K. These are businesses that -- the risk business, now, this take a very long time to build, that are therefore very good businesses when you've built them correctly with the right data sets and the right technology. So we're very excited that we're starting to do some of these, and in particular, this one has just gone live in the U.K. But in terms of actual business revenue in the near term, this is negligible in the scale of Reed Elsevier, as well as in the scale of Risk Solutions for 2012.

Matthew Walker
Nomura Securities Co. Ltd., Research Division
It's Matthew Walker from Nomura. Just 2 or 3 questions, please. First one is on CapEx. You mentioned potentially peaking in 2012, particularly in the legal side. What do you think your CapEx to sales will be from 2013 onwards? Second question is you mentioned also in the slides volume similar growth in science or in Elsevier. Can you give us a feel for what's happening in terms of pricing? And last question is on emerging markets. You revealed 17% rest of world or outside North America, Europe. What is the actual EM definition? So the rest of the world includes some developed markets like Japan, et cetera?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Yes. Let the start by this. Maybe I'll answer the last 2 and then let Mark come back to the CapEx question, and then I'll start with the other 2. Volume growth we talked about in research, and as you know, we had this at the

seminar, that volume growth is the main driver of growth within the research business and will continue to be so going forward. When you look at pricing, to me, it’s something that's a little unusual to think of at this point because most of our business there is, of course, long-term contracts that are renegotiated with long-term different components of content, different components of usage, different technology and tools included, and there are contractual growth rates that are built into those. And there's really no such thing anymore as sort of an effective price other than the effective price per article per user and so on that we look at. So if you look at how that is developing today, that overall contract environment, where we are today looking into 2012 and forward is actually very similar to where we were a year ago. There's not much of a change in the overall average environment. Of course, there are lots of changes within a customer, within a region, by type of customer and so on. But if you average out across Elsevier, it's actually very similar to a year ago. So therefore, the outlook is currently similar. You said on emerging markets. Yes, the 17% does include what we call more mature economies outside North America and Europe, of course, in particular Japan, for example. And I think there's always the question of how you define emerging market versus what is not an emerging market in some of those areas. But I think broadly speaking, if you think of it as sort of half of that being what you might define as emerging, I think you're probably not far. And now, let's get back to CapEx with Mark.

Mark Armour
Chief Financial Officer, Member of Executive Council, Member of Executive Board and Executive Director
Yes, in 2013, we should see the Legal & Professional CapEx beginning to subside. The exact pacing of that, I think, is a little bit premature to call. I mean, certainly, in 2012, part of the reason for the sort of continued high CapEx is the international development of the Lexis Advance product we've introduced into the U.S. market. Longer term, I think I mentioned before that we expect about 5% of CapEx to sales, although that is, of course, slightly dependent upon the portfolio mix. We've been selling businesses and print magazines and things of that, which of course don't have such a high CapEx-to-sales component. So I think we -- as we get through '12, we should start to see that come down.

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Yes, let's keep going down this row.

Vighnesh Padiachy
Goldman Sachs Group Inc., Research Division
Vighnesh Padiachy from Goldman Sachs. Just a couple of questions. The first one on the Elsevier margin. I mean, the margin has gone up again, and I understand there's FX hedging benefits. Mark, can you perhaps talk about those benefits into '12? Do they unwind a bit, or can we expect ongoing progress in that margin? The second question is could we just have a little bit more color on exhibitions and the comment on Europe, a bit of softness? Where is it geographically, any particular segments? How should we think about that?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Okay. Well, maybe I'll just first say -- comment on the margins and let Mark continue on the hedging. But it's clear that the margin correction in Elsevier is a combination of the relentless pursuit of process efficiency in the global shared services we talk about and continuously sort of reinventing how we do things to absorb the volume growth that exists in research. This year, the larger part to the margin expansion, clearly, was the FX and hedging, even though both were positive this year. Now that's not always the case on the hedging side, of course, but...

Mark Armour
Chief Financial Officer, Member of Executive Council, Member of Executive Board and Executive Director
Yes, In fact, I've included in the appendix of the presentation an analysis for the Elsevier margin. And what that shows is the 160-basis-point improvement in margin, 70 basis points came from the sort of constant-rate improvement in margin and 90 basis points came from the hedging program, including a little bit from other currency translation effects. The main impact in the currency hedging program is reflective of the decline in sterling that took place 2, 3 years ago. And the lower sterling rates, when we're exporting product from the U.K. into Japan, for instance, in the U.S., so we're hedging the yen and the dollar that will be coming into the U.K. And over time, the systematic hedging program, the lower sterling rate gets into the hedging mix. And so that creates the sort of the favorability of having weaker sterling in that coming into our results, but that happens over a period of time. So in 2011, we had about a sort of 3 percentage point pickup in operating profit growth in Elsevier because of the -- that impact of the weaker sterling getting into the mix. And that will continue in 2012. Not at the same rate. It will reduce down because steadily, that lower sterling rate is getting into the hedge mix. But we will -- we do expect a positive impact in 2012. It just won't be as large as it was in 2011.

Vighnesh Padiachy
Goldman Sachs Group Inc., Research Division
Exhibitions?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Sorry, yes, exactly. Yes, you said -- you saw the organic growth rates excluding cycling that I showed on the chart by the different regions for 2011, which is, as you would expect, Europe was lower than what we saw on the other -- in the other regions. And at this point, we're just into the first sort of 6 weeks of 2012, so it's too early to say what the European economic turmoil will do to this business in the year. At this point, for the last few months, we've seen sort of a slight softness coming in here, but I think the real issue isn't what has happened. The real issue there is what is happening to the overall European economy and will it stabilize or will it go in a different direction? And I don't think our exhibition business is any different from any other European business.

Mark Braley
Deutsche Bank AG, Research Division
It's Mark Braley at Deutsche. To come back to CapEx, in terms of the gap between CapEx and depreciation both for the group and within Legal & Professional, when should we think about that high CapEx feeding into higher depreciation? And in Legal & Professional, we were, at the half year, hoping for the CapEx-to-sales ratio to start coming down this year. We're now looking for that to start coming down in 2013. Is the CapEx investment in Legal & Professional proving higher and more difficult to execute than you had expected?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Yes, let me give -- answer the last one first, and then I'll get back to Mark on how it feeds through the P&L. The CapEx in legal is not proving any higher or more difficult than we had laid out. We started to lay out this investment plan, actually now it's back in the second half of 2008, actually. And both in terms of timeline and spend, we're very much on the plan that was outlined at that time. And in terms of the launches to the market that you've seen some come through, also tracking on that plan. So I think I remember saying something like that we were going to bring up the CapEx spend in legal and then keep it fairly high for a longer period of time as opposed to having the amount of spend that go up and down every 10 years or so to keep doing ongoing marginal [ph] investment. But clearly, there's a little bit of a peak period right now. And I think the fact that the peak period sort of stays for a couple of years is what we had expected. We may not have communicated clearly enough in that way, but that is -- it is what we expect, and we will be continuing on that track. And then clearly, it will start to gradually come down after that.

Mark Armour
Chief Financial Officer, Member of Executive Council, Member of Executive Board and Executive Director
Yes, amortization will -- or depreciation will start to climb as the -- after high levels of CapEx. What you see over time is the depreciation coming up to that CapEx level. But it does take a number of years, of course, because you're amortizing it over a period of years. But we will see a step-up in 2012 and, for that matter, further in 2013.

Ian Whittaker
Liberum Capital Limited, Research Division
It's Ian Whittaker from Liberum. Two questions, please. First of all, just in terms of the geographical split of profits. You mentioned constantly almost 20% of revenues. Can you just mention what it is of profits, of operating profits, please? And then the second question is just ask you with regards Legal & Publishing. I mean, it's sort of on the assumption that you do regard it as core, the question is, I guess, why you would consider it a core business, given when you actually look at it, it does tend to be a drag on overall group margins, it's a drag on overall underlying revenue growth? You look at the legal industry at the moment, it does have quite a lot of difficulties, and there's a question about longer-term growth from a -- in terms of law firms. So can you just perhaps give a couple of comments as to why you think legal publishing is still core to your business?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Okay. Well, the first question, yes, I think operating profits by region, that would imply that we still operate a bunch of legal sort of local businesses, which is actually most of our businesses are very global. Right? We operate global platform, global contents, there's some local presence, some local content. So I would not probably try to push that geographic profit split very far. I mean, is there anything you want to add, Mark? It's not fundamentally how we think of our business, but...

Mark Armour
Chief Financial Officer, Member of Executive Council, Member of Executive Board and Executive Director
Yes, I missed the very first part of the question, actually. You said in respect of Reed Elsevier or legal or...

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director

The profit distribution by geography as opposed to revenue distribution by geography. I personally don't think of them as being materially different.

Mark Armour
Chief Financial Officer, Member of Executive Council, Member of Executive Board and Executive Director
Yes, I mean, certainly, in terms of the origin of profits, I mean, clearly, the biggest component of profits is the U.S. In terms of margin across businesses, I think Erik's right. I mean, Elsevier is probably the most -- the best example of that is a truly global shared services function serving businesses, wherever they might reside in the world. So I think in terms of pretax profits, I've included in the appendix where -- the regional split of where the pretax profits lie. But in terms of margin, let's say now in legal, as we roll out global legal platforms and shared service centers, again, we look at it in terms of effectiveness on a global basis rather than a specific territory by territory.

Ian Whittaker
Liberum Capital Limited, Research Division
The -- I think the 35% you got in the appendices, I mean, would that be a rough -- that would be a good rough estimate of the profit split for Continental Europe?

Mark Armour
Chief Financial Officer, Member of Executive Council, Member of Executive Board and Executive Director
Well, no. In fact, I mean, because the bulk of our interest is in the U.S., I think the U.S. operating profits will be a slightly higher component of that.

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
So you said legal. Does legal fit the definition of a professional information service, especially information business where people use our information and tools to drive productivity? If you actually look at what a lawyer does every day, how they prepare, how they use the information, what tools they use and how they do it and how they measure productivity, economics of a legal business, you would say, yes, this fits strategically in that. And you also look at the sort of somebody doing legal research at a desk versus somebody doing scientific research, the workflow processes, the tools, the information, the technology that we use, the platforms we build them on, extremely similar and often shared. That's on a strategic perspective. If you then look at the profitability on the cyclical side, you can say long-term growth of lawyers compared to total population legal, number of lawyers in America has grown slightly faster than population growth for a very long period of time, for decades. And if you look at long-term growth for the legal profession globally, where legal infrastructure rule of law applying to growing economies, you can definitely see that it's a long-term growth thing. This is not a shrinking industry, also with continued growth and litigation regulation, legislation and growing business activity again. But there's no question that the legal industry today, an absolute cyclical low. There's no question about that. They've stabilized at that bottom or near that bottom. And right now, it's very subdued in many of our markets, in particular in the U.S. where we have the largest piece. So today, it's a stable, subdued business that is not growing that much, so it's a cyclical low end. And we are, of course, at our peak investment spend and -- peak investment spend and peak operational spend in that market. So if you look at it, therefore, we had the combination of 2 cycles that put it where it is today. Okay? Can we move on, please? Yes?

Richard Menzies-Gow
BofA Merrill Lynch, Research Division
Richard Menzies-Gow for Merrill Lynch. Three questions, please. Just following on from legal, really Mark's point on CapEx and so on. Given the flow-through to depreciation, can you give us a flavor for what revenue growth you think you need to see in that business to really get that 14% margin moving upwards with that in mind? Second question is just on exhibitions. I wonder if you could give us just a bit more around the numbers on the Brazilian deal you mentioned. It sounds like it's going from a JV to consolidated, so probably revenue up and margin slightly lower. Can you just give us some detail on that? And then third, I just wondered if you could make a comment on The Cost of Knowledge website, just in terms of any interaction you've had with people on that and just general thoughts around that.

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Okay. Yes, maybe I'll take -- let me take the last one first and work my way up. The Elsevier, sort of, petition boycott that you're referring to was started on January 23 in the mathematics community. And the signatories -- it's based on what the signatories claim are 3 business practices in pricing and forced bundling and restricting the exchange of information, all 3 of which are based on either misstatements of facts or misunderstanding of facts. Now nevertheless, we take it very seriously. We are very engaged here in making sure we address the communities involved in it, the individual stakeholders involved in it, to understand what their concerns are and make sure that we can address them. We also have a proactive communication plan in place with our communities to make sure that they understand what

the facts are, where they can find out about the facts, and we posted things internally as well as externally through our enormous network, of course, of editors and editorial board members. So that's what we're doing with it, and that's where it stands at this point. Now let's go over to you said back to margins in legal. Margins in legal, we are now at, as we said, sort of stable at 14%. And in order for that to start to work its way back up, you need to see some revenue growth returning. We haven't put in one specific number that we say that at that point it turns, but our objective is to rework the processes there and to install new back office infrastructure system and gradually work our way there. And clearly, we need for the material revenue growth to start to come back in for that to make a material difference on the margins of legal.

Mark Armour
Chief Financial Officer, Member of Executive Council, Member of Executive Board and Executive Director
I'll just comment on the Brazilian joint venture. You're right in that bringing in 100% of the revenues and 100% of the profit will have a margin impact whereas before, of course, there were no revenues. There were just our share of the profits. In 2012, the impact on margin will be less than 1 percentage point. And in 2013, it will be something similar, maybe a little bit more, but again, around the 1 percentage point mark. And the Brazilian company, as Erik mentioned, is cyclical in that it has biennial shows, which typically come into the odd years rather than the even years. So it will take a little bit out of the, sort of, cycling effect, which I think will be helpful all around. But there will be slight -- some pullback on margin this year. Having said that, of course, we expect to see a very strong growth year this year, both with the performance of the underlying business but also the biennial shows cycling in, in 2012.

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Okay, let's keep going that way, please.

Nick Michael Edward Dempsey
Barclays Capital, Research Division
It's Nick Dempsey from Barclays Capital. Two questions, please. First one on legal, just looking at Bloomberg Law, they signed up a deal with DLA Piper's U.S. business. I think it was last week they announced it. If Bloomberg's going to win major contracts like that, does that mean some displacement for at least one of Lexis in west law [ph] and should we worry about that as a multiyear drag factor? And then the second question on risk, we heard from [indiscernible] this morning the U.S. hiring is up 13% for them in January. Obviously, U.S. unemployment going down as well. So are you starting to see any positives from that? You don't mention that in your comments on screening. When would you expect to see that come through in screening?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Okay, first question in the legal dynamics in the marketplace. In terms of the actual current dynamics in the business in the marketplace, we have not seen any real difference in the competitive dynamics in the recent past from what we're not used to. It's always been a very competitive industry. You mentioned specific situations about announcements on specific customers. Bloomberg is a very large company, been very successful in financial services over a very long period of time. We have a lot of respect for them and take them very seriously. We look at everything they do, of course. Having said that, in what I consider the core, true legal sort of broad-based legal research platform and comprehensive services sort of 10 years into their efforts, they still don't really sort of compete on -- in that broad-based comprehensive research area. And I think that, that will be validated about what you hear from the marketplace and from customers as well. There are always individual customers, large customers or small customers that rotate in and out of preferred relationships and more of this or less of that. There's always some churn every year somewhere, right? And clearly, Bloomberg is in somewhat -- I mean, will [ph] sometimes announce new agreements and sometimes face down some that they've previously announced. But I don't think it's worth sort of going into any one of the thousands of law firms specifically. You said U.S. employment. What we're seeing right now is that market screening markets are -- actually, it's similar to what they were over the last 6 months. There's no material difference so far. U.S. employment levels, so the unemployment levels have improved slightly, but because churn or attrition has not increased much, that means that the actual new hirings across industries has not moved materially in terms of growth rate. So what we see right now is clearly too early to predict what will happen in the spring hiring season, in particular spring retail hiring season, which is important for us, which comes later in the year. Okay? Let's keep going on this row and then we'll move backwards. Yes?

Steven Craig Thomas Liechti
Investec Securities (UK), Research Division
Steven Liechti from Investec. You gave a good run-through in terms of the strategic rationale for legal going through your criteria that you gave earlier on. I wonder if you could do the same on exhibitions, because it doesn't strike me that a lot of the stuff that you're talking about strategically applies to exhibitions.

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Well I can slightly disagree with you, but let's start with the beginning here. Exhibitions, what exhibitions is to us. Exhibitions, number one, is a business that creates significant shareholder value for Reed Elsevier. And to do any form of separation partition would actually be detrimental to shareholder value. That is very clear to us and I think clear to our shareholders. It is a good business, has good organic growth throughout cycles and it earns good returns on organic investments, new launches and small acquisitions. Second, we are and have been demonstrably a very good owner of exhibitions. They have gone from a small company to the clear global leader in exhibitions, both in terms of quantity, in terms of quality and in terms of professionalism and use of professional tools and platforms. And you can see that they've developed very well under our ownership. And part of that is due to the fact that, strategically, it's becoming more and more similar to the rest of our business. You're targeting professional end users. That's what it is. These are people who are business professionals working in different industries. And these are people who go to an exhibition or do something for a very specific reason. What they do there, the data they need before and after and the electronic platforms to communicate with them at the show as well as before and follow up afterwards and the commerce surrounding it, are looking more and more like all the professional information type services. And the reason they've been so successful is because they can build up their global industry groups, they can leverage their global tools and platforms, and they have industry data, and they have practices and procedures that they can deploy globally and launch 43 shows in a year. Now having said that, is this a business that has the same amount of shared infrastructure or cost structure relatively speaking as some of our other businesses? Not quite, but it is a business that is good for our shareholder, increases shareholder value. It's better to keep it than not. It's a business that we have managed to run well, and it's becoming increasingly more like the others rather than less.

Thomas A. Singlehurst
Citigroup Inc, Research Division
It's Tom Singlehurst from Citigroup. I had actually just a couple of questions on overall cost growth. In the slides, you highlighted the overall underlying cost growth for the whole of Reed Elsevier was essentially 0, flat. I was just wondering whether you can give us a rough estimate of what that figure is likely to be for 2012, or whether that figure will naturally sort of be further up or down depending on the revenue outlook. That's the first question. The second question is on synergies between divisions. Because obviously, we're all giving you a hard time about potentially selling LexisNexis. But at the beginning, you said that was sort of a shared set of processes and structures in data collection, data delivery analytics, et cetera. Does that mean that incrementally from here, you would want to sort of create more shared infrastructure between divisions rather than less?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Yes, I mean, let me address both of these. Cost growth, we -- again our philosophy on cost is that we continue to rework cost growth and that we work on processes and efficiency and procedures to make sure that through time periods, we can keep our cost growth below revenue growth within the main businesses that we operate, that sort of philosophical approach that we have. Therefore, if revenues fluctuate slightly, we will rework our processes possibly in a slightly different pace and a slightly different order. It's not like we will suddenly say, "Let's take a new step in costs." But we'd rather rework that machinery. And I think it's important for us throughout economic cycles to have that philosophy and to stick to that philosophy, which means that, yes, we will rework it. We will reshape our cost structure at a pace and in a way that will slightly align with the economic cycle of the markets and, therefore, our growth rate in revenue. Second question, shared infrastructure. More or less, I think you -- I think we need to take a little bit of a historical perspective on this and understand some of the ways that this has happened and it continues to happen. If you go back 13, 14, 15 years, Elsevier was essentially a print publisher, and LexisNexis existed as an online service. We built all of ScienceDirect on the LexisNexis infrastructure hardware and software infrastructure in Dayton, Ohio and operated from there, and it very quickly became the world's largest leading electronic platform for scientific information, very, very quickly. It was close to the average. And still today, we operate ScienceDirect and Scopus from the LexisNexis campus in Dayton, Ohio. That's just one example. And then as you saw in terms of shared infrastructure, you saw when we bought ChoicePoint that it operated by itself at 24% margins as a stand-alone company. And 24 months later in a much worse economic environment, we integrated it and we operated 38% margins. So there is a lot of sharing of infrastructure and knowledge and other things that go on, on an ongoing basis, that are not so big and so dramatic. But it happens all the time where tools and software are shared. We have actually built out a very shared infrastructure on sort of hardware data centers, sort of communication security and so on. So there are many of those examples that are being -- that have already been shared and that are continued to be shared and will grow in sharing going forward. We're by no means stopping. If you look at the approach that we said here, that relentless pursuit of innovation in our own processes as well as building things for our customers, we continue to leverage them across. Okay, up here.

Giasone Salati
Espirito Santo Investment Bank, Research Division

It's Giasone Salati from Espirito Santo. I think it's 3 questions. First, could you break down exactly what has -- what is -- what are the one-off impacts on margins from 2011 to 2012 and what we should expect just automatically from currency consolidation of joint ventures and so on? It is my impression that you are suggesting margins should be lower just on mechanical adjustments. Secondly, really top down, 3 years ago, 2 years ago, we were sitting here all agreeing, I guess, that Reed Elsevier was under-invested. 24 months later, we have actually margins even higher than what they were 2 years ago. What is your view on that? Is that you found over time that it was under-invested but it was also badly managed, and there was plenty more cost cutting to do, and there is more to come or vice versa? And lastly, great set of results in the P&L but operating cash flow is flat and the free cash flow is down. Could you extend your guidance of growth for 2012 to cash flow if you expect neutral or going down?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Well, I'm going to ask Mark to take most of those. I just wanted to first comment on the question around many of you saying parts of Reed Elsevier was under-invested or all of it, whatever some of you said and that margins are up. I think these may be 2 slightly different things when you look at investment of capital into different pieces of the business. And we said that there was a time period when LexisNexis Legal had ramped up investment and then to a couple of years to rethink and regroup their future technology strategy and then started to ramp it back up again. And that's why we're now at the higher level in LexisNexis. And I think we've laid out that pretty clearly. And you could argue that was it the wrong time to start? Was it the right time to start? Were they under-invested in a time period and so on? Well, clearly, as a new CEO, it would have been better if they had started a bit earlier before I got involved. But given where we are, I think we're now doing the right thing on increasing CapEx there. I think that's slightly different, sort of meaning the investment going up in different parts of the business. I think that's slightly different from can you operate this business with a focus on cost efficiency, process efficiency that constantly keeps reworking your main businesses' operating cost structure? And I believe that regardless of whether they've been managed well or managed poorly, you can always try to look for further ways to redefine how you operate and run a business. And it's not necessarily at the highest margin businesses or -- are therefore the hardest. It may actually be that if you don't think about the margin but you think of your reinventing your operational cost structure in terms of process innovation, it can be found equally in well managed companies and poorly managed companies or high-margin or low-margin businesses.

Mark Armour
Chief Financial Officer, Member of Executive Council, Member of Executive Board and Executive Director
I'll comment on the one-offs on margin. I mean, I think the -- maybe you misunderstood the comment I made about the hedging benefit. It's a further benefit and so -- to margin development. And in terms of the comment I made about the Brazilian joint venture becoming a wholly-owned subsidiary, my comment on margin related to the exhibitions business, not to Reed Elsevier. So as far as Reed Elsevier rule is concerned is a bit lost in the noise. And I think you should -- the comment that Erik made earlier is that the goal is to manage cost growth so that it is lower than revenue growth, which, of itself, has a positive impact in underlying margin as a goal.

Giasone Salati
Espirito Santo Investment Bank, Research Division
And that includes the flow-through of higher CapEx into depreciation?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Yes.

Mark Armour
Chief Financial Officer, Member of Executive Council, Member of Executive Board and Executive Director
Yes, yes. I mean, depreciation is just -- it's in other costs. And so the biggest cost base we have is people, and salaries tend to go up. So these are just costs that just need to be managed. On cash flow, our stated target is for a cash flow conversion of 90%-plus. We've had 93% in 2011, and we've had higher before that. I mean, in 2010, we had high CapEx as well, but we also had, sort of as we moved through sort of 2010 into '11, we've had the benefit of sort of catching up some of the leakage of working capital during recessionary times. And of course, we are now sort of getting more into more business growth, so it makes improvements in working capital harder and CapEx is still high so, but -- as I say the target remains 90%-plus, and we think we'll deliver that.

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Okay. Oh, we got one more back there. Okay, yes. Okay, so we take our last question.

Andrea Beneventi

CA Cheuvreux, Research Division
It's Andrea Beneventi from Credit Agricole Chevreaux. Apologies. I still have 4 questions in my list, and I think they're quite important. The first one is do you see trading at Elsevier accelerating in particular at U.S. private non-for-profit institutions due to higher enrollments, please? The second one is what impact do you expect from the liberalization of the ownership of legal firms in the U.K. and possibly in the U.S., which is a big debate at this stage? The third one is on background screening. How does current trading compare to the cyclical slowdown that you have seen in 2009, actually the end of '08, please? And the fourth one is for Mark. Could you quantify the currency transaction effect on that at this stage, year-to-date, please?

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Okay. Let me try to take them in the order that you asked them. You said first, trading of our Elsevier accelerating. You specifically mentioned enrollments at I think sort of career schools, professional things that feed into our medical environments. Is that what you meant?

Andrea Beneventi
CA Cheuvreux, Research Division
That's correct. Private non-for-profit universities in the U.S.

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Non-for-profit or profit?

Andrea Beneventi
CA Cheuvreux, Research Division
Non-for-profit.

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Non-for-profit is what you meant?

Andrea Beneventi
CA Cheuvreux, Research Division
Yes.

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Oh, okay. Okay. No, I mean, if you look at non-for profit sort of enrollment in the U.S., we haven't seen much movement recently. And I mean, it's clearly subdued last year and it's still under pressure on many different ways. But those are small changes and it's not accelerating, meaning it's not -- we don't see it falling off a cliff any further, and we don't see it picking back up immediately. It's an under-pressure environment. I'd say probably broadly speaking, right now, it looks not that different from 6 months ago or something like that. On the for-profit, it's very different. There was a big cut down last year because of the industry regulation and changes and so on. And now they have said, as you may know, that they predicted sort of probably the decline stabilizing a bit this year. So that's what we see there. Legal firms, well, our view is regardless of how legal firms are regulated and what they can do, our objective is the same. Our objective is to sell information and tools that help them become -- be more productive and get better results. And regardless of ownership or industry structure, that's our objective. And if there are some changes coming from that deregulation or different changes, then we will try to adjust our tools to help them in the new environment. That's our philosophy. You said background screening, is it a falloff compared to '08 or '09? No, if you look at a background screening business, the way it looks today in the U.S., we're seeing an environment very similar to what you saw a few months ago. We have not seen a falloff at this point. We are seeing something that continues to be aligned with what we saw over the last 6 months. Last one, refresh my memory?

Andrea Beneventi
CA Cheuvreux, Research Division
Yes, that was on the impact of currency transaction effect on...

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Right. That's why -- I'm sorry. You said Mark on it.

Mark Armour

Chief Financial Officer, Member of Executive Council, Member of Executive Board and Executive Director
Yes, on the currency hedging program, as I think I indicated earlier, I mean, this year, we had about a 3% benefit to the Elsevier operating profit as the weaker sterling got into the hedging mix. And so that improved Elsevier's operating profit by about GBP 20 million to GBP 25 million. In 2012, we expect the effect to be less. So I expect it to be probably around half of that, maybe a little bit more, but of that sort of order of magnitude. Then in terms of other currency translation effects, 1% on the dollar or on the euro have a broadly similar effect, about GBP 4 million or GBP 5 million on pretax profits moving -- depending which way those currencies weakened or strengthened against sterling.

Erik Engstrom
Chief Executive Officer, Member of Executive Board and Executive Director
Okay. Thank you very much for joining us and look forward to seeing you again soon.