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EDITED TRANSCRIPT

REL.L - Interim 2014 Reed Elsevier PLC Earnings Call

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OVERVIEW:

Co. reported 1H14 revenues of GBP2.8b and reported net profit of GBP454m. 1H14 adjusted EPS grew 11% at constant currencies.

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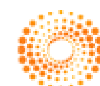

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PRESENTATION

Tony Habgood *- Reed Elsevier PLC - Chairman*

So good morning, ladies and gentlemen, and welcome to Reed Elsevier's interim results announcements for 2014. Thank you all for coming here on this busy morning. And for those of you on our webcast, thank you for taking the time to listen in.

I believe we've produced another good set of results, with EPS in constant currencies up 11% as a result of underlying sales being up 4%, 3% without exhibition cycling, underlying operating profit up 5%, lower interest charges and a slightly smaller number of shares in circulation. PLC EPS in sterling are up 5%, and NV in euros up 8%. Taking all these increases in EPS into account and, of course, our dividend equalization formula, we're recommending interim dividend increases of 5% for PLC and 14% for NV.

You will not be surprised to hear that we're continuing to execute on our strategy of -- on our strategic and financial priorities and that Reed Elsevier is continuing to evolve. The benefits of that evolution are, I believe, becoming ever more apparent. And we're well positioned to continue to grow into the future.

Duncan will now take you through the financial results and Erik will describe our strategic and operational progress in detail. Thank you.

Duncan Palmer *- Reed Elsevier PLC - CFO*

Thank you, Tony, and good morning, everybody. I would like to start this morning with the financial highlights for the first half of 2014. Our primary measures of revenue and operating profit growth are on an underlying basis, which exclude the effects of currency movements and all of the acquisitions and disposals which took place in 2013 and in 2014 to date.

In the first half of 2014, underlying revenue growth was 4%, or 3% excluding the impact of biennial exhibition cycling. Underlying adjusted operating profit grew 5%. Adjusted profit before tax grew 8% at constant currencies, driven by operating profit growth and lower interest expense.

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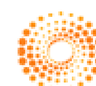

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Adjusted earnings per share grew 11% at constant currencies, benefiting from buybacks over the last 18 months. Operating cash flow conversion was 89%.

I will now go through the profit and loss statement in more detail. I will present the results in sterling. In the appendix you can find the equivalent euro-denominated results.

Revenues were GBP2.8b and adjusted operating profit was GBP860m, with the adjusted operating margin rising year over year from 28.8% to 30.2%. Net interest expense was GBP69m, GBP23m lower than in 2013, reflecting the impact and timing of term debt refinancings at lower rates, exchange rate movements and certain one-off benefits.

The adjusted effective tax rate for the first half was 23.5%, in line with the prior year, and we expect a similar rate for the full year. Adjusted net profit increased by 2% to GBP603m. And reported net profit was down by 11% to GBP454m.

I will now walk through a reconciliation of adjusted net profit to reported net profit. The largest adjustment is for the amortization of intangible assets, which result from acquisitions, such as brands, customer lists, content and software. The first half of this year has not seen the recurrence of a non-cash deferred tax credit that benefited reported profits in the first half of 2013.

Turning to earnings per share and dividends, adjusted earnings per share increased by 5% for PLC and 8% for NV, the lower growth for PLC reflecting sterling's year-on-year strength against the euro. At constant currencies, adjusted earnings per share grew by 11%. We have declared equalized interim dividends that deliver a 5% increase for PLC and 14% for NV, the average of which is broadly in line with adjusted earnings per share growth at constant currencies.

Now let's focus on the financial results of our major business areas. We've broken out the impact of both currency and portfolio actions on our reported results in arriving at our underlying growth rates. Looking at revenue, you can see that all four business areas grew underlying revenues in the first half, delivering overall underlying revenue growth of 4%.

Reported revenues in sterling were impacted by a 7% currency headwind and a 3% reduction resulting from portfolio actions, the majority of which were disposals that took place in 2013. These 2013 actions were largely in the legal business and in the risk and business information business.

Looking at adjusted operating profit performance, underlying profit grew at or ahead of underlying revenue across all four business areas, delivering underlying growth of 5%. The impact of currency movements on adjusted operating profit was similar to that on overall revenue. However, the portfolio impact was broadly neutral.

Next, in the context of currency movements that we have seen in the first half, I'd like to spend a few moments describing Reed Elsevier's geographic revenue and currency exposure. The pie chart shows the geographic split of our revenues in the first half. Approximately half of our revenues are generated in North America, with only 7% generated in the UK and 22% from the rest of Europe.

Of the remaining 22% of revenues generated in the rest of the world, about 30% are denominated in US dollars. As a rule of thumb, the full-year sensitivity of adjusted profit before tax to a 1% movement of the dollar against other currencies is about GBP7m or EUR9m, as we described in February. The impact on first-half adjusted profit before tax was about GBP40m or EUR20m.

Turning to cash flow. In the first half we converted 89% of adjusted operating profit into operating cash flow, up from 85% in the first half of 2013. In the full year we expect cash conversion to exceed 90%.

Capital expenditure in the first half was 4.3% of revenues compared to 5% in the first half of last year, reflecting phasing of expenditure. For the full year, we would expect CapEx as a percentage of revenues to be around 5%, similar to 2013. Depreciation was lower, principally reflecting currency translation. Our EBITDA in the first half was GBP974m.

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Moving to free cash flow, cash interest paid was lower than in the first half of 2013 due to lower financing costs and the timing of term debt interest payments. The reduction in cash taxes paid was largely due to payment timings.

Free cash flow before dividends was GBP573m compared to GBP471m in the first half of last year. After the final dividend payment of GBP408m, free cash flow was GBP165m compared to GBP76m in the first half of last year.

Moving to the uses of our free cash flow after dividends, in the first half we completed asset disposals with a total consideration of GBP26m, spent GBP95m on acquisitions and deployed GBP400m in buying back shares. Net debt, at GBP3.3b, was GBP206m higher than at the end of 2013, primarily reflecting the first-half weighting of buybacks and dividend payments, partially offset by exchange rate movements. Our net debt to EBITDA was 2.3 times on a pensions and lease-adjusted basis, or 1.8 times on an unadjusted basis.

Our debt is denominated in a number of currencies, reflecting the global nature of our businesses, with the majority of our borrowings in US dollars. For the purposes of this slide, I will talk in dollar terms.

At the end of June, we had net debt of $5.6b, with gross debt of $5.9b, the difference representing financial instruments and cash. During the first half we managed our debt portfolio through a number of actions, including the issue in May of $480m of floating rate notes due in 2017.

As a result of the actions we have taken, the interest rate on gross debt reduced from 4.8% in full year 2013 to 4.2% in the first half of 2014 and we would expect the rate to be broadly similar for the full year. Average gross debt is likely to be higher in the second half of 2014 due to the phasing of operating cash flow, dividends and buybacks.

Looking at the debt's maturity profile, you can see we have nothing remaining to refinance in 2014 and relatively little in 2015. Future term debt maturities are well spaced. The opportunity to reduce the average interest rate on gross debt through further refinancing in the medium term is therefore limited.

Finally, turning to the balance sheet. Net capital employed at the end of the first half was GBP6.4b, compared to GBP6.6b at the end of 2013. The majority of our capital employed is goodwill and intangible assets, associated with historical acquisition activity.

The GBP300m decrease was mainly driven by currency translation, with the impact of acquisitions more than offsetting -- more than offset by amortization and disposals. The net pension obligation increased, reflecting the impact of lower long-term discount rates in the UK, US and the Netherlands. Reed Elsevier continues to maintain a negative net working capital position, driven by advanced receipts in our subscription and exhibition businesses.

That concludes our overview of the financial performance in the first half of 2014. Now I would like to hand over to Erik to talk through strategic and operational progress.

Erik Engstrom - *Reed Elsevier PLC - CEO*

Thank you, Duncan. Good morning, everybody. Thank you for coming and for taking the time to be here today. As you've seen this morning, our positive business trends continued in the first half of 2014, with underlying revenue and profit growth across all business areas, continued improvement in profitability and strong cash generation. And we saw further improvement in our business profile and earnings quality, again primarily through organic development as we built out our leading global platforms and continue to migrate towards more advanced electronic decision tools.

In terms of our financial performance, underlying revenue growth, excluding biennial exhibition cycling, was again 3%. Underlying operating profit growth was 5%. Earnings per share at constant currencies grew 11%, with the first half benefiting from the timing of our debt refinancing initiatives and share buybacks, as Duncan mentioned. And our net-debt-to-EBITDA ratio remained in a range that we're very comfortable with.

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All major business areas again delivered underlying revenue growth, with close to half our revenues coming from business areas that are growing mid single digits or above. And all major business areas again delivered underlying operating profit growth, with, as you can see from this chart, over half of our operating profits now coming from business areas that are growing their profits mid single digits or above.

Let's look at the first-half progress in each of our major business areas. Our STM business grew 3% as overall underlying revenue growth accelerated slightly in the first half. Primary research saw strong growth in article submissions and usage across scientific and medical, and subscription revenue growth was around 0.5 percentage point higher than a year ago.

We saw continued good growth in scientific and medical databases and tools and good electronic revenue growth across all segments. Declines in print book sales moderated, reflecting a stabilization in the first half in nursing education markets.

In pharma, promotion declines continued, in line with prior year. For the full year, we expect improvement in subscription revenue growth rates to continue, but some uncertainty remains around the trajectory of book sales in the second half.

Risk solutions and business information have now been fully combined into one business area. It already operated with one CEO, one Head of Technology and one Head of HR since last year. But as of May this year, it also operates with a combined finance department under one CFO and therefore will now be reported as one segment.

The overall combined revenue growth rate was maintained at 6% in the first half. Insurance saw strong growth, driven by good take-up of new products and services and expansion in adjacent verticals. Strong growth in business services was driven by identity and fraud solutions. As expected, mortgage refinancing volumes were lower than in the prior year.

In government, federal markets were impacted by carryover effects from the slowdown in the fourth quarter of 2013, but new sales have now returned to normal levels. The state and local segment continued to see strong growth.

Major data services maintained strong growth, and leading brands and other business magazines and services were stable. For the full year we expect the fundamental growth drivers to remain strong and the underlying revenue growth trends to continue.

Legal again grew 1%, with underlying revenue trends unchanged. Growth in online solutions was largely offset by continued print declines. US and European markets remained subdued, while other markets saw good growth.

The rollout of new platform and product releases continued as planned, with adoption and usage progressing well. Of the 250-basis-point margin improvement, around 0.5 percentage point was timing-related, around 1 percentage point was driven by process innovation and infrastructure decommissioning, and around 1 percentage point came from portfolio changes over the previous 12 months.

For the full year we will continue the rollout of new platform and products and maintain our focus on process improvement. Our customer market remains subdued, however, limiting the scope for underlying revenue growth.

Exhibitions grew 8%, or 6% excluding biennial cycling and timing effects, with like-for-like underlying growth rates maintained in most geographies. The US and Japan achieved strong growth. Europe saw modest growth overall, with good growth in international events partly offset by continued softness in some domestic events. Other international markets continue to generate strong growth, albeit slightly below prior-year rates in some geographies, including Brazil and China.

We launched 20 new events, primarily targeting high-growth sectors and geographies and completed two small acquisitions. For the full year we expect first-half trends in underlying revenue growth to continue and the positive impact of cycling to be around 2 percentage points of growth.

As you can see here, our strategic direction is unchanged. It's still to evolve into a company that delivers improved outcomes to professional customers across industries, to get there primarily through organic development, supplemented by selective portfolio reshaping, and to drive an evolution of our business profile and improve the quality of our earnings.

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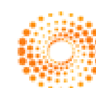

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Our number-one priority is to continue to invest in the organic transformation of our business. In terms of format migration, with print now down to only 16% of our revenues, we're now primarily focused on launching new products and services to drive the transition from electronic reference to electronic decision tools by adding broader datasets and embedding more sophisticated analytics.

In terms of geographic footprint, the transformation from electronic reference to more sophisticated electronic decision tools is driving growth in the US and in Europe, and we're continuing to expand in higher-growth geographies. And finally, we're reducing our advertising exposure, now down to only around 2% of our revenues.

After organic transformation, our second priority is the reshaping of our portfolio. In the first half we continued to limit our acquisitions to targeted datasets and analytics and assets in high-growth markets that support our organic growth strategy. As you can see, in the first half we completed 10 acquisitions of small assets for a total consideration of GBP95m. We also continued to dispose of assets across business areas, including further exits from advertising and marketing services, closing six small transactions for a total consideration of GBP26m.

With a strong balance sheet and strong cash flow characteristics, and with our average acquisition spend comfortably covered by free cash flow after dividends, we will continue to take a pragmatic approach to ensuring that the value compounding in our business translates into shareholder value. We plan to continue to keep long-term dividend growth broadly in line with earnings-per-share growth at constant currencies, and we plan to keep our leverage in a range similar to where it has been over the past four years.

Therefore, for the full year 2014, as previously announced, we're again deploying a total of GBP600m on share buybacks. GBP400m was completed in the first half and GBP200m will be completed in the second half.

So in summary, in the first half of 2014 the positive trends in our business continued and we saw further improvement in our business profile and earnings quality. Our full-year outlook is unchanged. Underlying trends in our business continue to be positive as we enter the second half and we remain confident that we will deliver another year of underlying revenue, profit and earnings growth in 2014.

And I think we're now ready to go to questions. Maybe today I'll start over here and go down this way. So let's start down here, or you can start at the end for now.

QUESTIONS AND ANSWERS

Matthew Walker - *Nomura Securities - Analyst*

Thanks very much. It's Matthew Walker from Nomura. Three questions, please. The first one is on STM. You saw an improvement there, small improvement in the growth rate. I think it's down to new sales mostly. Has there been any improvement, small improvement, in budgets for your customers? That's the first question.

The second question is on open access. I know the federal bodies who were taking up the White House initiative are reporting back on what they consider to be an appropriate embargo period. Could you update us on that?

The last question is I came across something somewhere recently about Reed Ventures. Is there any hidden value in Reed Ventures that is material at all?

Erik Engstrom - *Reed Elsevier PLC - CEO*

Okay. Let me take each one of those. The first one, you said in STM, the pickup in subscriptions. What you've seen there is a slight pickup in activity in the research market. You see our submission rates are up a little bit and just touched double digits this year, and our usage growth also double digits. And you can see that new sales, a little bit higher again, so you can see. So therefore the subscription base that we have in the first half and therefore running for the year is half a point higher than it was about a year ago.

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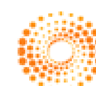

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If you say is this specifically related to budget or any changes in budgets, I think you continue to see significant differences by geography and by type of institution and their current budget situation. And many of our customers are still going through difficult times. So I think it's not at this point right to call that there's a big trend change or some big change in the budget environment.

The second question you asked was on US open access development. Well you're referring to the OSTP memorandum from now about a year and a half ago that directed the different agencies to come up with policies. And they're still working on that, the individual agencies, and there's interaction going on between different scientific bodies, between different agencies and between industry associations. And I assume that we will hear more over the next few months on that one.

But I think it's important to note that about half of the volume coming from what's under that umbrella is the NIH, and we've already had a voluntary method in place from Elsevier's perspective with the NIH now since 2005. That covers, as I said, about half of what this new policy is about.

The third question was Reed Ventures. We operate Reed Ventures for two reasons. Number one is for the strategic reason, which is that it keeps us engaged in very new developments in technology, and we have a group that therefore stays on top of small start-up companies and new technology developments and talk on that regularly and then introduce them to us and we get introduced to them. Then -- this is the first reason.

The second reason is that we operate it as an effectively standalone venture that makes money. So if you look at hidden value, that is the part of the second question, second priority. And yes, there's some value there, but it's not material in the context of the market cap of Reed Elsevier. It's material to us in terms of strategic value, our first priority, even though it does make money for us.

Okay, next? Let's go here.

Ian Whittaker - *Liberum - Analyst*

It's Ian Whittaker from Liberum. Again, three questions. Just coming back to your comment on keeping leverage around the same where it's been over the past few years, that would suggest that, at some point relatively soon, you're going to either have to increase the level of share buybacks or indeed the amount of acquisitions that's coming through. I just wondered whether you have any point of view on that, which one you prefer, if either of them.

The second thing is just on legal publishing. You mentioned around 50 bps of the improvement was coming through on the margin due to timing. If we reverse that out, should we therefore assume probably around 200 bps of margin improvement for legal for the full year? Does that seem reasonable?

And the third question, really more of a minor one, just in terms of the stabilization on nursing that you mentioned within STM, again, is that more of a timing issue or do you think that's now -- it's more permanent in nature?

Erik Engstrom - *Reed Elsevier PLC - CEO*

Okay. I'll answer all three of those. The first one on -- if you look at our leverage and our buybacks, the way we look at it is we have a clear view on what we're trying to do strategically. The number one organic investment, organic development, even with pursuing the ones we want to pursue, our CapEx-to-sales ratio is not going to change materially and have a material impact on us, but that's our number-one priority.

Our second priority is then to do the small add-on acquisitions of datasets, content sets and analytical tools that help accelerate our organic growth. That can fluctuate a bit in terms of what we find and what's available and at what scale. Most of those are 10s of millions of pounds in purchase price, but they can be a little lumpy and they can come in and out.

We've now pursued that strategy for about five years systematically, and we've averaged about GBP300m a year in acquisition spend. Sometimes it's a bit higher. Sometimes it's lower. But it's not easy to predict what will happen in every 6- or 12-month period. But that's our second priority.

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Then if you say that we want to keep our dividend growth, our long-term dividend growth in line with earnings per share growth at constant currency, and we want to keep our leverage roughly where it's been over the last years, that means that we will then be pragmatic about what we do with the rest. And right now that means buybacks at roughly this current level this year. Now all these different factors could impact what that is in the future, but that's how we think about it. And we'll probably continue to have the same approach going forward even though the numbers can vary.

The second question on legal. Yes, you said in the first half and at this point today, standing here in July, the current run rate of margins, if I exclude the timing effects, the current run rate of margins is about 200 basis points higher than a year ago. Of course, we always try to do everything we can about our margin, and sometimes we're a little more successful, sometimes a little less, on moving it up. So I don't know exactly what it will be at the end of the year. But today, in the first half, 200 basis points, and currently our run rate is 200 basis points.

NHP. Yes, in the first half our revenues, our growth rate in that segment, it has stabilized a bit. Now I don't know enough about the North American education markets more broadly speaking and the dynamics of the different channels to give you a prediction for the future of that industry. We're not the right people. This is such a small part of our business. There are other people who are better at predicting the future of that industry than we are.

But in the first half it has stabilized a bit. And of course we hope that that is a sign of something that it is starting to stabilize. But I actually don't know enough about that industry segment to give you a forecast or a prediction. I think there's still some open issues in terms of regulations in private -- for private education there and so on that I think are still playing out.

Let's see. Yes, here. Keep going.

Steve Liechti - *Investec - Analyst*

Thank you. It's Steve Liechti from Investec. Just on margins again, do you mind just going through on Elsevier in terms of, I think it was a 0.8 percentage points on the margin there, how much of that was hedging, how much of that was FX and just explain to me so I understand exactly what the FX effect is and how that affects the overall margin for Elsevier?

And then secondly, I know you've combined risk with RBI, but looking at the numbers that you gave of the breakdown, it looks to me as though the risk margin has gone down, the pure risk margin has gone down in the first half relatively materially. Can you just talk me through that?

Erik Engstrom - *Reed Elsevier PLC - CEO*

Okay. I'm going to ask Duncan to follow up with the Elsevier FX margin comment in a minute. But I'll first answer the question around risk. Yes, if you look at -- the absolute margins between risk and RBI are becoming less and less meaningful because they share all these infrastructures, and that's why we don't report them that way anymore. So for the half year our reported segment is the combined one. We've tried to say -- if we just had rolled it forward it would have looked something like this. So I wouldn't take the exact number that seriously in the split-up, right.

But there is -- if you'd looked at last year's margins for risk, you could see that in the first half last year the margins were a little higher than for the full year because we had some timing issues in the year and we had some portfolio changes during the year last year. And those -- the changes that are lower this year compared to last year is due to portfolio changes. We did acquire a few small companies that we plugged in that are operating slightly differently in terms of initial cost structure than the assets that we're holding.

If you look at it on a like-for-like basis underlying revenue growth, you could see that underlying revenue growth, underlying cost growth and therefore underlying profit growth are almost all exactly the same number within risk. So we're basically following the approach in risk in our data services, in RBI, of growing the cost base roughly in line with the underlying revenue growth. So we're trying to drive the overall growth rate by keeping underlying costs broadly in line with underlying revenue growth.

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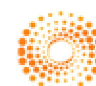

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Steve Liechti - *Investec - Analyst*

Can I just follow up just on that particular point? So what you're saying is there's a timing issue, to some extent, in the first half for pure risk. And I understand what you're saying about think about it together. But if I was forecasting, which I do on a risk basis for the full year, then the timing issues and the acquisition thing should work through so the margin in the full year should still be stable or up.

Erik Engstrom - *Reed Elsevier PLC - CEO*

Well the timing issues were last year more than this year, if you see what I'm saying. But the acquisitions have come in. We have acquired a few companies that are slightly -- that are small but -- as they start slightly lower than our average margins in risk.

Steve Liechti - *Investec - Analyst*

So sorry, just to be pedantic, so does that mean that they're low initially because you're setting them up and stuff like that, therefore they will go to the Group level relatively quickly? Or are they going to be a more permanent drag on that margin?

Erik Engstrom - *Reed Elsevier PLC - CEO*

More the former than the latter, yes. But of course we might be buying things in the future that look different. I can't tell you what we will be buying. But these are the small enough that it's the initial effect I'm commenting on, yes. Okay.

Duncan Palmer - *Reed Elsevier PLC - CFO*

So I was going to talk about Elsevier margins. So there's actually a slight in the appendices, page 39, which gives you a very fulsome, I think, breakdown of the decomposition of movements in growth rates in Elsevier or scientific, technical and medical in revenue, adjusted operated profit and margin. You asked about margin.

Basically the bottom line in the first half of 2014, if you look at page 39, is of that 0.8% increase in operating margin, about 0.7% of it was to do with currency, either the hedging, the currencies we hedge and, as you know, we take some of our longer-dated subscription revenues and hedge them back into the currencies where we have operating costs and try and take out some of that volatility in long-dated subscription revenues. That had about a 0.2% impact. Other current movements actually had about a 0.5% impact. And the actual constant currency and underlying movements in margin were basically -- margins were basically flat apart from that.

So the overwhelming majority of the impact on margin was due to currency, a little bit due to hedging, but the majority just due to other currency movements across the board in the Elsevier business.

Steve Liechti - *Investec - Analyst*

But there's no funny skew in terms of your cost base relative to your revenues to model?

Duncan Palmer - *Reed Elsevier PLC - CFO*

Not particularly, no.

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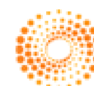

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Erik Engstrom - *Reed Elsevier PLC - CEO*

Okay. Let's move on now. Go back on that side.

Ruchi Malaiya - *BofA Merrill Lynch - Analyst*

Hi. Good morning. It's Ruchi Malaiya from Bank of America-Merrill Lynch. On the combination of risk and business information, could you tell us a bit more about whether you see more opportunities from cost synergies versus revenue synergies, or in fact both from combining those?

And also just digging into the detail there on major data services, is that growing at a similar growth rate to risk standalone and then it's the other businesses which are pulling down the growth rate? Should we think of major data services as an ongoing growth rate being more comparable to risk? Thanks.

Erik Engstrom - *Reed Elsevier PLC - CEO*

Yes. Risk and RBI, we are putting these together to be able to drive revenue growth over time. But because we are combining the -- I think the real skills from the risk side, their expertise in large databases, in powerful analytics and in very advanced technologies, we're combining that with the RBI's global geographic footprint, much more international, and their industry-specific databases, where there's applied data and some other things. So we put those together, we therefore get a combination that's more powerful in terms of driving growth in the medium to long run. So it's a strategic revenue growth-driving initiative. It does not have any material cost implications by just putting them together in the scale of what we -- the way we think of material.

The second question was major data services, are they comparable to the risk business? Yes, they are. They're very similar actually. They're very similar in profile and in terms of growth rates over the last year or two and in terms of growth rates we look at going forward. So yes.

Ruchi Malaiya - *BofA Merrill Lynch - Analyst*

Thanks. I'm sorry, just one follow-up question. Should we continue to see some trimming in that RBI part of the portfolio? We've seen a couple of disposals in recent weeks. Is that the end game, to become more pure play on the major data services?

Erik Engstrom - *Reed Elsevier PLC - CEO*

Yes. If you see what we've done at RBI over the last few years, and even, as you said, over the last few months and weeks, it is consistent with the approach we're taking across the rest of Reed Elsevier, which is that we have been exiting businesses that we do not think translate into the kind of information solutions business that we want to be in, or we do not see material value creation for Reed Elsevier going forward.

So we will continue to divest small business segments that are either some of these advertising and marketing services related, which is most of what we've done in RBI more recently, as well as there are likely to be again, not just again in risk and RBI but in other places, some other small local print assets in different locations that we'll actually continue to dispose of, just like we have in the past. But the large steps we've taken, they are -- they're harder to find, so to speak. We have done the larger pieces and you're not likely to see a string of smaller steps.

Ruchi Malaiya - *BofA Merrill Lynch - Analyst*

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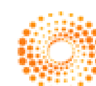

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Erik Engstrom - *Reed Elsevier PLC - CEO*

Go there. Sorry.

Claudio Aspesi - *Sanford Bernstein - Analyst*

Claudio Aspesi, Sanford Bernstein. A quick question. Looking at your underlying revenue growth and underlying adjusted operating profit growth for scientific, technical and medical and for risk solutions, they're about in line with revenue growth. These businesses are largely electronic. They're largely fixed cost. What's missing that it's not leading to operating leverage, providing much faster growth in operating profit?

Erik Engstrom - *Reed Elsevier PLC - CEO*

Yes. I think the way we think about is that these businesses are large global, as you say, platform-driven businesses. We have global scale. In Elsevier, as you know, we're probably the largest platform player in that segment. And they are platform-driven. You were describing it absolutely the way we see it. And in some of our risk segments it's actually similar in those segments that we have large platforms.

But if what we wanted to do was to remain in the segments the way they are today and just drive them for their inherent scale economics, we probably could push harder to try to get cost leverage out of it. But with margins in those two large groups today now, as you can see in the first half, they're both over 35%. Right. With margins in that scale, we think the primary future value creation will come from revenue growth.

And therefore for us to continue to drive, number one, volume growth, by making sure that we're making the tools better and more valuable and so on and spreading them out, and pushing volume growth first and therefore investing in innovation and better tools and so on at the scale of our revenue growth, we think is a better strategy for the longer term. And then over time try to push up the revenue growth and keep the organic revenue growth higher for a longer period of time without trying to maximize the margin or maximize the profit leverage, so to speak, from that scale in the near term.

So we think of it is a proactive decision or strategy to manage in that direction as opposed to managing in a slightly different direction that could probably be possible. Okay?

Tom Singlehurst - *Citigroup - Analyst*

Morning. It's Tom here from Citigroup. I have one question and it was on organic revenue growth. I think this is the seventh consecutive half year where you've delivered 3% organic ex-cycling, which, if nothing else, makes our job a little bit more boring. But the serious question is should we ever expect that to accelerate?

And I suppose the sub-question is, I presume within this, well certainly within the 3%, we've seen, I suppose, a gradual improvement in some of those later-cycle, more depressed revenue growth areas, like STN, but the faster growth areas have maybe somewhat slowed from their run rate earlier a couple of years ago. So, as I say, the question is shall we just think about 3% being the level that you can grow at or is this prologue to something a bit more exciting over the next couple of years?

Erik Engstrom - *Reed Elsevier PLC - CEO*

Well we think what we are trying to do to the shape of the business and way overall and the way we're trying to operate in our different market segments, we think that that overall is creating, number one, a more predictable revenue growth profile. And I think you confirm that you certainly think it has been predictable.

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But the second piece that we're talking about is also that we wanted to be a higher growth profile on average through economic cycles. And I think that we are structurally moving, over time, into higher-growth segments. We're getting bigger and higher growth segments. And we do expect that our organic revenue growth rate will accelerate over time.

Now what exactly the revenue growth rate is any one 6-month period, in any one 12-month period, this year or next year, you said over the next couple of years, that we can't directly control and I don't know what it will be exactly because it depends not just on what we do, but it depends on the economic environment in general in our different geographies. And it depends on the specific economic situation in some of our target markets.

And they have their own cycles. Right. There are geographic cycles and also industry cycles in our target markets. And that means that the exact number will vary a bit. I think the exact growth will vary less in the future than it has in the past throughout the economic cycles. And the average growth rate, organic growth rate over time should be higher than it has been.

Vighnesh Padiachy - *Goldman Sachs - Analyst*

Morning. It's Padi from Goldman Sachs. Slightly related to that, I guess one of the components of that organic growth has been legal only at 1%. You've made some disposals there, Martindale-Hubbell, and you've sold out of Poland and so on. Are there other things you can do in terms of portfolio management at legal to improve the organic growth there?

Erik Engstrom - *Reed Elsevier PLC - CEO*

Yes. There are other things we can do, and some of those will relate to portfolio, but they're likely to be small. The portfolio changes we have done in legal now have been the slightly larger pieces. What is now left to do within legal, just like in the rest of the Company, is likely to be a few small events here and there. And that overall won't have a material impact on the growth rate.

What will have a material impact on the growth rate there, of course, over time, what we do to improve the quality of that business, but more importantly the overall legal industry cycle and the revenue growth and activity levels in the legal industries in the US and in Western Europe.

Vighnesh Padiachy - *Goldman Sachs - Analyst*

And you've launched a lot of new products. Will that help stimulate the growth rate or does it need the industry to pick up?

Erik Engstrom - *Reed Elsevier PLC - CEO*

The things we are doing to launch new products, meaning launch new platform functionality, different product sets or even specific new products that are separate and paid for separately, that -- they are growing well and that does help, but we have a large core business there that is multiyear subscription that's selling into a legal industry. And the legal industry cycle and the legal industry growth rate will, in the near term, continue to be the main driver of our revenue growth rate this year or next year, just like it will for other players in the industry I think.

Vighnesh Padiachy - *Goldman Sachs - Analyst*

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Jonathan Helliwell - *Panmure Gordon - Analyst*

Thanks. It's Jonathan Helliwell at Panmure Gordon. You're very clear in your priorities for driving growth and the organic focus. I just wonder what it would take to tempt you into making a larger acquisition either in terms of financial criteria or in terms of strategic criteria. You're clearly reaping the benefits from the current strategy, but what would a bigger deal have to offer to tempt you into it?

Erik Engstrom - *Reed Elsevier PLC - CEO*

I find it very hard to see something that would, at this point, tempt us into a bigger deal. When I assume that you mean bigger, you don't mean the kind of deals we've done or twice that size; you mean something that's a different order of magnitude? Yes. Yes.

No, I think the approach that we have had over the last five years has resulted in this kind of profile, which varies a bit from year to year. And if we keep having the same approach over the next few years, you could see the same profile or you could see a little less in one year or you could see -- in theory you could have -- we've had one company that was in a few hundred millions of pounds, right, one over the last five years. Could we have two? Yes. Could we even have one in one year? Could we have two in the same year? Yes, we could. But it's the same profile. It's the same approach if you look at the overall scale of the Company.

That is not what you're talking about, right? You're talking about something that's a different order of magnitude. And I don't see any strategic initiative that we're looking at today or any financial argument that would say that that's a better way to spend our time than to leverage the content sets we have, the asset bases we have and the technology platforms we have to drive organic growth, which we can do at very good returns. And we can also get good returns from the smaller plug-in acquisitions to that.

So let's come back this way.

Andrea Beneventi - *Kepler Cheuvreux - Analyst*

Thank you. Good morning, gentlemen. It's Andrea Beneventi from Kepler Cheuvreux. I will stick to the traditional three questions, if I may. The first one is on the 0.5% growth at STN subscriptions. If I remember well, the average contract length is three years. And therefore I would tend to extrapolate a new sales growth rate of 1.5% for the recent contracts. Would you agree in principle with this reasoning?

Second question is on legal. You mentioned 200bps of margin expansion with timing effect. What if we adjusted also for the consolidation of Martindale-Hubbell and changes in perimeter? Where would these margin growth rates be?

And finally on exhibitions, organic growth is at the very top of the industry and your portfolio tends to be rather European. So could you help me a little bit understand where growth is coming from and how you achieved that?

Erik Engstrom - *Reed Elsevier PLC - CEO*

Okay. Let me make sure I understood them. I think I got the first one, so let me cover that one first. And I want to make sure I clarify on the second.

So the first one, that the subscription base in primary research, that the overall growth rate there, the overall growth rate this year is about 0.5 percentage point higher. As we said, that's primarily due to the activity levels have picked up and new sales are up a little bit. But there are also other things with the activity level up and other things coming through our current three-year contracts because you've had some issues with the number of customers that are under financial pressure and have started at different points in time. As you say, some are three-year deals. Some are five-year deals. Some have been rolling one-year deals. So there are other impacts as well, so you can't do the mathematics exactly the way you did it, unfortunately.

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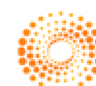

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I think the only way you can look at it is to say that, yes, the run rate right now, including new and old and in-progress, is running about 0.5 point higher, and that's likely to stay for this year and that's the new base rate, so to speak, and I think that's the way you have to look at it. I wouldn't be able to try to split it out into the new component, even though that is a material part of it. But the overall activity level is up a little bit, as I said, across in research right this year.

The second question I want to make sure I understand. You said over the legal 200 basis points, yes? Say again what exactly you were looking for. Yes. How much was --?

Andrea Beneventi - *Kepler Cheuvreux - Analyst*

Well possibly growth in legal margins net of timing, the calendar effect that you mentioned, net of businesses that you have deconsolidated, like Martindale-Hubbell, and other changes in perimeter. So the underlying --

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Erik Engstrom - *Reed Elsevier PLC - CEO*

Yes. Okay. That's what I thought I said. Yes. So if you think about it this way, the reported margin for the first half is 2.5 basis points -- 2.5 percentage points, 250 basis points higher than in the first half last year on a like-for-like basis -- reporting basis. About 50 basis points, 0.5 percentage point, is really tiny. Right. We're really running on a 200-basis-point higher margin this year than last year. And of that basically half is portfolio-related. The different things we did with Martindale-Hubbell and a couple of other things and the way they have impacted it is about half.

So the true organic operational like-for-like margin improvement this year is about 1 percentage point in the first half. Right. And if you look at that over the last couple of years, we've had margin improvements of that around 50 basis points. And I've said at some point it could be a little higher. It could be a little lower some time depending on how hard we work and what's the steps we can take and also a little bit dependent on revenue growth.

But with this low revenue growth we have today, we believe that we should be able to continue to grind up margins a little bit every year organically and that it's been more like 50 basis points organically historically. And sometimes it can be higher. Sometimes it can be lower. This year, in the first half, it's a little bit higher. Right? Does that answer your question?

Andrea Beneventi - *Kepler Cheuvreux - Analyst*

Yes, indeed.

Erik Engstrom - *Reed Elsevier PLC - CEO*

Then you said exhibitions growth. Our exhibitions growth, if you look at the, well, 8% underlying for the first half, but if you strip out the cycling and timing effects, the more interesting number for you is probably is really more like 6% like for like. That's the one that you can compare to other growth rates.

We have high growth in US and we continue to drive very high growth in Japan. If you then look at the -- and that continues, same levels as we've had the last couple of years. There's no material change. In Europe again, there's not that much of a change. Europe for us, which is almost -- if you think about our -- the way I think of our growth rates, the way I think of our portfolio here, broadly speaking, US is 20%, Europe is 40%, rest of the world is 40%. It's not exact numbers, but it's pretty close.

So then you say US continues to grow very well the way it has. Europe continues to grow the way it has, meaning low single-digit moderate growth, but pretty much similar to a year ago. And then you say in the rest of the world, what's happened is Japan is continuing to grow the way it has, on the same management trajectory that the US has been. And in some emerging markets you see a little bit slower growth, a few percentage points

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lower. So you add that all up, that's how that like-for-like has gone from 7% to 6% on a like-for-like basis in the first half. And that's really how it all adds up. Does that --?

Andrea Beneventi - *Kepler Cheuvreux - Analyst*

Very clear. Thank you.

Erik Engstrom - *Reed Elsevier PLC - CEO*

Thank you.

Nick Dempsey - *Barclays - Analyst*

Thanks. This is Nick Dempsey from Barclays. I've got two questions left. Just on risk, if we're saying that the federal government drag started in Q4 last year and should wash out at the end of Q4 and your recent contracts there have been better, can we therefore expect an acceleration in risk growth next year just from that factor?

And the second question, did I understand Duncan correctly that it's going to be harder or there are fewer levers to keep the absolute level of interest coming down in 2015 and 2016?

Erik Engstrom - *Reed Elsevier PLC - CEO*

Okay. I'm going to ask Duncan to answer your second question. All right? But I'm going to first answer your risk growth thing.

Federal government, you're only talking about federal government here now, yes? Federal government -- let me put it this way, our total government segment of the old risk business was less than 10% of the old risk business, total government. Federal government is about half of that. So we're talking here about below -- this is low single-digit percent of the whole risk business just to start with.

And the slowdown started really in the third/fourth quarter last year. It carried over into the first quarter this year primarily and then new sales started to pick back up again. So it started to stabilize during the first half already. So because -- so the run rate now is better than it was in the first quarter. But because it's such a small piece of risk, you're not talking about the combined risk in business information, federal government is now low single-digit percent and you're talking about a few percentage points' movement there, you're not going to find it is the answer.

We're describing the trends to you because they're trends we have described before. But the slight differences that you're seeing now in government, they will not have a material impact on the growth rates. And especially now that they've come back to stabilization, the volatility from here is very limited.

Okay. Duncan?

Duncan Palmer - *Reed Elsevier PLC - CFO*

Yes. So what we're talking about on interest rates, so if you go back a couple of years, we were running at an average interest rate on gross debt of over 5%. Last year I think it was 4.8%. The first half of this year has been 4.2%. I think I said for the year as a whole it's going to be of that order of magnitude.

What's been driving that over recent years obviously is a lower market interest rate environment as we've been refinancing debt. And we've refinanced quite a lot of debt over the last couple of years. We've been able to reduce that rate and also improve some of the efficiency in terms

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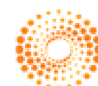

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of the amount of cash we carry on the balance sheet, for example. So that's also helped us to make that weight come down. I think the opportunities for that rate to come down in the future are less because there's less to refinance going forward.

Now what I think you -- to model overall interest expense, obviously you have to have some model of how much debt you think we're going to have and what's going to happen to market rates. I don't really have a crystal ball on what's going to happen to market rates. I'm sure you're as expert as I am in that area. But in terms of how much debt we have, and we've indicated that we're comfortable with the net-debt-to-EBITDA range we're in, but obviously it's -- from your modelling point of view it's a function of what kind of assumptions you're going to make about how that plays out.

So again, we're not providing specific guidance about how much debt we're going to have. But I do think the average interest rate on gross debt is likely this year to be sitting at the level that we were sitting in the first half. And going forward I think the opportunity to make some of the same sort of improvements we made over recent years is probably less because there's less refinancing to do.

Does that make sense? Right.

Erik Engstrom - *Reed Elsevier PLC - CEO*

Okay. Well thank you very much for coming and for taking the time to be here today. I look forward to seeing you again soon.

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