DIRECTORS' REPORT AND BUSINESS REVIEW

CHIEF EXECUTIVE'S REVIEW

OVERVIEW

NEXT has had a good year, achieving **3.1%** growth in sales and **9.0%** growth in underlying profit before tax. Strong cash generation allowed us to buy back 4.5% of shares outstanding which, along with a lower tax rate, resulted in EPS growing much faster than profits.

In the year to January 2013 post-tax EPS grew by **16.6%**. Our full year dividend has been increased in line with EPS to 105p.

REVENUE excluding VAT Underlying business excluding exceptionals	**January 2013 £m**	**January 2012 £m**	
NEXT Retail	**2,190.9**	2,191.4	0.0%
NEXT Directory	**1,192.6**	1,088.7	+9.5%
NEXT BRAND	**3,383.5**	3,280.1	+3.2%
Other	**164.3**	161.0	+2.0%
Continuing business	**3,547.8**	3,441.1	+3.1%

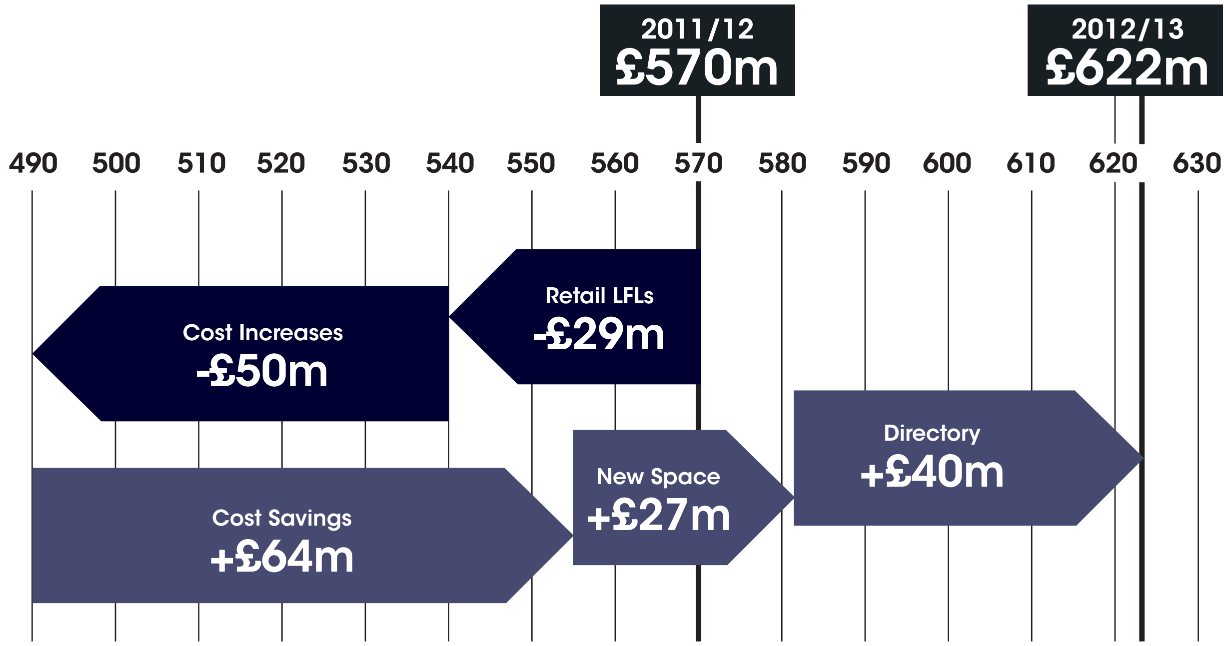
PROFIT and EPS Underlying business excluding exceptionals	**January 2013 £m**	**January 2012 £m**	
NEXT Retail	**331.1**	323.7	+2.3%
NEXT Directory	**302.1**	262.6	+15.1%
Other	**17.0**	12.4	
Operating profit – underlying	**650.2**	598.7	+8.6%
Net interest	**(28.6)**	(28.4)	
Profit before tax – underlying	**621.6**	570.3	+9.0%
Taxation	**(148.5)**	(142.9)	
Profit after tax – underlying	**473.1**	427.4	+10.7%
EPS – underlying	**297.7p**	255.4p	+16.6%
Dividends per share	**105.0p**	90.0p	+16.7%

NEXT PLC ECONOMICS

Five straightforward profit drivers

The table below sets out the five main drivers of the Group's Profit and Loss account. It shows how the profit from (1) new Retail space and (2) Online sales, more than offset the profit lost as a result of (3) declining sales in the existing store base. It also shows how (4) cost inflation has been more than offset by (5) cost savings.

Profit Year Ending Jan 2012		**£570m**	
Profit from sales increases/decreases			
(1) Profit from new space	+27m		
(2) Profit from additional online sales growth	+40m		
(3) Cost of lost sales in existing stores	- 29m		
		+38m	+7%
Cost increases and savings :			
(4) Inflation in cost base	- 50m		
(5) Cost savings	+64m		
		+14m	+2%
Profit Year Ending Jan 2013		**£622m**	+9%



Five straightforward objectives

The Company has five core operational objectives, as set out below. Underlying these operational goals is the ever present and overriding financial objective of delivering long term, sustainable growth in earnings per share.

Develop the NEXT Brand	Develop, improve and expand our product ranges, focusing on being better by design.
Rigorously control costs	Control costs through constantly developing more efficient ways of operating. This must be done without detracting from the quality of our products and services.
Invest in profitable new space	Open profitable new retail space, maintaining the Company's strict payback and profitability hurdles of 15% net store profit (before central overheads) and payback on net capital invested in 24 months.
Invest in online growth	Invest in growth from our online business, through improving UK services and new overseas markets.
Generate and return cash	Focus on cash generation. Return funds that are not needed to develop the business to shareholders through share buybacks. This must be earnings enhancing and in the interests of shareholders generally.

PRODUCT AND THE NEXT BRAND

Without great product, all our other activities are in vain. We believe there is the opportunity to further improve and expand our product ranges, particularly at the more aspirational end of our collections.

NEXT has always maintained that, if we are to succeed, our products must be better by design. Additional time and money has been invested in the design process for Autumn Winter 2013. We hope to see continuing improvements in the fashion content and quality of our ranges as the year progresses.

DIRECTORS' REPORT AND BUSINESS REVIEW

COST INFLATION AND COST CONTROL

We are very clear that we must not compromise service or quality to save money, nor should we stop taking on new costs that improve our service offer. So we must control costs through operational innovation and improved purchasing. The tables below outline the main contributors to cost increases and cost savings over the last year.

Cost Increases	£m
Cost of living awards and other wage related inflation	17
Costs of Directory delivery service improvements	15
Rent, rates & other occupancy inflation	7
Retail in-store design, online overseas and additional brochure	6
Systems investments and other	5
Total	**50**

Cost Savings	£m
Gross margin improvements	22
Retail manpower efficiencies and other cost savings	19
Directory operating efficiencies	10
Lower freight costs	3
Non-stock purchasing improvements (e.g. paper)	3
Other	7
Total	**64**

Looking at the year ahead we expect cost inflation to be less challenging at around £35m. Once again, we believe that we can offset all these increased costs through saving initiatives.

RETAIL

Retail sales were level with last year. New space added 3.2% to Retail sales and 2.1% to total Brand sales. Retail profit of £331m was 2.3% higher than last year, representing a 0.3% improvement in the Retail net margin.

RETAIL SPACE

Retail Expansion in 2012/13

During the year we added 250,000 square feet to our store portfolio. This was less than the 300,000 we had budgeted at the start of the year. The shortfall was because it has taken longer than expected to get planning permission for new projects and because a fire delayed one of our new large sites.

The table below sets out the change in store numbers and space since January 2012.

	Store Numbers	Sq. ft. (000's)
January 2012	**536**	**6,475**
New stores, re-sites (6) and extensions (9)	+5	+196
Closures	- 6	- 28
Home stand-alones	+5	+85
January 2013	**540**	**6,728**

Healthy Returns on Capital and High Profitability

New store profitability and payback on net capital invested are both comfortably within Company targets. Forecasts for stores opened in the last 12 months, shown in the table below, are based on sales since their dates of opening.

	Sales vs target	Forecast profitability	Forecast payback
Mainline	+9%	24%	17 months
Home	+5%	19%	22 months
Total	**+8%**	**23%**	**19 months**

Space Expansion in the Year Ahead

There continue to be good opportunities to profitably increase UK retail selling space. Our expansion programme is built bottom-up, on a location by location basis, and there remain many towns and cities where we believe there is the potential to offer wider ranges in larger stores.

Planning remains a problem, though often more of a delay than a brick wall. We are actively working with planning officers, councillors and local communities to deliver new shops, investment and jobs. We continue to make a greater investment in the external architecture of our new stores, particularly on Retail Parks. Our aim is to transform the quality of construction associated with out-of-town retail and create the sort of buildings that communities will see as an asset, not an eyesore.

In our dealing with local councils it is noticeable that some are much more pro-growth and pro-jobs than others. Many local councils are enthusiastic and efficient; but a few remain an unhealthy mix of Luddite intransigence and incompetence. Going forward, in areas where councils traditionally have got away with just saying "no", we will be more active in harnessing the law and the full weight of public opinion to campaign for growth.

Next year we expect to add at least 250,000 sq. ft. of trading space (net of closures).

Store Portfolio Profitability

We continue to closely monitor the profitability of our store portfolio. Underperforming stores are actively managed with a view to possible closure before they become uneconomic. On average our store leases have 7 years to run before expiry or a break clause.

Our portfolio remains extremely profitable, with 89% of our sales coming from stores delivering more than 15% profit contribution on sales.

Store profitability	Percentage of turnover
>20%	71%
>15%	89%
>10%	95%
>5%	99%
>0%	99.4%

Over the last five years the steady process of opening new space and refitting existing stores has transformed our portfolio. Of the 6.7 million square feet of trading space we have today, 3.7 million (54%) is in stores that are either brand new or enlarged. Of the remaining 3 million square feet, 2.2 million has been refitted, leaving just 800,000 (13%) square feet of the portfolio unchanged from 2007.

DIRECTORS' REPORT AND BUSINESS REVIEW

RETAIL PROFIT ANALYSIS

Operating margin improved slightly on last year. The table below details the margin movement by the major heads of costs.

Net operating margin last year		**14.8%**
Increase in bought-in gross margin	The improvement in bought-in gross margin was driven by an improved USD exchange rate. This improvement was partly offset by selling a higher proportion of Home and Childrenswear; these product categories have a lower gross margin than the average.	+0.3%
Reduction in freight and faulty	The cost of freight fell and in addition we used less unplanned air freight. Faulty stock rates also reduced.	+0.3%
Increase in store payroll	The annual cost-of-living pay award and staff bonus would have pushed wage costs up by 0.5%, however this cost was almost completely offset by in-store efficiency initiatives.	- 0.1%
Increase in store occupancy	Rents and rates increased as a percentage of sales mainly as a result of negative like for like sales. Rental inflation was minimal and continued to decline. Business rates inflation, which is linked to September RPI, was very high at 5.6%. Electricity costs also increased significantly in the first half.	- 0.4%
Warehouse and distribution	The annual cost-of-living pay award was offset by cost saving initiatives.	+0.0%
Central overheads	Central overheads reduced as a percentage of sales.	+0.2%
Net operating margin this year		**15.1%**

DIRECTORY

NEXT Directory sales were up 9.5% and profit increased by 15.1%.

UK SERVICE

NEXT Directory continues to provide good opportunities for growth. In the UK, growth is driven by the wider online market and by improving delivery services. Last year we added Same-Day, Evening, Sunday and Next-Day to Store delivery services, all at a £2.99 premium to the standard service.

In 2013 we have already improved our delivery services further:

- The cut off for standard next day delivery to home has been moved back to 10pm.
- Next-Day delivery to stores has been improved to allow collection after 12.30pm (as opposed to 4.00pm) and the price of this service has been reduced from £2.99 to 50p.

INTERNATIONAL ONLINE

International sales grew from £33m to £54m. We now sell direct to 60 international territories, and also through 6 partners in 14 of those countries. Our international online business contributed £10m to profit. In the year ahead we expect our overseas online business to grow to at least £70m, adding a further £4m to profit.

SALES ANALYSIS

The increase in sales came from four main sources which are set out in the table below.

	Contribution to growth
UK full price sales	5.2%
Clearance Tab	2.2%
Markdown sales	0.1%
International online	2.0%
Total sales growth	**9.5%**

CUSTOMER ANALYSIS

Directory active average customers increased year on year by 10.3% to 3.3 million. Customer growth is set out below, broken down into credit and cash customers.

Average customers '000s	January 2013	January 2012	Change	Increase in customer base
Total credit customers	2,663	2,557	+106	+3.5%
Total cash customers	641	438	+203	+6.8%
Total active customers	**3,304**	**2,995**	**+309**	**+10.3%**

DIRECTORY PROFIT ANALYSIS

Operating margin increased by 1.2% to 25.3%. The table below details the margin movement by the major heads of costs.

Net operating margin last year		**24.1%**
Increase in bought-in gross margin	The improvement in bought-in gross margin was driven by an improved USD exchange rate. In addition Directory sold a higher proportion of Womens and Menswear, these product categories have a higher gross margin than the average.	+ 1.0%
Reduction in freight	The cost of freight fell and in addition we used less unplanned air freight.	+ 0.2%
Higher markdown & obsolescence	Directory took more drop stock from Retail for its Clearance Tab. The additional obsolescence charge on this stock was the main cause for this adverse movement in margin.	- 0.4%
Decrease in bad debt & increased service charge	The continued improvement in bad debt rates increased margin by +0.3%. Service charge growth increased margin by a further +0.2%.	+ 0.5%
Decrease in marketing	The improvement is mainly due to non-recurring costs incurred last year for the development of our new website software.	+ 0.3%
Decrease in call centre	Call centre costs increased margin through improved processes, including automatic credit scheduling, (+0.2%) and a reduction in call volumes & length (+0.1%).	+ 0.3%
Decrease in catalogue production	Photography costs reduced, improving margin by +0.3%. More customers elected to trade without a catalogue; this reduced print costs as a percentage of sales.	+ 0.5%
Increase in warehouse and distribution	International distribution costs, to service our growing overseas business, eroded margin by -0.5%. We added new processes in our warehouses to enhance our delivery offer; this eroded margin by a further -0.8%.	- 1.3%
Central overheads	Overhead costs increased at a lower rate than sales.	+ 0.1%
Net operating margin this year		**25.3%**

DIRECTORS' REPORT AND BUSINESS REVIEW

INTERNATIONAL RETAIL

We have a profitable franchise business, with partners operating 170 stores in 33 countries. Our 19 directly owned stores (in 7 countries) made a small loss. We do not intend to open any new directly owned international stores going forward. Revenue and income for our international business is set out below.

£m	2013	2012	
Franchise income	**61.5**	58.7	
Owned store sales	**16.2**	17.6	
Total revenue	**77.7**	76.3	+1.8%
Operating profit	**8.4**	7.9	+6.2%

We are budgeting for International Retail to make a profit of £10m in the year ahead, the improvement coming mainly from the closure of loss making stores.

NEXT SOURCING

NEXT Sourcing profit recovered from the previous year, when a significant provision was required against unshipped faulty stock. That issue has been resolved and £1m of excess provision has been released this year. NEXT Sourcing competes for business against the many other suppliers to NEXT Retail and NEXT Directory, it provides around 40% of NEXT Brand stock.

£m	2013	2012
Sales	**507.1**	519.0
Operating profit	**30.8**	21.1
Operating margin	**6.1%**	4.1%

We are forecasting NEXT Sourcing profits to be around £30m in the year ahead.

OTHER PROFIT AND LOSS ACTIVITIES

£m	2013	2012
Lipsy	**2.0**	1.3
Property management	**3.5**	5.6
Central costs	**(35.3)**	(30.6)
Pension variation	**3.6**	6.7
Unrealised foreign exchange	**3.4**	(1.1)
Associates	**0.6**	1.5
Total	**(22.2)**	(16.6)

LIPSY

The full year sales of £58m and profit of £4m, before amortisation and profit share of £2m, was the best performance under the four years of our ownership. Internet sales, through Lipsy's own site and the NEXT Directory, doubled to £17m and are now ahead of wholesale sales. Lipsy's retail sales were £22m, taken from 51 stores trading 60,000 sq. ft.

PROPERTY MANAGEMENT

Underlying profit was down by £2m to £3.5m. We now own very few retail freeholds. At the end of the year we sold a development property occupied by Ventura (a business we divested in 2011): the £9m profit is shown as exceptional. We do not anticipate any property management profit in the year ahead.

CENTRAL COSTS

The charge has increased by £5m mainly due to performance-related pay and Company wide share-based incentives. We expect central costs to decrease by £1m in the year ahead.

PENSION SCHEME

The actuarial pension credit fell from £7m to £4m. We expect this credit to be around £3m in the coming year. During the year we made changes to our final salary pension scheme (which has been closed to new entrants since 2000). This change gave a credit adjustment which was partially offset by the cost of hedging out a tranche of pension liabilities. The net effect of these two changes was an exceptional post-tax credit of £28m.

INTEREST AND TAXATION

The interest charge was £28m. For the year ahead we expect net debt to range between £400m and £600m, resulting in a similar interest charge.

Our tax rate reduced as expected to 23.9%, following the reduction in headline UK corporation tax rates. On the assumption that tax rates continue to reduce as announced, we expect our effective rate to be no higher than 23% in each of the next two years.

BALANCE SHEET

The balance sheet remains strong with year end net debt of £493m and forecast peak borrowing requirements being very adequately financed by our bonds and bank facilities of £923m, as set out in the table below.

	£m
2013 bonds – repayment due September	85
2016 bonds	213
2021 bonds	325
Total bonds nominal value	**623**
2016 committed bank facility	300
Total debt facilities available	**923**

We believe NEXT will generate around £250m of cash in the year ahead after capital expenditure, interest, tax and dividends, but before share buybacks.

CASH GENERATION, NET DEBT AND SHARE BUYBACKS

STRONGER THAN EXPECTED CASH FLOW

Cash generation was significantly ahead of our expectations. Operational cash flow, before buybacks and before additional cover in the ESOT, was £376m. This was a long way ahead of our original £240m forecast, the variance has been driven by higher profits, lower capital expenditure and year end stock levels, higher Directory customer payments and a number of other one off factors.

During the year we used surplus cash to buy 7.5 million shares (4.5% of shares outstanding as at Jan 2012) at an average price of £32.13 and a cost of £241m. In addition we used £52m to increase the share option cover in our Employee Share Ownership Trust: this had the effect of reducing net shares in issue by a further 0.7%.

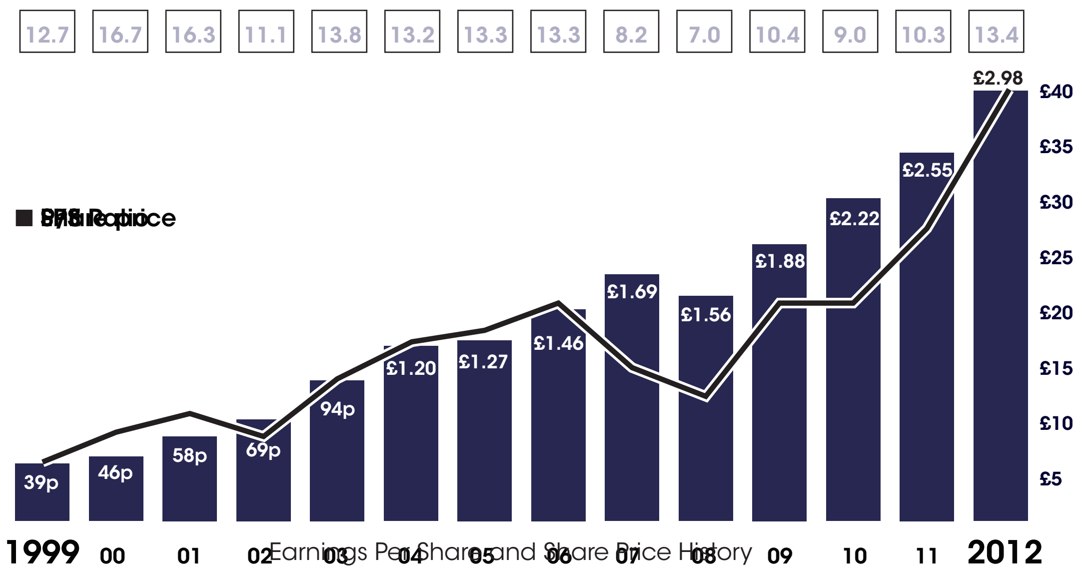
DIRECTORS' REPORT AND BUSINESS REVIEW

BUYBACKS, EPS AND SHARE PRICE

Despite their increasing popularity, share buybacks are still widely misunderstood. There are still those who wrongly believe that they are some sort of share support scheme. This, of course, would be futile as any attempt to support a share price would evaporate as soon as the money ran out.

The only reason share buybacks can deliver long term value is because they *permanently reduce the number of shares in issue* and so increase the amount of profit attributable to each share (EPS). An important part of the logic of share buybacks is the implied link between growth in EPS and growth in share price. Whilst, in the short term there might appear to be no link, in the long run share prices tend to reflect the fundamental value of the earnings and dividend stream. If the share price did not rise with EPS, the buyback programme would eventually leave a single share owning all the profits and dividends!

The graph below illustrates the long term correlation of share price to EPS for NEXT plc over the period we have been buying back shares. The blue boxes indicate earnings per share and the black line shows the share price. The boxes at the top of the chart show the historic price/earnings (PE) ratio.



THE LONG GAME – THE NEXT PLC RULES OF BUYBACKS

Over the long term, we have been following these rules when considering buybacks:

1. Share buybacks must be earnings enhancing and make a healthy Equivalent Rate of Return (see below).
2. Only use the cash the business does not need. NEXT has always prioritised investment in the business over share buybacks.
3. Use surplus cash flow, not ever-increasing amounts of debt. We have never allowed our share buyback programme to threaten our investment grade credit status and will not do so going forward.
4. Maintain the dividend at a reasonable level through growing dividends in line with EPS. NEXT will continue to increase dividends in line with EPS.
5. Be consistent. NEXT has been buying shares every year for more than 10 years, reducing the shares in issue by more than 50%.
6. For share buybacks to be an effective use of shareholder cash, the core business must have the prospect of long term growth.

EFFECT ON BUYBACKS OF A RISING SHARE PRICE

The graph above demonstrates that the relationship between our EPS and share price has recently returned to its near historical average. It is important to recognise that this relative rise in the PE ratio reduces the benefit of share buybacks. The more expensive the shares become, the smaller the share of the business can be bought with the same amount of surplus cash.

For example, two years ago when our share price was £21, our operational free cash flow of £200m enabled us to buy 5.2% of the Company. Today with the shares around £40 our expected surplus cash flow of £250m will only buy 3.9%.

The overall effect is simple: as the PE ratio rises the earnings enhancement of buybacks falls. So, given our current PE ratio, how should NEXT assess the desirability of share buybacks?

Essentially there are two measures we look at. The first is the *earnings enhancement* of a buyback when compared to the enhancement to earnings from keeping the cash in the bank and earning interest. The second is the comparison between the earnings enhancement of a buyback compared to the return that would have to be achieved from investing the cash in an alternative investment, the *equivalent rate of return (ERR)*.

With long term borrowing rates for NEXT at around 4%, a share buyback of £250m at £40 would be 2.5% earnings enhancing. The problem with this method of assessing buybacks is that at low interest rates buybacks remain earnings enhancing beyond £60, so we consider the equivalent rate of return measure to be more helpful.

EQUIVALENT RATE OF RETURN (ERR)

The tables below set out the maths used to calculate ERR. The top table shows the enhancement achieved from acquiring £250m of shares at £40, which is 4%. The second table shows that if we were to increase our profits by 4% we would have to invest in an asset yielding 10%. Given that share buybacks carry no additional operational risk, the returns at 10% remain very attractive.

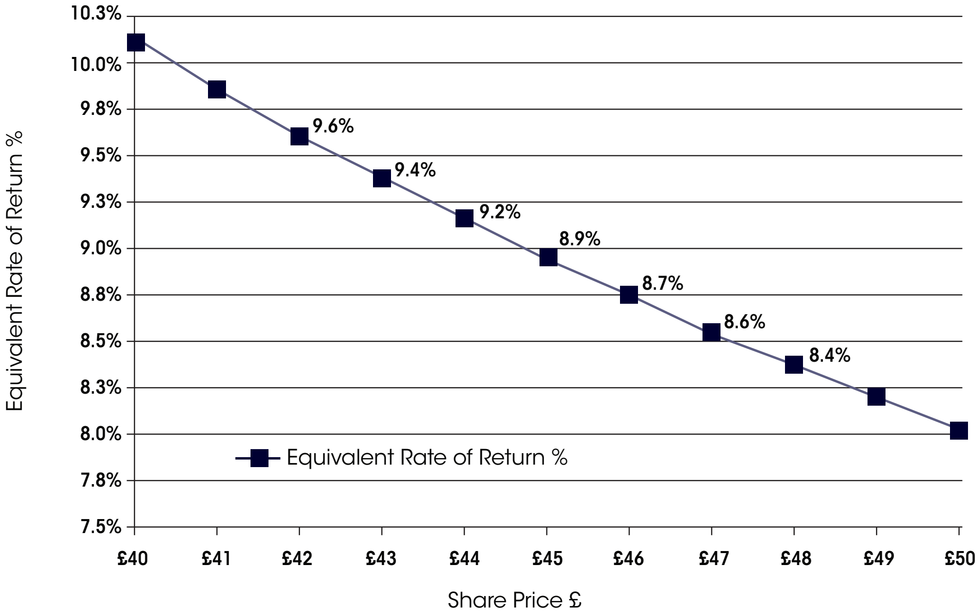
Enhancement £250m Buyback (pre interest costs)	
Share price	£40.00
Market capitalisation	£6,400m
Cash used for buyback	£250m
% Acquired (250/6400)	3.9%
EPS Enhancement 1/(1–3.9%)	4.1%

Calculating ERR	
Company profits	£622m
Additional profit required for 4% growth in EPS	£25.3m
Additional profit as a percentage of £250m invested in buyback (ERR)	10.1%

(These workings are shown as an explanation of Equivalent Rate of Return. Of course, a simpler way of calculating ERR is to divide profit before tax into market capitalisation!)

DIRECTORS' REPORT AND BUSINESS REVIEW

The graph below shows how ERR falls as the share price rises. As the yield approaches the Market's expected return on equity (say 8%), the buyback becomes less attractive. If the returns dropped much below 9% we would become less enthusiastic, so to a certain extent the share price provides a natural moderator of a disciplined buyback programme.



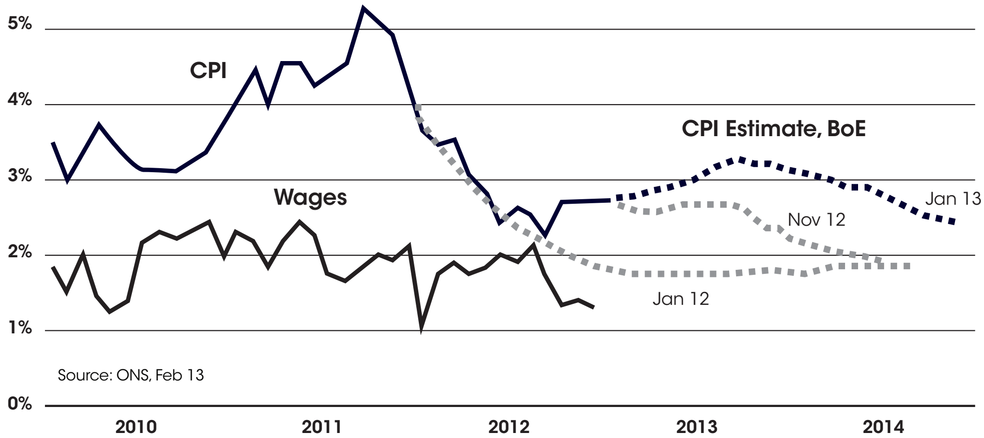
OUTLOOK FOR 2013

THE CONSUMER ECONOMY

The consumer environment looks set to remain subdued. The inevitable deleveraging of public and private finances means that the nation must slowly work its way back to affording the lifestyle it was already enjoying before the financial crisis.

This process of retrenchment is manifesting itself in earnings growth running below the rate of inflation. This decline in real earnings looks set to continue for at least one, if not several more years to come. Indeed the outlook for 2013 inflation has worsened since this time last year.

The graph below shows the difference in CPI and wages. The black dotted line is the Bank of England central inflation forecast as at January 2013, the grey dotted lines are the equivalent estimates in January and November 2012. Estimates for inflation steadily rose last year, leaving the outlook for real earnings as difficult as 2012, if not slightly worse. So we are planning on there being very little if any improvement in the underlying consumer economy.



OUTLOOK FOR NEXT BRAND SALES 2013

In this environment we will continue to budget for our existing stores to take moderately less than the previous year.

Any growth in sales must come from investment in profitable new space and the continuing growth in the online market, both in the UK and overseas. In the year ahead we expect these avenues of growth to continue to exceed underlying declines.

We are budgeting for total NEXT Brand sales for the full year to rise within a range of +1% to +4%.

The first few weeks of the year have been quiet and serve to reinforce a more cautious approach. At present, sales are at the bottom of our target range, though we expect this situation to improve. We will get a better understanding of the underlying consumer environment once temperatures return to seasonal levels. We will issue further guidance with our May trading statement.

OUTLOOK FOR GROUP PROFITS AND EPS

Assuming sales fall within our budgeted range, we expect Group profits before tax, for the full year, to be in a range of £615m to £665m, which would represent a year on year movement of between -1% to +7%. Assuming we achieve our buyback plan, EPS would rise by between +4% and +13%. The table below sets out our guidance for the full year:

	Lower end of guidance	**Upper end of guidance**
Total Brand sales % growth (E)	+1%	+4%
Profit before tax (E)	£615m	£665m
Profit before tax % growth (E)	-1%	+7%
EPS % growth (E)	+4%	+13%

OUTLOOK FOR RETAIL SELLING PRICE INFLATION 2013 AND BEYOND

Overall factory gate prices are stable. Any increases in Far Eastern wages have generally been offset by manufacturing productivity improvements or the development of new Far Eastern sources of supply, in particular Bangladesh and Cambodia.

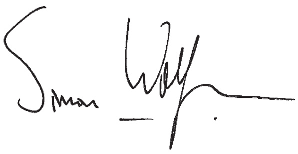
The recent sharp fall in the value of sterling will have very little impact on this year's pricing as we have bought forward most of our foreign currency requirement for the current year. If the pound remains at its current rate of exchange against the dollar, we would expect our prices to rise in 2014.

INTERIM MANAGEMENT STATEMENT

Our next statement will cover the first fourteen weeks of the year, to 4 May 2013, and is provisionally scheduled for Wednesday 8 May 2013.

IN SUMMARY

NEXT has performed well in a difficult year, delivering good growth in sales and profits along with exceptional advances in earnings per share and dividends. The year ahead looks no less challenging but the Group is well prepared and has further opportunities for growth. We remain strongly cash generative and have every chance of delivering another year of increased sales and earnings per share.



Lord Wolfson of Aspley Guise
Chief Executive
21 March 2013