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## Transformation not completed

Dear Reed Elsevier Shareholder,

The beginning of March 2009 brings Crispin Davis's ten years as Reed Elsevier's CEO to a close. Given the development of the share price during that time, his term of office cannot be considered an undivided success. When Davis began as CEO in September 1999, Reed Elsevier shares (those of the Dutch company) were trading at EUR 10.75. Ten years later they are trading at EUR 9.18 or a 15% negative performance. Although this constitutes an outperformance relative to the market (the AEX index), the fact remains that Davis has never succeeded in being truly convincing. It was above all prior to the outbreak of the credit crunch that Reed Elsevier was consistently performing worse than the market. Davis himself recognises that the share price trend has been disappointing.

### Errors of judgment in strategic implementation

After becoming CEO, Davis announced his intention of switching over four divisions — science, legal, business and education — to the internet. Owing to a number of errors of judgment this transformation from a broadly based publisher (newspapers, general publications, books and scientific journals) into a supplier of high value electronic information has, by 2009, still to be completed. Similarly Reed Elsevier made a strategic error of judgment when purchasing US educational book publisher Harcourt. Newspaper division Reed Business Information (RBI), which is strongly reliant on advertising revenues, has also been put up for sale at the wrong moment.

Harcourt turned out to be exceptionally cyclical and failed to promote the goal of stability at Reed Elsevier. There was, moreover, scarcely any synergy with the medical, legal and business divisions. Reed Elsevier also overestimated the speed at which this division could make the switch to the internet. Finally, after a time-consuming integration process, Harcourt was disposed of again at the end of 2006. Costly management time that could have been better used elsewhere was lost.

Given its sensitivity to the economic cycle, the timing of the planned sale of RBI raises questions. Although strategically this was a logical step, RBI was only put on sale when the economy was already past its peak (at the beginning of 2008) and when the credit crunch had started to bite. Even when Reed Elsevier itself offered to take over a substantial portion of the purchaser's financing, a sale proved impossible. For the time being the publisher has no other choice but to hang on to the business until conditions improve. Aside from the expectation that this may take quite some time, it is doubtful whether Reed Elsevier will be able to collect the EUR 1.5 billion selling price it has itself factored in. Yet another costly error of judgment.

### Flat trend in sales, slight margin increase

Under Davis's management Reed Elsevier has not grown significantly. Sales amounted to EUR 6.7 billion in 2008, equal to those of 2007 and only thanks to the ChoicePoint takeover. Moreover sales scarcely deviate from the EUR 6.2 billion that was already posted in 2000. On the other hand, the transformation has had a positive impact on profitability. For the first time since 2002 EBIT for 2008 once again rose above 20%, although profitability remains unimpressive.

### **Risky ChoicePoint takeover**

Prior to the RBI sale Reed Elsevier purchased US data supplier ChoicePoint at the beginning of 2008 for EUR 2.8 billion. EUR 1.5 billion of the loan contracted for the ChoicePoint purchase has since been refinanced at an average interest rate of approximately 8.25%. As an illustration the average rate of interest at which Reed Elsevier could raise finance until that time amounted to 6.8%. Financing charges have thus risen sharply and these must be compensated for by restructuring and benefits of synergy. Whether true synergy benefits can in fact be obtained is doubtful given that Reed Elsevier does not yet operate at all in this business segment.

It is, in addition, clear that ChoicePoint is an expensive acquisition. Reed Elsevier paid 24 times forecast earnings for 2008 and 13.3 times earnings for 2007, while Reed Elsevier itself was trading at only 12 times earnings. This means a substantial dilution of earnings and value creation will be more difficult as ChoicePoint is valued significantly higher than Reed Elsevier itself.

### **Simplification of the governance structure necessary**

Ian Smith's arrival as the new CEO provides a good opportunity for a major overhaul of Reed Elsevier's corporate governance structure. In the current structure the UK and Dutch companies are positioned alongside each other and each is quoted separately. Both entities have an interest in the different divisions and, moreover, Reed Elsevier plc has an interest in its Dutch counterpart. The VEB takes the view that this unnecessarily complicated structure must be simplified. As Fortis with its dual structure has shown, a binational structure is extremely complex, inefficient and hampers management reaction time, especially in critical periods. This simplification can be achieved by making a clear choice between the UK legal form and its Dutch variant and by choosing a single stock exchange listing. This would bring to an end the various boards, a complicated reporting structure (that hampers financial reporting as well), holding duplicate shareholders' meetings, dual head offices and two sets of articles of association.

On behalf of the Dutch Investors' Association (Vereniging van Effectenbezitters),



Jan Maarten Slagter, director

If you want to respond to this letter, e-mail us at [info@veb.net](mailto:info@veb.net).

Note: When this letter was drawn up neither the definitive annual accounts for 2008 nor the annual report nor the agenda for the shareholders' meeting had yet been made available.