2002 revenue[1] by geography
%

Region	%
North America	44
UK	16
Continental Europe	23
Asia Pacific, Latin America, Africa & Middle East	17

2002 PBIT[1,2] by geography
%

Region	%
North America	51
UK	14
Continental Europe	20
Asia Pacific, Latin America, Africa & Middle East	15

2002 revenue[1] by sector
%

Sector	%
Advertising and Media investment management	47
Information, insight & consultancy	15
Public relations & public affairs	11
Branding & identity, Healthcare and Specialist communications	27

2002 PBIT[1,2] by sector
%

Sector	%
Advertising and Media investment management	57
Information, insight & consultancy	9
Public relations & public affairs	10
Branding & identity, Healthcare and Specialist communications	24

Notes
[1] Percentages are calculated on a constant currency basis. See definition on page 134.
[2] PBIT: Profit on ordinary activities before interest, taxation, goodwill amortisation and impairment, fixed asset gains and write-downs. The calculation of PBIT is set out in note 28 of the financial statements.

Letter to share owners

Dear Share Owner

Our seventeenth year, 2002, was the second difficult year in succession for your company. Although not as brutal as 2001, the recession which started towards the end of 2000, continued to bite and spread from the US into Europe and affected parts of Asia Pacific and Latin America. In these circumstances, the results of your Company were only satisfactory, as our operating companies balanced their costs, primarily in people, against declining revenues.

Revenues fell by almost 3% to under £4 billion. Headline profit – that is profit before tax, goodwill and impairment, fixed asset gains, investment write-downs and FRS 17 interest (bit of a mouthful) – fell by 19% to £401 million and diluted earnings per share on the same basis also fell by 19% to 24.9p. The only really good news was that we increased the dividend by 20% to 5.4p per share.

The share price, the real measure of your wealth, fell for the third successive year, this time by more than 37%, but broadly in line with comparative indices. However, your Company's share price performance ranked fifth in terms of total shareholder return in a comparator group of 15 global competitors since 1 January 1999.

The rest of this letter to you is based on constant currency comparisons, which are more meaningful given the relative weakness of the dollar and strength of the euro in 2002. On a like-for-like basis revenues were down almost 6%, pretty much in line with worldwide demand for advertising and marketing services in 2002. Our market share probably held or increased during the year.

Encouragingly, the like-for-like decline in revenues lessened throughout the year – in the first quarter down 9%, in the second quarter down 8%, in quarter three down by just over 3% and in the final quarter down by under 3%. This trend has continued into 2003, with the first quarter flat compared to the previous year. As last year, given tougher economic conditions, your Company's like-for-like revenue growth objective has been modified from 5-10% to 0-5%.

By discipline, Information, insight & consultancy (previously Information & consultancy and re-named following the transfer of our strategic marketing consultancy businesses from Specialist communications on 1 January 2003), continued to grow most strongly, although the recession did start to affect it in the second half of the year. Advertising and Media investment management and Branding & identity,

Healthcare and Specialist communications remained less affected, but Public relations & public affairs continued to be most affected. As a result, marketing services remained, by revenue, at around 53% of our business in 2002.

Geographically, Continental Europe, Asia Pacific, Latin America, Africa and the Middle East were less affected by the slow-down, with the US and the UK being most affected. As a result, markets outside the US remained by revenue at 56% of our business.

PBIT margins fell to 12.3%, well behind our original objective of 15% and even our revised objective of 13%. However, this performance was better than it may seem at first glance, as these margins reflected all severance and restructuring costs, unlike most of our competitors who have taken exceptional charges, hence flattering their numbers. To some extent these margins also reflect improvements in productivity, as average like-for-like headcount fell by over 8%, with revenues on a similar basis falling by almost 6%.

As a result, profit before goodwill and impairment, interest, tax, fixed asset gains and investment write-downs (another mouthful) fell over 14% to £480 million. In 2001 we wrote down the value of certain minority investments in new media and technology following the collapse in equity valuations in these sectors. In 2002 we wrote these investments down a further £20 million to reflect incremental falls in value.

In addition, given the impact of the recession, we have also taken a goodwill impairment charge of £146 million, primarily to reflect a fall in value of first generation businesses acquired. This amounts to just over 3% of the goodwill in the balance sheet at the beginning of 2002. These non-cash charges are primarily why pre-tax profits fell by 50% to £205 million and diluted earnings per share by over two-thirds to 7.7p.

We generated free cash flow of over £349 million, down almost 31% on last year, which was only marginally over-absorbed by acquisition payments and investments of £281 million, share repurchases and cancellations of £76 million and dividends of £56 million. We, therefore, almost achieved our recently introduced additional cash flow objective of also covering acquisition payments and share buy-backs with our cash flow. Mainly as a result of the full-year impact of cash acquisition payments made in 2001, average net debt rose to £1,343 million from £822 million at 2002 exchange rates. Your Board is still comfortable with this level of gearing, the resultant interest cover of over six times and recently revised credit ratings of BBB+ and Ba1, which have been lowered one notch, primarily reflecting the industry's difficult trading conditions.

2003 will be another difficult year, but not as difficult as either 2001 or 2002, however. The end of hostilities in Iraq should help, although media markets in the US were relatively undisturbed, with the major cost to the media owners being that of additional news coverage which may have amounted to about $100 million. The prospects for this year's up-front network media buying season in the US look good – at least from the point of view of the media owners. Continued concerns about possible conflict with Syria, Iran or North Korea do not help and the Israeli–Palestinian situation is still not stable. Worries of further terrorist activity do not help either.

> ‘… the major cause for concern remains the state of the world economy’

However, to some extent the geopolitical issues are side-shows, as the major cause for concern remains the state of the world economy. We are still recovering from the South Sea Bubble or tulipmania of 2000 and the unprecedentedly long bull market of the 1990s. You really have to go back to the 1920s to find a similarly long-lived cyclical upturn.

Managements remain cautious, particularly given that the average life of a CEO seems to be about four years. The last three years have really witnessed a business-to-business recession, with the consumer only becoming more cautious in recent months. In a low inflationary, relatively high unemployment economy and with very little pricing power, the relentless focus of most clients is on cost – witness the rise of the procurement function.

There is no doubt that we must improve our processes and eliminate waste too, providing clients not only with outstanding creative ideas, but inspired co-ordination and integration of that creativity and at the lowest possible cost.

However, you cannot cut costs to achieve growth forever, and every statistic or piece of data available points to the fact that those companies that innovate and invest in the production and marketing of products and services succeed, whilst cost cutters fail. By any quantitative financial criteria, research shows that those companies that invest during recessionary periods, emerge from those difficult times stronger than their competition, whether measured by sales, market share, margins, return on capital, or whatever measure chosen.

There is a finite limit to cost cutting. There is none to revenue building – at least until you reach 100% market share. The continued emphases in the US automobile and truck markets on zero-coupon financing and cash

give backs, and in the food manufacturing industry on trade incentives to achieve greater distribution are not the answers. It really amounts to a zero sum game, with profitless prosperity and break-even economics at full capacity. Compete on price, you create commodities, compete on innovation, you create brands.

Having said all that, the prospects for 2004 do look better. The quadrennial factors will kick in. President Bush will want to be re-elected and will want a stronger economy to influence electors. Government deficit spending and the stimulatory impact of military spending may help. The Athens Olympics will stimulate media spending, as will the European football championships in Portugal. In addition, political spending in the US Congressional elections will crowd out media markets and push up media prices. All this should ensure that advertising and marketing services will grow by 3-4% versus a flat, or marginally growing market in 2003. However, still not back to the growth levels of the late 1990s or 2000.

At WPP, like-for-like revenues were virtually flat in the first quarter of 2003. Not bad given the impact of the Iraqi conflict on client decision-making and indicative that the market for advertising and marketing services seems to have stabilised.

Our budgets project flat like-for-like revenues for 2003, with the first half being slightly down and the second half marginally up. Operating margins are budgeted to rise by up to one margin point, with operating profits up 10%. Most analysts are doubtful of our ability to improve margins by one margin point this year and are forecasting a rise in headline pre-tax profits from £400 million to £425-435 million.

> **'Our goal remains to become the world's most successful and preferred provider of communications services to multinational and local companies'**

Our raison d'être continues to be to find ways of adding value to our clients' businesses and our people's careers and thus justify WPP's existence. Our goal remains to become the world's most successful and preferred provider of communications services to multinational and local companies.

We have three strategic priorities. First, in the short term, to weather this difficult recession. Secondly, in the medium term, to continue to successfully integrate the acquisitions of Young & Rubicam Inc and Tempus. Thirdly, to increase the share of marketing services revenues from approximately 53% where it is now to two-thirds, within five to 10 years; and similarly increase the share of Asia Pacific, Latin America, Africa and the Middle East revenues from 20% to one-third; and finally, to increase the share of Information, insight & consultancy, direct and interactive revenues from just over one-third to 50%.

Our six objectives remain as follows:

- First, to continue to raise operating margins to the levels of the best performing competition. 2001 and 2002 have delayed our progress. 13.3% (an improvement of one margin point) now becomes our target in 2003, with 13.8% (an improvement of another half a margin point) in 2004. Beyond 2004, we think there is life after 13.8%. 15% remains our medium-term objective. With regard to the longer term, agencies such as Dentsu and BBDO have achieved 20% although the accounting problems at IPG and its McCann subsidiary have indicated there can be difficulties.
- Second, to continue to increase the flexibility in our cost structure. Our success in this area proved very valuable in 2001 and 2002. Variable staff costs, freelance and consultants' fees have fallen to about 5% of revenue from approximately 7% in 2000. We aim to rebuild this ratio again.
- Third, to improve share owner value by optimising the investments of your Company's £400 million cash flow across the alternatives of capital expenditure, mergers and acquisitions and dividends and share buy-backs. Capital expenditure tends to approximate to the depreciation charges, so the emphasis is more on the balance between mergers and acquisitions, share buy-backs and dividends.

With the slow-down in economic activity, acquisition pricing has become more attractive, particularly outside the US. However, some vendors have not altered their price expectations and others have also become more cautious as their performance has wavered too. The smaller companies in the private markets remain more attractive with single-figure and low double-digit price earnings multiples.

We continue to increase dividends significantly given dividend cover of four and a half times. However, given the fixed charge nature of a dividend, we still tend to favour a rolling annual share buy-back program, as historical data seems to indicate that this has the greatest impact on share owner value.

- Fourth, to continue to develop the role of your Company as a parent company, beyond that of a financial holding or investment company which focuses solely on financial matters such as planning, budgeting, reporting, control,

treasury, tax, mergers and acquisitions, and investor relations. With a relatively small team of approximately 200 people at the centre, predominantly based in London and New York, with some support in Hong Kong and São Paulo, we continue to focus on the areas of human resources, property, procurement, information technology and practice development.

Talent, or the quality of our people, is the key differentiator in our business and we continue to aim to raise our game even further in this area with new appointments and added resources.

In the human resources area we continue to develop our short- and long-term incentive plans, our WPP Leaders, Partners and High Potential groups; our Worldwide Ownership Plan; our Worldwide Partnership Program; our Atticus Awards – our literary Oscars; our training and knowledge-sharing programs and specialised seminars on creativity, retailing and interactive; and our Marketing Fellowship Program.

In addition, we continue to develop, both internally and externally, an understanding of the vast resources within the Group through a variety of communications: our Group directory, *Navigator*; our global newspaper, *The WIRE*; our monthly online news bulletin, *e.wire*; our weekly *FactFiles* profiling Group resources; and our annual marketing *Atticus* Journal; as well as developing our online communications, the WPP intranet and the Group website, **www.wpp.com**.

In property management, we continue to implement the WPP Space Program which seeks to improve the return on our annual investment of $500 million in our property, by improving communications, speed of response and efficiency, through new design and layout of our premises. This unique product has made an impact in the real estate industry and received the *Innovation in Corporate Real Estate Award 2002* from NACORE International, the international association of corporate real estate executives.

In procurement, we continue to take initiatives in various regions of the world to improve the way we purchase goods and services and co-ordinate Group buying.

In information technology, we are increasingly co-ordinating our $360 million annual investment in hardware, software and information technology salaries.

Finally, in practice development we continue our 'horizontal' initiatives in 10 identified high growth areas across our 'vertical' operating brands – in media investment management; in healthcare; in privatisation; in new technologies; in new geographic markets; in retailing; in internal communications; in entertainment and media; in financial services; and in telecommunications and hi-tech. In addition, we are developing our direct investments in new media and our start-ups and internal strategic alliances, which reinforce our practice development initiatives.

All these initiatives are designed to ensure that we, the parent company, really do (and are perceived to) inspire, motivate, coach, encourage, support and incentivise our operating companies to achieve their strategic and operational goals.

- Fifth, as we move up the margin curve, to place greater emphasis on revenue growth. A legitimate criticism of our record against the best performing competition is that we have been unable to deliver the highest levels of organic revenue growth. In the last half of the 1990s we averaged 8% organically against 10% for the best performing companies. 2000 was a bumper but unsustainable year. 2001 was disappointing, falling back into the middle of the pack but 2002 (and the start to 2003) seem to indicate a revival. Your Company continues to be amongst the leaders in net new business wins.

> **'Our objective is to position our portfolio in the faster growing functional and geographical areas'**

Our objective is to position our portfolio in the faster growing functional and geographical areas. Our practice development activities are also aimed to help us achieve this objective and acquisitions so far in 2003 – in Advertising and Media investment management; in Information, insight & consultancy; in Public relations & public affairs – are also key.

Achieving our strategic priorities, referred to previously, by expanding the market shares of our businesses in Asia Pacific, Latin America, Africa and the Middle East to one-third, in marketing services to two-thirds and in Information, insight & consultancy, direct and interactive to one-half, are also critical.

We will expand our strong networks – Ogilvy & Mather Worldwide, J. Walter Thompson Company, Y&R Advertising, Red Cell, MindShare, Mediaedge:cia, Research International, Millward Brown, Kantar Media Research, Hill & Knowlton, Ogilvy Public Relations Worldwide, Burson-Marsteller, Cohn & Wolfe, OgilvyOne, Wunderman, CommonHealth, Sudler & Hennessey, Enterprise IG and Landor – in high growth markets or where their market share is insufficient. In 2002 we strengthened our position in Advertising and Media investment management in the UK, France, Germany, Spain, The Netherlands, Switzerland, Sweden, Finland, the Czech Republic, Slovakia, Australia, New

Zealand, China, India, Taiwan, Brazil and the Middle East; in Information, insight & consultancy in the US, Ireland, France, Poland and Thailand; in Public relations & public affairs in the US, Norway, China, Australia, Japan and Taiwan; in direct and promotion in the US; and in sports marketing in Germany. In 2003 there will be more work to do again in the heartland of Continental Europe – France, Germany, Italy and Spain.

We will also enhance our leadership position in Information, insight & consultancy by continuing to develop our key brands with particular emphasis on North America, Asia Pacific and Latin America. We will also reinforce our growing position in media research through Kantar Media Research. This includes our investments in television audience research through IBOPE, AGB Group and Markdata, which following even greater success in the UK and Australia, now have strong representation in 36 countries in Europe, Latin America and Asia Pacific.

In addition, we will reinforce our worldwide strength in direct and interactive marketing and research through our traditional channels such as mOne, Mediaedge:cia, OgilvyOne, Wunderman, digital@jwt, Blanc & Otus and Lightspeed. Where the recent compressions in financial valuations may offer significant opportunities, we will also invest directly in the new channels. Lastly, we will continue to develop our specialist expertise in areas such as healthcare, retail and interactive and to identify new high growth areas.

■ Our sixth objective is to improve still further the quality of our creative output. Of the three things we do, strategic thinking, creative execution and co-ordination, creative execution is probably the most important – but we use the phrase in its broadest sense. Clients look for creative thinking and output not just from advertising agencies, public relations and design companies, but also from our Media investment management companies, MindShare and Mediaedge:cia, and our research companies. Millward Brown is already arguably one of our most creative brands.

We will do this by stepping up our training and development programs; by recruiting the finest talent from outside; by celebrating and rewarding outstanding creative success both tangibly and intangibly; by acquiring strong creative companies; and by encouraging, monitoring and promoting our companies' achievements in winning creative awards.

A colossal amount remains to be done – and given the pace of change that our clients face and therefore challenge us with, it seems certain that once these objectives are achieved they will be replaced by new ones.

As companies grow in size, most chairmen and CEOs become concerned that their organisations may become flabby, slow to respond, bureaucratic and sclerotic.

Any sensible chairman or CEO would not want this to be the case. They would want both the benefits of size and scale with the responsiveness and energy of a smaller firm. For the first time new technologies enable this to be achieved more effectively and easily.

WPP is no different. We want the scale and resources of the largest firm together with the heart and mind of a small one.

As a parent company, we continue to develop practical principles and policies for charitable giving, the environment and support for communities and the arts, based on best practice guidelines. Our activities complement our operating companies' initiatives and programs in these areas. A summary of the Group's approach to corporate social responsibility can be found on pages 75 to 77. We calculate that the WPP organisation donates more than £12 million to charitable causes each year in the form of direct and indirect donations.

In stark and unwelcome contrast to the year 2000, 2001 was a truly brutal year. 2002 was just as testing and 2003 looks to offer only slight relief: most of the world continues to experience troubled times, and uncertainties prevail. If we peer ahead to 2004, however, there is prospect of some cheer; and if and when it comes, those who have earned it most deservedly will be those 62,000 men and women in WPP companies around the world.

Testing times test people to their limits. Over the last three years, WPP people have responded with great courage and grim determination. Work such as theirs offers both financial and emotional rewards; for most of our people, neither has recently lived up to that of past years and present hopes. Yet their work on behalf of our clients has been unaffected: as unstinting and imaginative as ever. On your behalf, we are proud to honour their achievements and thank them wholeheartedly for their irrepressible professionalism and doughty dedication. ■

Philip Lader
Chairman

Sir Martin Sorrell
Group chief executive