Interim Results 2005/06 (IFRS) – 17 November 2005

SLIDE 1

No text

SLIDE 2 – Overview

This presentation relates to the conversion of UK GAAP numbers to IFRS. Additional information is contained in the announcement made today.

The trading outlook remains unchanged.

IFRS causes little operational impact on operating profit for Morrisons and the HY1 operating profit figure before "exceptionals" is unchanged at £50.7m.

The reported loss before tax for the half year increases by £8.4m to £82.1m and the full year 2004/5 reported pre tax profit reduces by £104.1m to £193.0m. In both cases the major impact is the reversal of the negative goodwill arising from the Safeway acquisition.

Net debt has decreased by £19.1m because of the impact of fair valuing financial derivatives.

SLIDE 3 – Context

The financial numbers in this presentation are those presented under UK GAAP on 20 October re-stated to IFRS.

The transition date for IFRS is 2 February 2004. The opening balance sheet at that date along with all other reported comparative numbers have been converted to IFRS.

The principles of all material differences have been agreed with our auditors KPMG who have conducted a limited review of these adjustments. They have no issues to highlight on the IFRS conversion work and will give their formal opinion when they report on the full year financial statements in March 2006.

The company has adopted accounting policies based on the standards expected to apply on 29 Janaury 2006, the balance sheet date of the first full set of financial statements under IFRS.

All references to UK GAAP refer to the UK GAAP in force on 31 January 2005, the date of last set of full published financial statements.

SLIDE 4 – Applicable IFRS standards

The standards that impact on the company are outlined below. These have been split into those that have an operational impact and those that are non-operational or of a corporate nature.

Material differences between UK GAAP and IFRS are explained in the following slides.

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SLIDE 5 – Key IFRS 1 First-time adoption options

A number of transitional options are available under IFRS 1.

IFRS 3: Business Combinations

The Safeway acquisition was the only material business combination considered. As Safeway was acquired after the transition date (2 February 2004), IFRS3 already applies.

IAS 19: Employee Benefits

The option to recognise the full pension deficit and flow the actuarial gains or losses through the Statement of Recognised Gains and Losses has been taken. This approach is similar to FRS 17 which is the basis for UK GAAP.

IAS39: Financial Instruments

The option not to re-state comparative data in respect of the valuing of financial instruments has been adopted. Accordingly the values of bonds and their supporting financial derivatives follow UK GAAP rules in the 2004/05 comparatives. The date of transition for these items is 31 January 2005.

IRS2: Share Based Payments

The option only to value post-November 2002 share-based payment awards has been taken. This has the impact of excluding a number of legacy Safeway share-plan schemes that would have distorted the comparative data following the divestment programme.

Other than the exemption mentioned above in relation to IAS39 all IFRSs and IASs, together with the applicable interpretations, have been applied in full.

SLIDE 6 – Highlights UK GAAP to IFRS

Coincidentally total IFRS Operating Profit, pre-exceptionals shows no change from UK GAAP in H1 2005/6. A reconciliation of the underlying movements is included in Slide 21.

The only change within exceptional items reflects the retiring of the Safeway brand.

Before taxation profits are further impacted by the reversal of negative goodwill amortisation taken under UK GAAP.

Net debt is lower as the inclusion of financial derivatives has created an additional financial asset.

SLIDES 7/8 – Pre-tax profit bridge: Share based payments (IFRS 2)

In the H1 2005/6 the IFRS impact before tax is a charge of £2.6m. £2.3m of this relates to the LTIP that was put in place on 1 September 2004.

Under UK GAAP there is no material charge for ESOP's, Save-As-You Earn or share-plan schemes for employees. LTIP costs are booked at the time of payment.

Under IFRS an annual charge based on the fair value of the options or shadow options in the case of the LTIP, is booked, spread over the vesting period. The stochastic model has been chosen to calculate the fair value charge as it is more capable of considering the share price volatility and performance criteria necessary to value ESOP's.

Only the LTIP has a balance sheet impact as the accounting creates a provision which is used to cover payments made.

SLIDES 9/10 – Pre-tax profit bridge: Employee benefits IAS19

The company has separate pension schemes for Morrisons and Safeways, both of which have deficits.

It is anticipated that pension costs under IFRS will be broadly similar to FRS 17 which shows the full pension deficit or surplus on the balance sheet whilst recognising gains and losses through the STRGL.

IAS19 is similar to FRS 17. The exceptions, which have resulted in a small increase in the total deficit, are the accruing for death in service costs over the expected life of members rather than recognising these on a cash basis, and the use of bid value rather than mid-market value when establishing asset valuations.

IFRS carries the full value of deficits and surpluses on the balance sheet. Actuarial gains and losses will be taken through the SORIE (IFRSs version of the STRGL), in line with UK GAAP.

SLIDES 11/12 – Pre-tax profit bridge: Leases (IAS17)

The treatment of premiums for long leasehold land results in a small favourable impact in each of the periods under review. Under IFRS long leasehold land has been reclassified as an operating lease. The profit variance arises from the depreciation rate applied under UK GAAP, and the timing of operating lease rentals under IFRS.

Under UK GAAP land and building leases are recognised as operating leases. Premiums paid for long leasehold land are recognised within tangible fixed assets and written off over the life of the building.

Under IFRS buildings can be classified as finance leases. Land is always an operating lease, so premiums paid for long leasehold land are classified as operating lease prepayments and written off over the life of the lease as laid out in the leasing standard.

Morrisons business model is primarily freehold rather than leasehold. Approximately £230m of premiums paid for long leasehold land have been re-classified.

SLIDES 13/14 – Pre-tax profit bridge: Impairment provision (IAS 36)

Under IFRS, there is a requirement to look annually for indication of impairment.

Our evaluation has confirmed that our asset values are supported and require no impairment.

In order to establish whether an impairment has taken place the carrying value of assets is compared against the higher of their value in use or their market value. These tests are carried out annually.

The asset values of the core Morrisons stores are based on original historic costs.

The value in use of the retained Safeway stores will not be confirmed until the conclusion of the Optimisation Plan in 2006. In completing the hindsight period adjustments for the Safeway acquisition, we have confirmed that the valuations used for the fair value review represent the fair value of the portfolio acquired.

Uneconomic stores or ones that did not fit the Morrisons model have already been divested.

Goodwill is also required to be tested annually for impairment. This is on a portfolio, rather than on an individual store basis.

SLIDE 15 – Pre-tax profit bridge: Intangible retirement and goodwill

The impact of IFRS on the Safeway acquisition gives two material adjustments.

Under IFRS brands on acquisition have to be recognised, and the Safeways brand has been valued at £40m. This value has subsequently been derecognised post acquisition as a divestment and conversion programme was initiated from the day of acquisition and the Safeway name is being discontinued.

The other adjustment is the reversal of the amortisation of the negative goodwill under UK GAAP.

SLIDE 16 – Business combinations (IFRS 3)

Under UK GAAP no value was ascribed to intangible assets. Negative goodwill from the Safeway acquisition is amortised over its useful life. The hindsight period for finalising the fair values is 2 years.

Under IFRS intangibles have to be recognised on acquisition if they meet the criteria of IAS 38 *Intangible Assets*. The only material intangible that could be recognised is the Safeway brand but as no long-term economic benefit is going to be derived from the name, it has been valued and then retired.

All other fair value adjustments follow the same principles of UK GAAP other than there is a material difference with deferred taxation (see Slide 25). The largest adjustment to fair values under UKGAAP was the property uplift and this remains materially unaltered under IFRS.

These financial statements reflect the final adjustments to the Safeway acquisition as under IFRS the hindsight period is reduced to one year.

What was identified as negative goodwill under UK GAAP is now positive goodwill under IFRS. A bridge is provided in Slide 23.

SLIDES 17/18 – Pre-tax profit bridge: Financial instruments (IAS32/39)

Under UK GAAP hedging derivatives are normally recorded off balance sheet and any amounts due or receivable accounted for on settlement.

Under IFRS derivative instruments are included on the balance sheet at fair value. The movements on hedges that are ineffective or do not qualify for hedging are posted to the Income Statement.

The only derivatives that the company has, cover the interest and currency movements of the bonds that formed the major part of the Safeways debt. These were brought on at fair value at the date of acquisition under UK GAAP.

These were not turned into “IAS hedges” in H1 2005/6 and consequently the fair value movement has been taken through the Income Statement rather than the SORIE which is the proposed accounting treatment from H2 onwards.

Under IFRS these are on balance sheet at full fair value. Those that do qualify and are effective are posted to the SORIE.

The treatment of loans and bonds is materially the same as they are recognised at initial cost and then held at amortised cost.

Preference shares are held as equity under UK GAAP but under IFRS have been reclassified as debt.

SLIDE 19 – Pre-tax profit bridge

This is the complete bridge of the material items affecting pre-tax profit.

SLIDE 20 – Other impacts

There are a number of other impacts which are minor in nature or just affect balance sheet classification.

SLIDE 21 – Operating Profit bridge

Operating profit is affected by four items. Share-based payments, long leasehold land and pensions have been described in Slides 7-12.

Under IFRS “Profit on the sale of fixed assets” is included within Operating Profit whereas under UK GAAP it was not.

SLIDE 22 - Impact on profit guidance

IFRS is not expected to have any impact on previous guidance for 2005/06.

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SLIDE 23 – Goodwill bridge

Pensions relates to the increase in the Safeways pension scheme due to the different valuation rules for pension assets under IAS 19.

The negative goodwill figure shown under UK GAAP becomes positive under IFRS due primarily to deferred tax figure as detailed in Slide 24.

The figures in grey are those that are hindsight adjustments under both IFRS and UK GAAP.

SLIDE 24 – Taxation (IAS 12)

Under UK GAAP the company provided in full for deferred taxation. The fair value uplift on the properties acquired is not treated as a permanent difference as the properties are expected to be part of the continuing business. Consequently under UK GAAP no deferred tax is provided.

Under IFRS deferred taxation on potential capital gains has to be provided in full; even if they are sold and the gain rolled over.

SLIDE 25 – Net Asset Bridge

The adjustments in grey represent the net balance sheet effect of the adjustments covered in earlier slides. More details of these movements can be seen in the detailed reconciliations available on the web site.

SLIDE 26 – Dividends (IAS 10)

The dividend adjustment is due to dividends not being recognised under IFRS until they are authorised rather than when they are proposed under UK GAAP.

SLIDES 27 to 30

These slides show the abbreviated primary statements (Income Statement, Balance Sheet, Cash Flow and Statement of Recognised Income and Expense) together with the Analysis of Net Debt, which form part of the Interim Report under IFRS for 2005/06 that has been announced today.