Our four stakeholder ambitions
Our shareholders

A strong balance sheet

A cash generative business with low levels of debt

Sales, profit and dividend growth

Trevor Strain
Chief Finance and Commercial Officer

Introduction

We have once again made good progress in becoming a broader, stronger business. 2018/19 sales growth was the strongest for nine years, profit was again up, cash flow was strong, debt remained low and return on capital employed (ROCE) improved.

We continue to invest for growth, and remain focused on that growth being cash generative, capital light and returns accretive.

We have a sustainable ordinary dividend policy and a capital allocation framework, against which we assess the uses of free cash flow.

Once again, adhering to the principles of this capital allocation framework, the Board is recommending a return of surplus capital to our shareholders through another special dividend in addition to the special dividend paid at the half year.

Summary income statement

	2018/19 £m	2017/18 £m
Revenue	17,735	17,262
Operating profit	394	458
Net finance costs	(75)	(80)
Share of profit of joint ventures (net of tax)	1	2
Profit before tax	320	380
Profit before tax and exceptionals*	406	374
Basic earnings per share before exceptionals*	13.17p	12.19p
Basic earnings per share	10.34p	13.30p

Revenue

Total revenue during the period was £17.7bn, up 2.7% year-on-year. Revenue excluding fuel was £14.0bn, up 3.2%. Adjusting for the 53rd week in 2017/18, total revenue including fuel was up 4.7%.

Group like-for-like (LFL) sales excluding fuel was up 4.8% over the year, including contributions from supermarkets of 1.2% and online through central fulfilment of 0.3%.

It was an important year for wholesale, which contributed 3.3% to LFL growth as we accelerated supply to McColl's and made good progress with our other wholesale partners, which enabled us to achieve our target of £700m of annualised wholesale sales ahead of our initial end-2018 guidance.

Operating profit

	2018/19 £m	2017/18 £m
Operating profit	394	458
Adjustments:		
– Impairment and provision for onerous contracts	5	(6)
– Profit/loss on disposal and exit of properties	(2)	(19)
– Pensions exceptional items	26	(13)
– Other exceptional items	42	25
Operating profit before exceptionals*	465	445

Operating profit was £394m (2017/18: £458m). Operating profit before exceptionals was £465m (2017/18: £445m), which was a margin of 2.6%, up four basis points year-on-year.

£406m

Profit before tax and exceptionals* (2018: £374m)

Profit before tax

	2018/19 £m	2017/18 £m
Profit before tax	320	380
Adjustments:		
– Impairment and provision for onerous contracts	5	(6)
– Profit/loss on disposal and exit of properties	(2)	(19)
– Costs associated with the repayment of borrowings	33	16
– Pensions exceptional items	26	(13)
– Net pension interest income	(18)	(9)
– Other exceptional items	42	25
Profit before tax and exceptionals*	406	374
Profit before tax and exceptionals margin	2.3%	2.2%

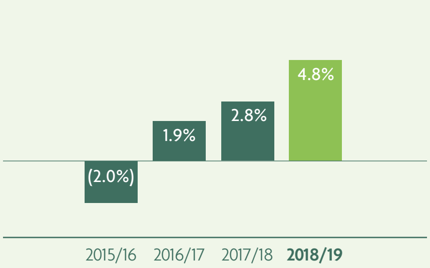
Reported profit before tax was £320m (2017/18: £380m). After a review of emerging practice around Alternative Performance Measures, 'profit before exceptionals' is now our key adjusted profit measure. It is defined as profit before tax, exceptional items, and net pension interest. In moving from 'underlying profit' to 'profit before exceptionals' there is no financial impact of the change on 2017/18 reported numbers.

Profit before tax and exceptionals was up 8.6% to £406m (2017/18 53 weeks: £374m). As previously reported, last year's 53rd week added £5m to profit, meaning profit before tax and exceptionals was up 10.0% on a 52-week basis.

This is another strong performance, with the core supermarkets continuing to grow despite some significant headwinds such as depreciation and start-up costs as we continue to build a broader, stronger Morrisons.

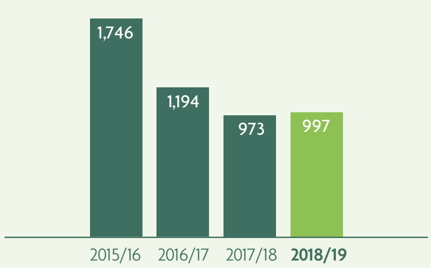
* Alternative Performance Measure as defined in the Glossary on pages 132 – 133.

Group LFL sales (exc. fuel)



Definition
See the Glossary on page 132 for a definition.

Net debt (£m)



Definition
See the Glossary on page 133 for a definition.

During the period we invested in both the start-up of our new store-pick capability and the new Erith customer fulfilment centre for Morrisons.com, and the accelerated roll-out of wholesale supply to McColl's. This enabled us to both significantly increase our online household coverage and achieve our target of £700m of annualised wholesale supply sales earlier than expected. This meant we incurred some additional online and wholesale supply start-up costs, which eased slightly in the second half. The net incremental profit before tax from wholesale, services, interest and online, was a further £12m during the year, bringing the cumulative total to £54m.

Within exceptional items (as fully detailed in note 1.4 of the financial statements), was a £33m one-off cost of completing a successful tender offer across £233m of bonds. In addition, other exceptional items included £28m in relation to increased stock provisioning, as continued automation of our ordering systems led to operational changes, additional information regarding stock levels and a change in the methodology for estimating stock provisions.

Also within other exceptional items was a £12m charge relating to one-off costs associated with improvements to the distribution network. These costs were incurred as part of a programme to increase network capacity, and support the accelerated roll-out of wholesale supply.

For pensions, following a High Court judgement in October 2018, there was a £7m exceptional charge relating to the estimated cost of equalising the minimum pension benefits for men and women. In addition there was a £19m charge relating to the closure of a scheme to future accrual. Net pension interest income was £18m, up £9m year-on-year.

* Alternative Performance Measure as defined in the Glossary on pages 132 – 133.

Earnings per share

Basic earnings per share decreased to 10.34p (2017/18: 13.30p), and earnings per share before exceptionals* increased to 13.17p (2017/18: 12.19p), up 8.0%.

Debt, cash flow and working capital

Summary cash flow

	2018/19 £m	2017/18 £m
Cash generated from operations before onerous capital payments	854	926
Onerous capital payments	(12)	(42)
Cash generated from operations	842	884
Proceeds from sale of property, plant and equipment and investment property	22	108
Capital expenditure	(461)	(500)
Dividends paid	(289)	(129)
Dividends received	7	8
Purchase of own shares	(9)	(4)
Tax and interest	(130)	(136)
Costs incurred on repayment of borrowings	(30)	(17)
Proceeds on settlement of share options	15	26
Other non-cash movements	9	(19)
Movement in net debt*	(24)	221
Opening net debt*	(973)	(1,194)
Closing net debt*	(997)	(973)

Net debt* remained low at £997m (2017/18: £973m).

Free cash flow* was £265m (2017/18: £350m, including £108m disposal proceeds), bringing the total to almost £3bn since the start of the programme in 2014/15. Adjusting for disposal proceeds, operating working capital*, and onerous payments, free cash flow was up £44m to £296m (2017/18: £252m).

With the majority of our original disposal programme already achieved, disposal proceeds were £22m in the year (2017/18: £108m), bringing the total to £1,023m since we started the programme. We still expect to achieve our £1.1bn target.

The cash outflow from ordinary and special dividends was £289m, a £160m increase year-on-year (2017/18: £129m). The operating working capital* outflow was £36m (2017/18: £35m inflow). The small outflow was primarily due to our investment in growth areas such as the new wholesale supply business. We still expect many future operating working capital generation opportunities.

Net finance costs

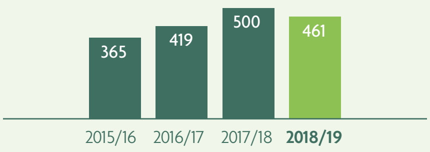
Net finance costs were £75m (2017/18: £80m). We completed tender offers of £233m across three sterling bonds which incurred an exceptional cost of £33m. Before this exceptional cost and the £18m net interest pension income, net finance costs before exceptionals* were £60m (2017/18: £73m).

Tax

We understand the importance of the tax contribution we make, and we take our responsibility towards the communities in which we operate and towards our colleagues, customers, investors and suppliers seriously. We have a tax management framework which ensures the needs of all of our stakeholders are considered. The Group is committed to paying all of its taxes in full and on time. The Group consistently ranks as one of the largest contributors across a range of UK taxes. In 2018/19, Morrisons made net payments of £1,127m to the UK Government of which £561m was borne by Morrisons and the remaining £566m was collected on behalf of our colleagues, customers and suppliers. Corporation tax payments made during the year were £76m which was in line with the current tax charge of £83m in the income statement.

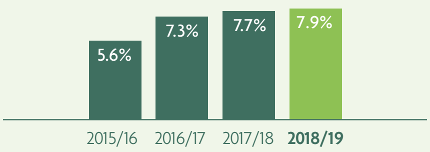
Our four stakeholder ambitions continued
Our shareholders

Capital expenditure (£m)



Definition
Measured as additions to property, plant and equipment, investment properties, intangible assets, assets held-for-sale and investments as per the cash flow statement.

Return on capital employed (ROCE)



Definition
See the Glossary on page 133 for a definition.

Summary balance sheet

	2018/19 £m	2017/18 £m
Fixed assets and investments	7,828	7,761
Working capital	(2,025)	(2,045)
Provisions and tax	(863)	(792)
Net pension asset	688	594
Net debt*	(997)	(973)
Net assets	4,631	4,545

Pensions

The net pension asset as at 3 February 2019 was £688m, an increase of £94m since 2017/18. We continue to work with the pension trustees to identify further opportunities to de-risk the schemes and completed a further £413m buy in of part of the Safeway scheme liabilities during the year. During 2018/19 we also announced the closure of the Retirement Saver plan to new members and future accrual.

Capital expenditure

Cash capital expenditure was £461m, (2017/18: £500m). In the year a further 59 stores went through our Fresh Look programme, meaning we have now refitted over half the estate. We also invested in improving distribution, both to support our growing business, and as part of our longer term network planning.

Borrowings

We continue to apply our policy of maintaining a conservative debt maturity profile and continue to reduce the level of gross debt. In the year, we completed a tender offer across three of our sterling bonds – repaying £233m.

The maturity profile of our remaining debt facilities is strong.

Return on capital employed (ROCE)*

Return on capital employed increased to 7.9%. The growth opportunities we are focused on are capital light and accretive to profit and returns.

Key balance sheet metrics

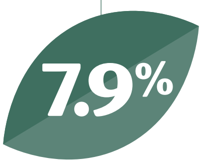
	2018/19	2017/18
Interest cover	6.8 times	6.1 times
Net debt*/EBITDA[1]	1.1	1.1
Gearing	22%	21%
ROCE*	7.9%	7.7%

1 EBITDA before exceptionals.

Financial strategy

Capital allocation framework

1 Invest in maintaining the estate and reducing cost
2 Maintain debt ratios to support investment grade rating
3 Invest for profitable growth
4 Pay dividends in line with stated policy
5 Return surplus capital to shareholders



Return on capital employed*

Our capital allocation framework remains unchanged. Our first priority is to invest in our stores and infrastructure, and to reduce costs. Second, we will seek to maintain debt ratios that support our target of an investment grade credit rating. Third, we will invest in profitable growth opportunities. Fourth, we will pay dividends in line with our stated policy, and then any surplus capital will be returned to shareholders.

Shareholder returns

Our policy is for the ordinary annual dividend to be sustainable and covered around two times by basic earnings per share before exceptionals. The final ordinary dividend will be 4.75p, bringing the ordinary dividend for the full year to 6.60p. In addition to the final ordinary dividend, the Board is proposing a final special dividend of 4.00p per share (in addition to the 2.00p special dividend paid at the half year). This takes the total dividend for the year to 12.60p, an increase of 24.9%.

The principles of our capital allocation framework have guided us in building a track record of capital discipline, and sustained improved total returns for shareholders. That framework has served us and our stakeholders very well for the last five years and remains unchanged.

We still have significant opportunities ahead. These opportunities span sales, costs, productivity and every aspect of improving the shopping trip. We are confident that the meaningful and sustainable turnaround remains in our own hands.

Trevor Strain
Chief Finance and Commercial Officer

* Alternative Performance Measure as defined in the Glossary on pages 132 – 133.