Our shareholders

A robust balance sheet with low debt, a strong maturity profile and significant cash flow generation.

"Our capital allocation framework has served the Company and its stakeholders well and remains unchanged. Free cash flow generation is significant and sustainable."

Michael Gleeson, Chief Financial Officer

Outcomes for our shareholders

A strong balance sheet

A cash generative business with low levels of debt

Strong financial performance and returns

Introduction

I am pleased to be your new CFO. Morrisons has a proud heritage, built on strong financial foundations and we remain focussed on maintaining our capital discipline principles.

2019/20 was another year of growth in profit, significant free cash flow and increased ordinary dividend, despite a tougher sales environment, demonstrating that Morrisons turnaround can be both consistent and sustained.

Momentum in building a broader, stronger business continued, with wholesale again expanding and further development of different Morrisons brands and store format innovations. As we enter our fifth year of turnaround, we are taking some important learnings and opportunities into 2020/21.

Summary income statement

	2019/20 £m	2018/19 restated[1] £m
Revenue	**17,536**	17,735
Operating profit	**521**	432
Net finance costs	**(87)**	(130)
Share of profit of joint ventures (net of tax)	**1**	1
Profit before tax	**435**	303
Profit before tax and exceptionals*	**408**	396
Basic earnings per share before exceptionals*	**13.18p**	12.85p
Basic earnings per share	**14.60p**	9.89p

1 Restated for application of IFRS 16 'Leases'.
* Defined in the Glossary on pages 152 to 154.

Revenue

Total revenue during the period was £17.5bn, down 1.1% year-on-year. Revenue excluding fuel was £13.9bn, down 0.8%. Group like-for-like (LFL) sales excluding fuel were down 0.8% over the year, including a negative contribution from supermarkets of 1.4% and a positive contribution from wholesale of 0.6%. Fuel sales were down 2.5% to £3.7bn, impacted by a highly promotional market.

For wholesale, sales grew with all our major partners during the year, and we remain on track for our target of £1bn of annualised wholesale supply sales.

Morrisons.com continues to grow. In addition to the Dordon customer fulfilment centre (CFC), we now store pick our customers' online orders from almost 40 Morrisons supermarkets, and have extended our coverage area to over 90% of British households. We have also begun a click & collect trial for customers in six stores.

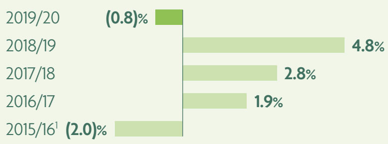
Operating profit

	2019/20 £m	2018/19 restated[1] £m
Operating profit	**521**	432
Adjustments:		
– Impairment and provision for onerous contracts	**(2)**	10
– Profit/loss on disposal and exit of properties	**(66)**	–
– Store restructuring and closure costs	**51**	–
– Other exceptional items	**9**	42
– Retirement benefit exceptional items	**–**	26
Operating profit before exceptionals*	**513**	510

1 Restated for application of IFRS 16 'Leases'.

We managed our costs well throughout the period, which offset some of the operating leverage impact of the lower sales. Operating profit before exceptionals was £513m (2018/19: £510m), with margin up 5 basis points year-on-year to 2.9%. EBITDA* margin before exceptionals was up 22 basis points, to 5.9%.

Group LFL sales (exc. fuel)



Definition
See the Glossary on page 152 for a definition.

1 2015/16 does not include wholesale contribution to LFL sales.

Net debt (£m)

Definition
See the Glossary on page 153 for a definition.

2019/20, 2018/19 and 2017/18 on post-IFRS 16 basis, 2016/17 and 2015/16 on pre-IFRS 16 basis.

£408m

Profit before tax and exceptionals*

Profit before tax

	2019/20 £m	2018/19 restated[1] £m
Profit before tax	**435**	303
Adjustments:		
– Impairment and provision for onerous contracts	**(2)**	10
– Profit/loss on disposal and exit of properties	**(66)**	–
– Store restructuring and closure costs	**51**	–
– Other exceptional items	**9**	42
– Costs associated with the repayment of borrowings	**–**	33
– Retirement benefit exceptional items	**–**	26
– Net retirement benefit interest	**(19)**	(18)
Profit before tax and exceptionals*	**408**	396
Profit before tax and exceptionals margin	**2.3%**	2.2%

1 Restated for application of IFRS 16 'Leases'.

Reported profit before tax was £435m (2018/19: £303m). Profit before tax and exceptionals was £408m (2018/19: £396m), up £12m or 3% year-on-year.

Exceptional items recognised outside profit before tax and exceptionals (as fully detailed in note 1.4 of the financial statements), were a net credit of £27m.

Of these, property disposal profit was £66m, the majority of which relates to our Camden store. Following a tender process, we sold Camden and our eight acre surrounding site to Berkeley Group for a total consideration of around £120m. Berkeley will pay £85m cash in stages over the years of the project, and will build a new Morrisons supermarket and convenience store on the site with a value of £34m. The consideration will be received over a number of years, so the proceeds have been discounted, resulting in a property disposal profit of £64m.

Restructuring costs were £51m, the majority of which relates to the announcement in January 2020 that we are investing in creating more frontline jobs, and reducing some team manager roles within stores.

Other exceptional items were £9m, mainly relating to costs associated with improvements in the Group's logistics network. A £2m net credit (2018/19: £10m charge) has been recognised in respect of impairment and provisions for onerous contracts following the Group's annual impairment review. Net retirement benefit interest income, which as usual was recognised outside of profit before tax and exceptionals, was £19m.

The net incremental profit before tax from wholesale, services, interest and online during 2019/20 was £14m, bringing the cumulative profit so far to £68m. We remain confident of our medium-term target of £75–£125m incremental profit from these four areas.

Net finance costs

Net finance costs were £87m (2018/19: £130m). Net finance costs before exceptionals were £106m (2018/19: £115m).

Earnings per share

Basic earnings per share increased to 14.60p (2018/19: 9.89p), and basic earnings per share before exceptionals increased to 13.18p (2018/19: 12.85p).

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 2019/20, Morrisons made net payments of £1,178m to the UK Government of which £611m was borne by Morrisons and the remaining £567m was collected on behalf of our colleagues, customers and suppliers. Corporation tax payments made during the year were £87m which was in line with the tax charge of £87m in the income statement.

Debt, cash flow and working capital

Summary cash flow

	2019/20 £m	2018/19 restated[1] £m
Cash generated from operations before onerous capital payments	**1,058**	983
Onerous capital payments*	**(41)**	(6)
Cash generated from operations	**1,017**	977
Proceeds from sale of property, plant and equipment and investment property	**34**	22
Capital expenditure	**(511)**	(461)
Dividends paid	**(302)**	(289)
Dividends received	**9**	7
Purchase of own shares	**(10)**	(9)
Tax and interest	**(190)**	(195)
Costs incurred on repayment of borrowings	**–**	(30)
Proceeds on settlement of share options	**12**	15
Debt acquired on acquisition of business	**–**	(2)
Leases non-cash	**(66)**	(53)
Other non-cash movements	**(57)**	10
Movement in net debt*	**(64)**	(8)
Opening net debt*	**(2,394)**	(2,386)
Closing net debt*	**(2,458)**	(2,394)

1 Restated for application of IFRS 16 'Leases'.

Group net debt remained low at £2,458m, compared to £2,394m at the end of 2018/19. Of the £64m increase, £57m related to non-cash movements ex-leases. On a pre-IFRS 16 basis (i.e. excluding lease liabilities), net debt was £1,082m, up £85m since the end of 2018/19 (£997m). Free cash flow was £238m (2018/19: £281m), or £295m prior to £57m non-cash movements, which is up £24m year-on-year.

Property disposal proceeds were £34m (2018/19: £22m), the majority of which relates to the initial instalment from the sale of our Camden store to Berkeley Group.

The cash outflow from ordinary and special dividends paid in the year was £302m, a £13m increase year-on-year (2018/19: £289m). The operating working capital* inflow was £18m (2018/19: £9m outflow).

* Defined in the Glossary on pages 152 to 154.

Our shareholders continued

Capital expenditure (£m)

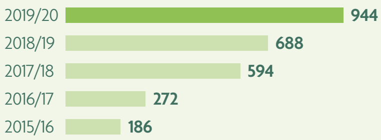
Definition
Measured as additions to property, plant and equipment, investment properties, intangible assets, assets held-for-sale and investments as per the cash flow statement.

Return on capital employed (ROCE)

Definition
See the Glossary on page 154 for a definition.

1 Restated for application of IFRS 16 'Leases'.

Net retirement benefit surplus (£m)



7.0%

Return on capital employed*

Summary balance sheet

	2019/20 £m	2018/19 restated[1] £m
Fixed assets and investments	**8,641**	8,581
Working capital*	**(2,038)**	(2,013)
Provisions and tax	**(548)**	(537)
Net retirement benefit surplus	**944**	688
Net debt*	**(2,458)**	(2,394)
Net assets	**4,541**	4,325

1 Restated for application of IFRS 16 'Leases'.

Retirement benefit

We recently completed the triennial pension valuation as at April 2019, with a funding surplus of £682m across the schemes. This compares to a surplus of £111m at the last valuation at April 2016.

At year end, the net retirement benefit surplus on the balance sheet was £944m, up from £688m in 2018/19. Net retirement benefit interest income was £19m, up £1m year-on-year, reported outside profit before tax and exceptionals.

Capital expenditure

Cash capital expenditure of £511m, (2018/19: £461m) is at a sustainable level and we maintained our capital discipline and adherence to our capital allocation framework.

In the year, a further 44 stores went through our Fresh Look programme, taking the total to almost 350. Four new stores were opened (including two replacements), and four stores were closed during the period, with an overall net reduction in space (including extensions), of 4,000 square feet.

Borrowings

The maturity profile of our remaining debt facilities is strong.

In September 2019, in advance of the upcoming maturity of our Euro Bond, the Group issued a £350m Sterling bond at a low fixed rate of 2.5%, which expires in October 2031. This was issued under the £3bn Euro Medium Term Note Programme. During the year, we also extended our revolving credit facility by a further year, resetting its five year term and resulting in a maturity date of June 2024. In addition, we also secured a further £100m 364 day committed revolving credit facility which matures in July 2020.

Return on capital employed (ROCE)*

Return on capital employed increased to 7.0%. The growth opportunities we are focussed on are capital light and accretive to profit and returns.

Key balance sheet metrics

	2019/20	2018/19 restated[1]
Interest cover*	**4.8 times**	4.4 times
Net debt*/EBITDA*[2]	**2.4**	2.4
Gearing*	**54%**	55%
ROCE*	**7.0%**	6.9%

1 Restated for application of IFRS 16 'Leases'.
2 EBITDA before exceptionals.

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 proposed final ordinary dividend is 4.84p, bringing the total ordinary dividend for the year to 6.77p. Including the 2.00p interim special dividend paid at the half year, the total dividend for the year is 8.77p.

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

Our capital discipline principles around low debt, well-funded pension schemes, sustainable capex and our overwhelmingly freehold store portfolio are fundamental, and our strong track record in all of these makes us distinct. Our capital allocation framework has served the Company and its stakeholders well and remains unchanged. Free cash flow generation is significant and, over the last six years, we have generated over £3.2 billion of free cash flow and paid or declared 64.7 pence per share in dividends, including four special dividends. With sales on an improving trend, profit growing for a fourth consecutive year, and free cash flow continuing to be strong, we had anticipated announcing another special dividend at year end. Instead, during the usual process of reviewing surplus capital payments, we determined it would be prudent to defer that announcement given current unprecedented events around COVID-19. This enables maximum future flexibility around how we prioritise uses of our strong cash flow and surplus capital, and we will keep our capital allocation options under review.

Michael Gleeson, Chief Financial Officer

* Defined in the Glossary on pages 152 to 154.