Delivering returns for our shareholders

Capital light growth and improving total return are our key ambitions for shareholders.

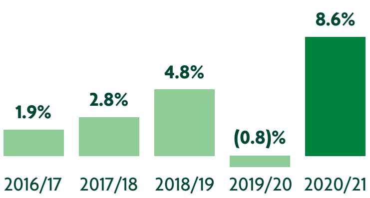
"With a very strong balance sheet, freehold store portfolio, net pension surplus, and strong underlying free cash flow, Morrisons continues to be well positioned to deliver for all its stakeholders."

Michael Gleeson
Chief Financial Officer

Our financial strengths have helped us be agile and decisive

Group like-for-like (LFL) sales (exc. fuel)*

8.6%



Introduction

It was a very different first year as CFO than I expected, but Morrisons strengths have been familiar and very much provided the foundations for everything we have been able to do for stakeholders during the year.

The balance sheet is very strong, both absolute and relative, 87% of our sites are freehold and the pension schemes are in a net £718m surplus position. Underlying debt is low, we have a strong maturity profile and, fundamentally, Morrisons is a very cash generative business.

These attributes have been hard won and carefully preserved over many years and will continue to be cornerstones of Morrisons. With the added benefit of significant operational gearing during a year of very strong sales growth (exc. fuel), we have been able to do some unique things in what are unique times and have more than played our full part during the crisis.

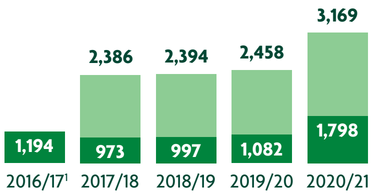
Summary income statement

	2020/21 £m	2019/20 £m
Revenue	**17,598**	17,536
Operating profit	**254**	521
Net finance costs	**(89)**	(87)
Share of profit of joint ventures (net of tax)	**–**	1
Profit before tax	**165**	435
Profit before tax and exceptionals*	**201**	408
Basic earnings per share before exceptionals*	**5.95p**	13.18p
Basic earnings per share	**3.99p**	14.60p

* Alternative Performance Measures as defined in the Glossary on pages 157 to 159.

Net debt*

£3,169m



- Net debt excluding lease liabilities
- Lease liabilities

1 Calculated on a pre-IFRS 16 basis.

Revenue

Total revenue during the period was £17.6bn, up 0.4% year-on-year, with net new space contribution of 0.4%. Total revenue excluding fuel was up 8.9%, with Group LFL excluding fuel very strong at 8.6%. Fuel sales were down 32.1% to £2.5bn, severely affected by the COVID-19 restrictions, especially during the periods of lockdown. For retail, LFL sales were strong from the start of the COVID-19 pandemic in March 2020, with retail contribution to LFL of 7.8%.

For wholesale, sales to all our partners were strong throughout the year. Since year end, we jointly announced with McColl's that 300 McColl's stores are to be converted to Morrisons Daily over the next three years. In addition, we have extended our partnership with McColl's by a further three years, with a new contract out to 2027.

Our online offer continues to grow at pace and sales more than tripled by the end of the year, with growth through Ocado's Dordon CFC, a significant increase in store pick and click and collect, and with the same-day delivery service 'Morrisons on Amazon'.

Profit

	2020/21 £m	2019/20 £m
Operating profit	**254**	521
Adjustments:		
Net impairment and provision for onerous contracts	**(7)**	(2)
Profit/loss on disposal and exit of properties	**(2)**	(66)
Restructuring and store closure costs	**56**	51
Other exceptional items	**15**	9
Online and home delivery transformation cost	**66**	–
Online and home delivery impairment write back	**(76)**	–
Operating profit before exceptionals*	**306**	513

Operating profit before exceptionals was down 40.4% to £306m (2019/20: £513m), and EBITDA before exceptionals down 18.5% to £847m (2019/20: £1,039m). After net finance costs before exceptionals of £105m (2019/20: £106m), profit before tax and exceptionals was down 50.7% to £201m (2019/20: £408m).

All these profit measures were significantly impacted by both the considerable direct costs of COVID-19 and other pandemic-related impacts on profit. Total direct COVID-19 costs were £290m, comprising extra payroll, extra colleague bonus, colleague and customer safety protection measures, distribution costs, seasonal waste and markdown, plus various initiatives for food banks, charities and local communities.

In addition, there was a significant impact on profit during the periods of temporary closure of our 407 profitable cafés (for an average of 24 weeks each during the year), plus lower sales and profit throughout the year in key categories such as Market Street service counters, food-to-go and fuel. Mitigating these various cost and profit impacts, operational gearing was strong and sustained throughout. This was helped by the benefits of vertical integration and the further significant investment in price cuts driving strong volume growth, and we again performed well in reducing both stock loss and the number of less effective promotions.

We also invested our operational gearing into extra discounts for the benefit of our colleagues, farmer suppliers, and key workers in the NHS, teachers, and blue light professions. In addition, in December 2020 we announced our decision to waive our entitlement to business rates relief. The total amount of waived business rates is £274m, of which £230m related to 2020/21 and was paid before year end. Without this payment, our profit before tax and exceptionals would have been £431m, up 5.6% year-on-year. Operating profit before exceptionals and the rates payment would have been £536m, up 4.5% year-on-year, and margin would have been up 12 basis points. EBITDA before exceptionals and the rates payment would have been £1,077m, up 3.7% year-on-year, and margin would have been up 20 basis points.

Exceptional items

Exceptional items recognised outside profit before tax and exceptionals (as fully detailed in note 1.4 of the financial statements) were a net debit of £36m (2019/20: net credit of £27m). Of the £36m, £56m were restructuring costs. We have now completed our major retail restructuring initiative announced in January 2020, and successfully launched projects to reorganise transport and insource some of our depots within the logistics network. These restructuring initiatives will simplify and speed up the business in line with one of our seven priorities, and continue to improve our efficiency and productivity. In addition, we modernised our ways of working at head office by adopting more digital and flexible ways of working for colleagues and a more streamlined central structure.

COVID-19 costs incurred during the year total £290m

	2020/21 £m
Extra payroll	**99**
Extra cost colleague bonus	**68**
Colleague and customer protection	**46**
Foodbanks and donations	**12**
Other costs	**65**
Total	**290**

* Alternative Performance Measures as defined in the Glossary on pages 157 to 159.

Guided by our capital allocation framework

The rapid expansion of online and home delivery capacity resulted in transformation costs of £66m being incurred, offset by a store impairment write back of £76m due to the improved utilisation of store assets for our online and home delivery offers.

Within the £66m, we incurred £42m of costs across our various online channels as we transformed our online operations very quickly and significantly grew our capacity, offering customers new ways to shop remotely with Morrisons and enabling a rapid fivefold increase in delivery capacity for customers.

In response to demand, we accelerated our multi-year online expansion plans and made one-off changes to transform our online business, operational processes and ways of working. The unprecedented scale and speed of the implementation of these programmes resulted in significant start-up costs during the year. We also incurred one-off costs of £24m relating to exceptional stock wastage.

The £76m store impairment write back related to stores where store pick online operations have become established, and asset utilisation has improved thereby generating a structural increase in sales and profit.

The annual impairment review produced a net credit of £7m after excluding the write back related to online capacity acceleration. This comprises a £65m release relating to other tangible assets, £9m credit on onerous contracts and a £67m impairment on intangible assets following adoption of more cloud-based technology.

Other exceptional costs of £15m includes £9m bonus for temporary colleagues not ordinarily eligible and £4m in respect of legal costs. In addition, net retirement benefit interest income was £16m, and property disposal profits were £2m.

Earnings per share

Basic earnings per share decreased to 3.99p (2019/20: 14.60p), and earnings per share before exceptionals decreased to 5.95p (2019/20: 13.18p).

Debt, cash flow and working capital summary cash flow

	2020/21 £m	2019/20 £m
Cash generated from operations before onerous capital payments	**308**	1,058
Onerous capital payments*	**(22)**	(41)
Cash generated from operations	**286**	1,017
Proceeds from sale of property, plant and equipment and investment property	**27**	34
Capital expenditure	**(539)**	(511)
Dividends paid	**(261)**	(302)
Dividends received	**8**	9
Purchase of own shares	**–**	(10)
Tax and interest	**(197)**	(190)
Proceeds on settlement of share options	**(1)**	12
Leases non-cash	**(80)**	(66)
Other non-cash movements	**46**	(57)
Movement in net debt*	**(711)**	(64)
Opening net debt*	**(2,458)**	(2,394)
Closing net debt*	**(3,169)**	(2,458)

Group net debt was £3,169m, compared to £2,458m at the end of 2019/20. Excluding lease liabilities, net debt was £1,798m (2019/20: £1,082m). Debt continues to be temporarily adversely affected by the impact on working capital of the ongoing lower national demand for fuel and fuel deflation, investment in higher levels of stock availability both during COVID-19 and in our preparations for Brexit, and the extension of the scheme to pay our smaller suppliers immediately during the crisis. Due to these effects and the impact of COVID-19 on profit, there was a free cash outflow of £450m (2019/20: £238m inflow). The cash outflow from ordinary and special dividends was £261m, a £41m decrease year-on-year (2019/20: £302m). The operating working capital outflow was £390m (2019/20: £18m inflow).

Net finance costs

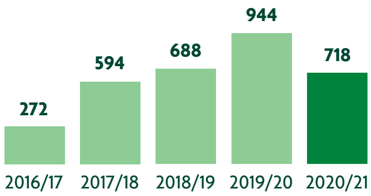
Net finance costs were £89m (2019/20: £87m), and net finance costs before exceptionals were £105m (2019/20: £106m).

* Alternative Performance Measures as defined in the Glossary on pages 157 to 159.

Total dividend up 27%

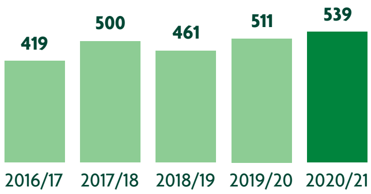
Net retirement benefit surplus

£718m



Capital expenditure

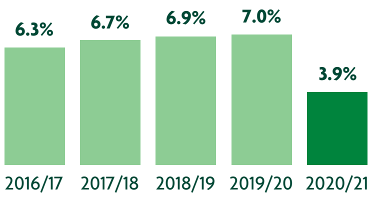
£539m



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)

3.9%



Definition
See the Glossary on page 159 for a definition.

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 2020/21, Morrisons made net payments of £1,260m to the UK government of which £633m was borne by Morrisons and the remaining £627m was collected on behalf of our colleagues, customers and suppliers. Corporation tax payments made during the year were £81m.

Summary balance sheet

	2020/21 £m	2019/20 £m
Fixed assets and investments	**8,843**	8,641
Working capital*[1]	**(1,687)**	(2,038)
Provisions and tax	**(489)**	(548)
Net retirement benefit surplus	**718**	944
Net debt*	**(3,169)**	(2,458)
Net assets	**4,216**	4,541

1 Excluding provisions.

Pensions

At year end, the net pension accounting surplus on the balance sheet was £718m (2019/20: £944m). Net retirement benefit interest income was £16m for the year, reported outside profit before tax and exceptionals.

Capital expenditure

Cash capital expenditure was £539m (2019/20: £511m). In the year a further 18 stores went through our Fresh Look programme. We also further developed our new food-to-go Market Kitchen concept, which is now in four stores. Six new stores were opened, and one store was closed during the period, with an overall net increase of c.157k square feet.

Borrowings

Despite the temporarily higher level of debt, liquidity remains very strong. At year end we were £880 million drawn on our total revolving credit facilities of £1.75 billion, so with still very significant headroom. In addition, since the year end, the Group has extended the duration of £400m of revolving credit facilities to dates between September 2021 and July 2022.

Return on Capital Employed (ROCE)

ROCE was 3.9%, down from 7.0% for 2019/20 due to the impact of COVID-19 on profit before tax and exceptionals. The growth opportunities we are focused on are capital light and accretive to profit and returns.

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 allocation framework has guided us in building a track record of capital discipline over recent years. Our first priority is to invest in the stores and infrastructure and 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.

Our policy is for the ordinary annual dividend to be sustainable and covered around two times by underlying earnings per share before exceptionals. In December 2020, we announced that we would declare a final 2020/21 dividend based on underlying profit before the impact of waiving £230m of business rates relief. The proposed final ordinary dividend is 5.11p per share, taking the full-year ordinary dividend up 5.6% to 7.15p (2019/20: 6.77p). In addition, in December 2020 we announced a previously deferred H2 2019/20 special dividend of 4.00p, which was paid in January 2021. In total, the full-year ordinary for 2020/21 plus special dividend is up 27% to 11.15p per share (2019/20: 8.77p).

With a very strong balance sheet, freehold store portfolio, net pension surplus, and strong underlying free cash flow, Morrisons continues to be well positioned to deliver for all its stakeholders. The capital allocation framework is the foundation of our Fix, Rebuild, Grow, Sustain strategy and guides our decisions. It has served the Company and its stakeholders well and remains unchanged. We are confident Morrisons can continue to generate strong free cash flow and surplus capital for shareholders, and will take a decision regarding a potential 2021/22 special dividend at the end of the year.

Michael Gleeson, Chief Financial Officer

* Alternative Performance Measures as defined in the Glossary on pages 157 to 159.