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Financial summary

52 weeks ended 29 January 2006

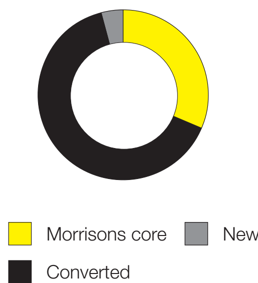
- **£12,114.8m** Group turnover up £11.1m (2005: £12,103.7m)
- **£61.5m** Profit before taxation and Safeway integration and conversion costs (2005: £332.2m)
- **£460.2m** Proceeds from store disposals, bringing total disposals to £1.4bn, funding capital expenditure over the conversion period
- **£374.4m** Integration and conversion costs, bringing total costs of Safeway integration to £513.6m
- **£1,147.6m** Net debt (2005: £1,160.9m)
- **£311.0m** Operating cash inflow (2005: £448.0m)

"The results we are presenting today are the outcome of an extremely challenging year for Morrisons. However, through this period of great change, we have built strong foundations for the company's future as a national retailer.

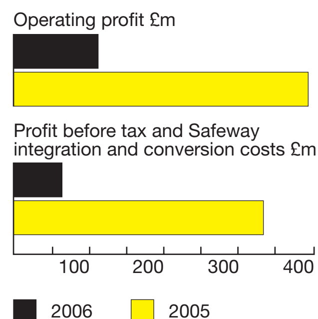
We can look forward to renewed strength and energy now that we are one company with one focus – **to be the Best Grocer in Town**"

Sir Kenneth Morrison CBE, Chairman

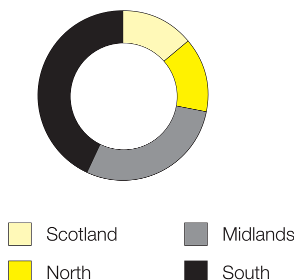
A substantial company
378 stores



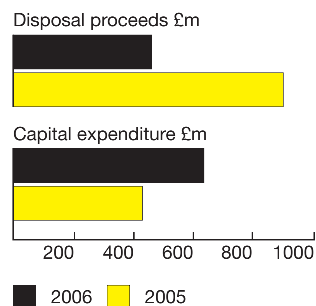
Profits down in a difficult year



A national retailer
378 stores



Proceeds from disposal programme funded capital expenditure



Chairman's statement

The year under review developed much as indicated and produced the expected disappointing financial result. It did, however, represent a period of great change and some major achievements.

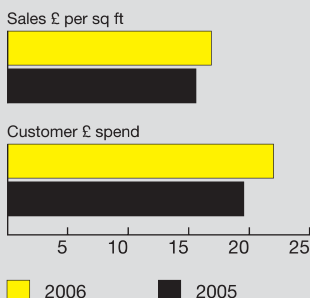
- The Safeway retail estate was completely investigated and decisions were made about the future of every store. Retained stores were converted and refitted to trade as Morrisons and most of the balance of stores were disposed of.
- Distribution has been constantly under review and many improvements have already been made. Plans for the final shape of this function are being developed.
- Operational systems have been modified and the Group now operates on one single basis with a common product file. Extensive work has been carried out in benchmarking the whole range of our own label products, which has been extended and modified to meet present demands.
- Problems with residual stocks identified from Safeway have all been dealt with and will not recur.
- The retraining of some 90,000 Safeway staff has been ongoing throughout this period and great progress has been made. They bring with them their experience and expertise and represent a valuable addition to our team. The team building effort has been substantial and was only made possible by the outstanding contribution of many existing Morrisons staff.
- Market share of trade has now stabilised after a great many store disposals have been made and forms a good platform for the future.
- Morrisons has been transformed into a national operation and much has been learned in the past 12 months.

£61.5m

Profits were down in a difficult year. Profit before tax and Safeway integration and conversion costs was £61.5m (2005: £332.2m). Cash flows remained positive and the conversion programme has been well received by customers.

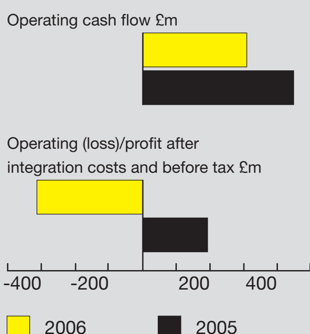
Sales per square foot and customer spend are both up

Despite a reducing number of stores turnover has been held level because customers have been spending more with us:



Operating cash flows are still strong despite operating losses

Careful management of working capital has resulted in a strong cash flow for the year:



Our financial results for 2005/06 indicate the consequences of a year of great change and some difficulty. Whilst turnover was in line with the previous year, at £12.1bn, our profits before tax and Safeway integration and conversion costs were down from £332.2m to £61.5m. Additionally, with Safeway integration and conversion at its peak in the year, the pre tax costs of this activity increased from £139.2m to £374.4m. We have written off the £103.2m goodwill created on the acquisition of Safeway. This arose on the conversion to International Financial Reporting Standards and the Board considers, in view of the Group's financial performance and the likelihood that profit recovery will take time, that it is appropriate to write off this item.

Despite the poor performance, our net debt reduced to £1.15bn, with proceeds from Safeway store disposals contributing to the costs of converting the stores that we have retained. The Board concluded that we should keep our total dividend at the previous year's level of 3.7p per share, meaning that a final dividend is proposed of 3.075p per share. Whilst this is uncovered in the year, it reflects the Board's confidence in future earnings recovery.

We have been fortunate to secure the services of Brian Flanagan, Paul Manduca, Susan Murray and Nigel Robertson as Non Executive Directors. I am pleased to confirm that they have already contributed significantly to the work of the Board and through their efforts on the various committees.

Other changes during the year included the appointment of Robert Stott as Chief Executive Officer in March and David Jones, an existing Non Executive Director, as Deputy Chairman.

Richard Pennycook joined the company as Group Finance Director in October with a brief to overhaul and strengthen the Company's financial administration. He has been responsible for the co-ordination of the Board's activities in developing an Optimisation Plan for profit recovery over the next three years.

100

years of integrity in all our dealings with suppliers large and small, at home and abroad.

Winner third year running of Availability Gold Award and first time winner of Customer Service Gold Award.

Key Facts

- **The only major food retailer to own and operate fresh food manufacturing and processing facilities.**
- **Over 30 years' experience of factory operations.**
- **3,500 colleagues employed in manufacturing.**
- **Most of the fresh fruit and vegetables that we sell we pack ourselves.**

In the early development of this plan it became apparent that this programme would take some time to complete and was likely to extend beyond Robert Stott's retirement date. The Board concluded that in this circumstance it would be prudent to commence the search for a successor for him. Egon Zehnder are conducting the search and good progress is being made. In the meantime, Robert remains totally committed to the business and the job in hand – as he has been for all the 33 years I have been fortunate enough to know him.

I am grateful to all colleagues for their strenuous efforts in difficult circumstances. In the interest of good team building, new colleagues from Safeway who accepted Morrisons terms and conditions qualify for profit share alongside their longer serving colleagues. In addition, we are pleased to announce that a new Save As You Earn scheme, open to all colleagues after a qualifying period, will be launched on 27 March 2006.

The Group made good progress during the year in completing the Safeway conversion and integration. The outlook remains highly competitive but I am confident that in our Optimisation Plan we have a clear route forward that will enable us to deliver an improvement in like-for-like sales and underlying trading performance in 2006/07.

At the date of this report, the Office of Fair Trading is considering a referral of the grocery market to the Competition Commission. Morrisons welcomes strong competition as being good for the consumer and good for business, and we have written to the OFT to suggest a number of ways in which the competitive landscape can be improved. We believe this can be achieved without the cost that a full market reference would incur.

Sir Kenneth Morrison CBE
Chairman

Chief Executive's operating review

The year under review has been one of high activity for many of our people and the pace of change was intense. Towards the end of the period, as our conversion, integration and disposal programmes came to a conclusion, the coherent shape for the business that we had planned became clear. This review will focus on much of the activity in the year, but it is perhaps helpful to begin with a summary of how the business looked at the end of the year.

Business profile

By any measure, the Morrisons that has emerged from the acquisition of Safeway is a substantial business. With £12.1bn of turnover, we are the UK's fourth biggest retailer, and with 11.8% grocery market share we feed approximately one in nine of the UK population. Our trade is now truly national, and at 29 January 2006 we operated 378 Morrisons stores, with 10.6m square feet of retail space. Some 9m customers per week pass through our doors, and they are served by 123,000 colleagues throughout the business. We also control many of the most important elements of our fresh food supply chain, through our abattoirs, bakeries, fresh food processing facilities and fruit and vegetable packing plants. With these activities, we are a "top 5" UK food processor. Morrisons has always maintained a prudent balance sheet, and this is illustrated by the fact that 92% of our store space is freehold or long leasehold, and the £6.7bn of property on our balance sheet at 29 January 2006 makes us a "top 10" UK property owner.

All of these statistics underline the scale of our new business, but do not actually say anything about what we want to be. Our vision is simple and – we believe – relevant to our customers. It is to be the Best Grocer in Town.

£m	Core Morrisons	Converted stores	New/Closed/ Divested stores	2005/06 Total	2004/05 Total
Sale of goods in stores	4,655	4,811	1,073	10,540	10,940
Fuel	1,111	1,225	130	2,516	2,052
Total sales inc. VAT	5,766	6,036	1,203	13,056	12,992
Sales per square foot (£)	20.03	17.33	12.44	17.68	15.46
inc/(dec) on prior year	(3.4)%	13.3%	(2.4)%	7.7%	(9.3)%
Customer numbers (m)	186.5	233.7	63.4	483.6	519.7
inc/(dec) on prior year	(1.8)%	12.0%	(59.8)%	(12.9)%	(9.9)%
Customer spend (£)	24.96	20.58	16.94	21.79	19.69
inc/(dec) on prior year	(1.6)%	(3.0)%	12.2%	4.3%	(6.9)%
Like for like sales (exc fuel) %	(3.4)%	8.9%	–	2.4%	10.4%

Trading review

Sales

Whilst total group sales (inc VAT) were level with the prior year at £13.1bn, the composition changed substantially. The process of disposing of Safeway stores that did not fit the Morrisons model resulted in stores with a total turnover of some £544m in 2005/06, being sold. This was compensated somewhat by increased sales through former Safeway stores that were converted to Morrisons. Additionally, fuel sales increased significantly as a result of the rise in oil prices and increased volumes.

Within turnover, important indicators of performance are customer numbers, average basket size and like-for-like store sales performance. Of most relevance to the continuing Group are the figures for those stores operated by Morrisons prior to the Safeway acquisition and still owned by the Group ("core Morrisons") and the post-conversion figures for Safeway stores converted to the Morrisons format ("converted stores").

Core Morrisons stores were impacted by the competitive effect of having to dispose of 50 large Safeway stores in the same catchment area as the equivalent core Morrisons store. These disposals were required by the Office of Fair Trading as part of their clearance of the Safeway acquisition. As these stores were acquired by competitors stronger than Safeway, there was an inevitable impact on the neighbouring core Morrisons store. In addition, customers were hit, during the year, by the effect of oil price and council tax rises constraining their spending power. For these reasons, core Morrisons saw like-for-like sales (excluding fuel) decline by 3.4% in the year, with customer spending down 1.6%.

Converted stores responded well to the removal of Safeway's weak trading format and replacement with the proven, value driven, Morrisons model. The initial sales uplifts were encouraging, and the overall like-for-like increase of 8.9% (excluding fuel) in the year provides a solid platform for further growth over the coming years. This was evidenced by performance of the small number of stores that had been converted for more than one year by the end of the financial period. This population of stores was exhibiting 3.8% second year growth (excluding fuel).

Profit conversion

	2005/06 £m	%	2004/05 £m	%
Total turnover (ex. VAT)	12,114.8		12,103.7	
Other operating income	18.5		18.3	
Raw materials and consumables	(9,155.5)		(9,110.3)	
Gross profit	2,977.8	24.6	3,011.7	24.9
Staff costs	(1,630.8)	(13.5)	(1,536.9)	(12.7)
Depreciation	(256.9)	(2.1)	(259.2)	(2.1)
Other costs	(978.6)	(8.1)	(820.2)	(6.8)
Operating profit before Safeway integration and conversion costs	111.5	0.9	395.4	3.3

The Group's gross profit margin decreased marginally in the year, reflecting the increased mix of fuel sales in the total turnover figure. This was a drag on margin – had sales mix remained the same, margin would have been 0.8% higher. There were positive benefits of consolidated buying terms from the combined business and the beneficial effect of putting more volume through our vertically integrated structure.

Staff costs rose by £94m, despite the divestment of stores and the run-down of Safeway head office facilities. This reflects, in part, investment in service in the stores, where the Morrisons operating model has a higher ratio of staff to customers than Safeway. Additionally, it reflects increases in distribution and manufacturing staff to service the new business.

Other costs increased from £820.2m to £978.6m, as new manufacturing and distribution facilities came on stream and we felt the impact throughout the business of the increased price of fuel. The additional distribution costs amounted to £75m and increased energy costs to £35m.

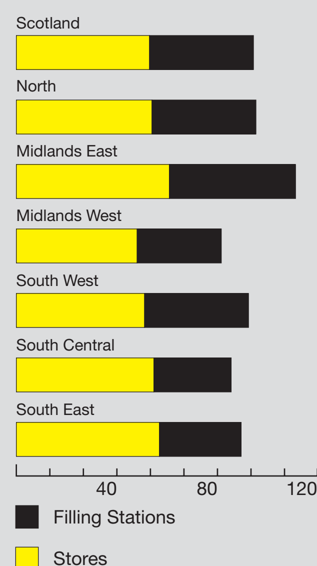
Conversion programme

160 stores were converted from Safeway to Morrisons in the year, bringing the total for the programme to 220. Despite the wider difficulties experienced by the Group, the execution of this programme was flawless and reflects great credit on the numerous colleagues involved. Each conversion was thoroughly done, with the stores remodelled to provide greater focus on fresh foods, the past under-maintenance of the estate rectified, systems and processes converted to Morrisons, the store signage changed and all colleagues trained in the Morrisons way.

The total cost of the programme was £623.4m, of which £467.4m was spent in the year – £320.4m of this was capitalised and £147.0m shown as exceptional Safeway conversion costs.

In many cases, the stores conversion programme has brought a new grocer to town. The majority of past Safeway customers have converted, with us, to Morrisons, although inevitably some have chosen to go elsewhere. Overall, however, the 15.8% increase in customer numbers since conversion illustrates that customers are trying us, and liking what they find.

It was to be expected that our competitors would respond to the looming threat of Morrisons' arrival in town as the conversion programme progressed. Most converted stores opened having to compete with competitors offering deep tactical discounts



100%

Every store converted on time and opened on time

Key Facts

- **220 stores converted in 18 months.**
- **241 stores sold since acquisition.**
- **15 new-build stores opened in 2 years.**
- **Over 11,000 new recruits.**

Chief Executive's operating review continued

in the weeks up to and following conversion – typically a £10 discount on a £40 shop, or an £8 discount on a £30 spend. The converted stores grew despite the intensity of the competition, and it is our approach to win and retain customers for the long term through great in-store service and the overall strength of our offer.

Divestment programme

127 stores were sold or closed in the period, bringing the total since the Safeway acquisition to 241. These stores either did not fit the Morrisons trading model, or were required to be sold by the OFT. The disposals included the Safeway stores in the Channel Islands, Northern Ireland and the Isle of Man, although we retained the successful store in Gibraltar. Also disposed of was our share in the convenience store/forecourt joint venture with BP in 61 locations.

Store development programme

We opened 7 new stores, at Hamilton, Auchinlea, Cardonald, Paisley, Livingston, Strood and Gloucester. It was particularly pleasing, given the presumption by some that Morrisons is a "northern" brand, that the 36,000 square foot store opened at Strood in Kent in October saw our best ever opening week sales performance.

Looking ahead, we will continue to focus closely on optimising our existing business in the coming year, and only expect to open four new stores in 2006 but probably twice this number the following year.

Support infrastructure

We strengthened and expanded both our manufacturing and distribution infrastructures in the period. In manufacturing, we expanded our in-house baking capacity through the acquisition in April of an 80% stake in Rathbones and our abattoir operation was expanded in early 2005 through the acquisition of a second facility, at Turriff in Scotland. Our two abattoirs are now processing the bulk of our current fresh meat requirements. We also extended our fruit packing facilities at Thrapston in Northamptonshire and opened a new vegetable packing house nearby at Rushden.

In distribution, we opened a new dedicated Regional Distribution Centre at Latimer Park, Kettering, in October. With 702,000 square feet and at a cost of £67m, this centre will serve approximately 70 stores in the Midlands and the South. We also announced, during the second half of the year, our intention to close three ex-Safeway depots that were poorly located, inefficient and surplus to requirements. The depots, in Bristol, Aylesford and Warrington are all now closed.

Store disposals summary

£m	2005/06	2004/05	Total
Total proceeds	460.2	903.0	1,363.2
Book value disposed of	433.4	903.4	1,336.8
Square footage (sq ft m)	1.7	1.4	3.1
Turnover in period	543.6	2,143.5	2,687.1
Annual rent obligation	9.7	8.4	18.1

Exceptional costs of £74m were incurred in closing these facilities, but as a result an annual net saving of £30m will benefit our cost base in the coming year.

The Safeway head office facility at Hayes in Middlesex was closed in December following the transfer of all IT processing to Yorkshire. The site was sold for £22m. Safeway's outsourced accounting facility at Crossgate, South Shields, was brought in house in September, in order to achieve tighter control of accounting for Safeway's residual business. Staff numbers in this site have been considerably reduced, but it will continue to operate payroll and certain accounting services. Morrisons new head office facility in Bradford remains on course to open in Spring 2006, and will house approximately 1,600 colleagues currently spread across a number of locations.

Colleagues

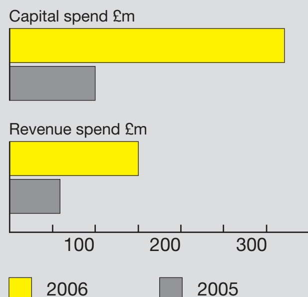
To be the Best Grocer in Town, we need to be the best shopkeepers in town, and Morrisons has always prided itself on the high standards of in-store service we provide to our customers. We were delighted, for our colleagues, to win the Grocer Award once again for best customer service, as well as that for availability, in a year of great change and some turmoil.

Our colleague numbers reduced over the year as a result of the store disposals programme and, latterly, the depot closures. These reductions more than offset the increased numbers of colleagues in converted stores, where the Morrisons retail model required more labour in-store than was the case in Safeway. Some of this relates to higher levels of food preparation in store, for example our freshly made sandwiches and our unique butchery operation. Some also reflects the way that Safeway were attempting to cut costs at the expense of service, for example by restricting the number of tills open to serve customers.

378

stores nationwide.

£623 million invested in the conversion programme



Key Facts

- **Over 10 million square feet of retail selling space.**
- **9 million customers per week.**
- **11.8% grocery market share.**
- **Same prices in all our stores.**

As we move forward, it is vital that we become "one Morrisons". The Group is made up of Morrisons colleagues who have been with us for many years, Safeway colleagues who are equally long serving, and others who are new to the business. More than 90,000 of our colleagues have been with Morrisons less than two years. They need to fully understand the Morrisons way, whilst those of us who have been in the business a long time need to learn from our newer colleagues. The process of truly becoming one team will take time, but with common goals and values, clearly articulated, I am confident that this will be achieved.

The market

Publicly available market share data shows that Morrisons share of the grocery market increased from 6.4% in January 2004 to 11.8% in January 2006, as a result mainly of the new space added by converting Safeway stores. As a truly national player in the market for the first time, our brand exposure has increased significantly, with the equivalent of one third of the UK population visiting our stores in any four week period. With the conversion, integration and disposal programmes complete, and as we get back to business as usual, the opportunity for us to serve these customers better, and to sell more, is significant. Already, the same market research shows that customers regard us as "best for value", through our combination of good prices, great promotions and consistent high quality.

UK consumers benefit from one of the best and most competitive grocery markets in the world. We respect our competitors, and recognise that they have moved on in the two years during which we have been inwardly focused on absorbing Safeway. Our Optimisation Plan, now under way, will see us take the fight to our rivals, and we relish the challenge.

Optimisation plan

Having virtually completed the process of converting or disposing of Safeway stores, moving onto one set of systems and operating with a single head office team, our focus now turns to getting the best out of our new business. Our Optimisation Plan, over the next three years, lays out a clear road map for profit recovery. The objectives are simple – apply the Morrisons philosophy, which worked so well over many years, to the new, bigger business, and adapt it where we have to, to reflect things that have changed.

There is no simple fix in the plan – it is about getting back to the day job, and delivering improvement store by store and line by line. Morrisons has become a new business, with 220 recently converted stores and 5.5 million new customers each week, being served by some 90,000 colleagues new to Morrisons. Much of what we have to do is to deliver, for customers, as we always have done, but we also need to recognise that our store portfolio is more diverse, in both space terms and geography, than it was. Morrisons has always been able to adapt successfully to new locations and geographic markets – the key to the Optimisation Plan will be more, and faster, adaptation than before.

Our vision is to be the Best Grocer in Town. We will get there by being customer focused, sales led, value driven, with a trading mentality and great attention to the detail of shopkeeping in our stores.

I am confident that this will be achieved.

Robert Stott
Chief Executive

Financial review

Overview

The Chairman's statement and Chief Executive's operating review describe the overall operating performance of the Group. This review summarises other aspects of the Group's financial performance, including financing costs, taxation, dividends and pensions, and also comments on key financial policies and procedures.

Conversion to International Financial Reporting Standards (IFRS)

This is the first annual report required to be prepared under IFRS. The Group's unaudited interim results, mailed to shareholders in November 2005, included details of the impact of the change to IFRS reporting on the results for both the year ended 30 January 2005 and the half year to 24 July 2005. A copy of that announcement is available in the Investor Relations section of the Group's web site.

As permitted by IAS 39 *Financial Instruments: Recognition and Measurement*, the Group elected not to adopt to remeasure financial assets and liabilities until 30 January 2005. The Group has also decided to keep its published holding company balance sheet under UK GAAP.

The impact of IFRS is not material to the operating result. The main impacts are on pensions, deferred tax, share-based payments, financial instruments and the classification of certain balance sheet items. Details are set out in note 34.

Finance income and costs

Net costs decreased by £13.2m to £52.2m. The Group generated cash, through trading and store disposals, resulting in drawings under the Group's revolving credit facility being on average £260m lower than in the prior year. In addition, interest capitalised was higher in the year, at £11.8m (2005: £6.4m), due to an increased number of new store and other infrastructure projects taking place in the year.

The impact of marking certain financial instruments to fair value, required by IFRS, resulted in a net, non-cash, charge of £6.2m included in the above total.

Safeway conversion and integration costs

As shown in the income statement, the Group recorded costs associated with the conversion and integration of Safeway of £374.4m in the year, bringing total costs expensed in the two years since acquisition to £513.6m. The largest cost in the period of £147.0m, shown in note 4, related to the conversion of stores from Safeway to Morrisons. These costs, comprising items such as staff uniforms, trolleys and remedial maintenance, were in addition to costs capitalised of £320.4m for items such as refrigeration plant and till systems. A total of 220 stores were converted, at an average cost per store of £2.8m, £418.9m of which was capitalised and £204.5m charged in the income statement.

Other integration costs included redundancies associated with the wind-down of the former Safeway head office and, late in the period, the announced closure of three Safeway depots with the loss of approximately 2,500 jobs. Additionally, an impairment of the closed depots was taken, to reflect their anticipated realisable values. An impairment of £103.2m, providing for the full amount of goodwill arising on the Safeway acquisition, has been booked within these costs. This is commented on below.

Taxation – effective rate

	2006 £m	2005 £m
(Loss)/profit before taxation	(312.9)	193.0
Tax at 30%	93.9	(57.9)
Goodwill impaired	(31.0)	–
Expenses and depreciation not deductible	(32.8)	(53.6)
Divestment profits covered by tax reliefs	32.5	23.5
Total	62.6	(88.0)
Effective tax rate	20.0%	45.6%
Split as follows:		
Pre-integration costs	25.4%	33.8%
Integration costs	20.9%	17.5%

Tax is a credit as a result of relief available against the loss made in the year. This will result in recovery of tax paid in prior years. The effective tax rate differs from the standard UK rate of 30% because:

- Goodwill impaired is not allowable for tax.
- Certain items of expenditure and depreciation are not allowable as deductions for tax.
- Divestment profits in 2006 are sheltered by capital losses and roll-over relief.

Safeway conversion and integration costs are deductible for tax purposes apart from the impairment of goodwill and the Safeway brand and some smaller sundry amounts. This gives rise to a 20.9% tax credit on these costs (2005:17.5%).

Profit before taxation and Safeway integration and conversion costs

As highlighted in note 3, in the previous year the Group made certain amendments to its accounting estimates which resulted in operating profits being £89m higher than they would otherwise have been. No such amendments were made in the year under review.

The Group operates a profit share scheme which is open to all employees subject to certain qualification criteria. Given the difficulty in predicting future profitability of the Group when the Safeway acquisition was announced, Morrisons qualifying employees were guaranteed that for two years (ending 29 January 2006) their profit share would be maintained at the level paid in the year ended 1 February 2004. Additionally, as an incentive to Safeway employees to transfer to Morrisons terms and conditions, employees who did transfer were offered the same arrangements. As a result, profit share amounting to £33.4m was charged in the year (2005: £19.7m) – a level significantly higher than would have been the case if no guarantee was in place. No guarantee applies to future years, when profit share will be limited once again to 5% of pre tax profits.

Included in operating profits are certain payments to the auditors, for non-audit work. The ratio of these payments to the audit fee is unusually high, reflecting assistance given by them in the year to the Board in reviewing its financial forecasting procedures. It is the intention of the Board, through strengthening of the Group's finance function, to ensure that non-audit fees paid to the auditors return to more normal levels. A formal policy setting out appropriate use of the auditors for such work has been adopted by the Audit Committee.

Earnings per share

Basic earnings per share moved from earnings of 4.14p last year to a loss of 9.46p this year. This is due to the following factors:

	Pence per share
Decrease in profit for the financial year before Safeway conversion and integration costs	(7.15)
Increase in Safeway conversion and integration costs	(6.85)
Impact of additional shares in issue	0.40
Overall decrease in basic earnings per share	(13.60)

The effect of the exercise of share options and conversion of preference shares during the year would be to dilute the basic loss per share. Therefore, in accordance with IAS 33 *Earnings per Share*, this has been ignored when calculating the diluted earnings per share.

Shareholders' funds and dividends

Shareholders' funds decreased by £357.3m, from £4,005.9m at 30 January 2005 to £3,648.6m at 29 January 2006. This is due to the following factors:

	£m
Retained loss for the financial year	(250.3)
Defined benefit pension scheme actuarial loss net of tax	(28.2)
Proceeds on the issue of shares	18.3
Dividends paid during the year	(97.8)
Other factors	0.7
Overall decrease in shareholders' funds during the period	(357.3)

Financial review continued

The Group's pension schemes' deficits increased in the year, despite good performance of the schemes' assets reflecting the general improvement in the stockmarket during the period. The gross actual return exceeded the expected return by over £165.3 million. This benefit was, however, more than offset by changes in financial assumptions, primarily a lower rate used to discount the scheme's liabilities, resulting in an increase in the gross pension scheme liability of £205.6m.

In accordance with IAS 10 *Events after the balance sheet date* and the amended UK Companies Act, the proposed final dividend for 2006 has not been reflected in these financial statements. The dividends charged against reserves of £97.8 million represent the final dividend for the year to 30 January 2005 and the interim dividend for the year to 29 January 2006.

In view of the financial performance of the Group during the current financial year, the Directors do not recommend an increase in the final dividend this year. The Directors therefore propose to maintain the final dividend at 3.075 pence per ordinary share. Subject to approval at the forthcoming Annual General Meeting the dividend will be paid on 30 May 2006 to shareholders on the register on 28 April 2006 and will be charged to shareholders' funds next year.

A full reconciliation of the movements in shareholders' funds is given in the notes to the financial statements.

Cash flow, capital expenditure and net debt

Despite the loss for the financial period, the Group generated cash from its operations and from the Safeway stores disposal programme in the year. Cash generated from operations was £311.0m after adding back non-cash depreciation of £256.9m and working capital benefits of £218.1m. Cash realised from the sale of stores, and subsidiaries was £460.2m.

The Group concluded the programme of converting Safeway stores to Morrisons in the year, opened 7 new Morrisons stores and also expanded its distribution and manufacturing infrastructures to support the enlarged business. 160 stores were converted in the year, at a capital cost of £320.4m. This programme was more than a change of signage and brand labels; it also addressed maintenance and layout issues to bring the stores to the high standards of the Morrisons estate. The construction of the new stores, a new 702,000 square foot distribution facility in the Midlands, the new head office building, and the acquisition of new baking facilities were the principal other investments, totalling £246.4m. Additionally, investment took place in assets due to open in the future, including new stores and the Group's new head office in Bradford. A total of £190.3m included in property, plant and equipment at the balance sheet date was for assets in the course of construction.

The Group's net debt reduced, marginally, to £1.15bn.

Impairment judgements concerning assets

The carrying values of assets are required to be tested annually for indications of impairment, and the Group undertakes this in the second half of the year. If these tests indicate that the value in use (as measured by discounted cash flows) or the market values of individual assets, or appropriate groups of assets, fall below their carrying value, then an impairment provision is required.

These tests and the judgements required in performing them and drawing conclusions are both complex and, because of the high carrying values of the Group's assets, highly significant to the financial statements. The Directors consider all relevant factors, both internal and external, in order to determine if there are circumstances or events that indicate that an impairment may exist.

Following the acquisition of Safeway, the Group has undertaken a significant disposal programme which has provided support for the fair values ascribed to the assets acquired. Approximately 20 stores remain to be sold, and the Directors are confident that the carrying value of these will be met by disposal proceeds.

The Directors have considered carefully the current trading and operating performance of the Group and its future prospects. Plans are in place to enhance trading and operational efficiency in the coming three years, and using the cash flows anticipated from this they have concluded that the individual carrying values of stores and other operating assets are supportable either by value in use or market values. They have also concluded that the overall value of goodwill created on the Safeway acquisition, of £103.2m, is not supportable and should therefore be written off.

The Directors intend to keep this issue under review until such time as the Group has returned to an appropriate level of reported profit.

Treasury management

Part of the change programme for the finance function is the creation of a treasury management function. A Head of Treasury and Taxation, and a Treasury Manager, have been recruited and will establish suitable treasury practices and policies that are appropriate for the governance of a listed company of this size and nature.

Financial instruments and financial risks associated with debt

The Group manages its borrowings and exposure to interest and foreign currency on instruments issued by using derivative financial instruments. The Group finances its operations with a combination of bank loans and bonds.

The foreign currency exposure is always covered on debt denominated in a foreign currency and during the year the interest exposure has been managed with interest rate swaps converting a portion of the Group's fixed rate interest to floating. These swaps were in existence at the time of the Safeway acquisition and relate to the risk associated with the bonds acquired through the acquisition of that group.

Credit rating

The Group's bonds, issued by Safeway Ltd, are publicly traded and rated by Moody's who downgraded their rating from Baa1 to Baa2 in January 2006, and maintain the rating on watch.

Defined benefit pension scheme liabilities

The consolidated defined benefit pension scheme deficit increased by £8.1m from £408.1m at 30 January 2005 to £416.2m at 29 January 2006. This increase can be analysed as follows:

£m	Assets	Liability	Total
At 30 January 2005	1,216.9	(1,625.0)	(408.1)
Actual return on assets	248.5	–	248.5
Interest and service cost charges	–	(143.1)	(143.1)
Actuarial loss	–	(205.6)	(205.6)
Contributions paid into the scheme	105.0	(12.9)	92.1
Benefits paid	(34.6)	34.6	–
At 29 January 2006	1,535.8	(1,952.0)	(416.2)

The actual return on assets exceeded the expected return by £165.3m reflecting the improvement in the stockmarket during the year and the fact that 78% of scheme assets were held in equities. The improvement in the asset valuation was more than offset by the actuarial loss in the year of £205.6 million, mainly as a result of the rate applied to discount the pension scheme liabilities decreasing by 0.5%.

In accordance with advice received from the Group's actuaries, the Directors have approved the adoption of the PA92 C2020 mortality table for the purposes of calculating the pension scheme's liability that has been included in the financial statements at the beginning and the end of the period. The Directors consider that, statistically, this table gives the best indication of the life expectancy of pension scheme members, taking into account their employment history, lifestyle and job location.

In accordance with annual practices, the status and ongoing funding of the Group's defined benefit schemes will be subject to further review in 2006/07.

Directors' report

The Directors have pleasure in presenting their report and the Group's audited financial statements for the 52 weeks ended 29 January 2006.

Principal activity

The principal activity of the Group is the operation of retail supermarket stores and associated activities.

Review of the year

A review of the Group's activities is presented in the Chief Executive's operating review.

Result and dividend

The loss for the period after taxation amounted to £250.3m.

The Directors have declared the following dividends:

	£m
Paid interim dividend of 0.625p per share (2005: 0.625p)	16.6
Proposed final dividend of 3.075p per share (2005: 3.075p)	82.2

Employment policy

The Group's comprehensive employment policies cover recruitment, selection, retention, remuneration, education, development and equality. The harmonisation of these policies throughout the Group is a priority.

Employee involvement
Employees are kept as fully informed as possible about the activities of the business. This is achieved through internal publications, communications programmes, notice boards, briefings, local, regional and national consultative committees.

The Group recognises a number of trade unions and has a partnership agreement with USDAW.

The Group encourages employee involvement in the financial performance of the business through profit share and savings related share option schemes.

Equal opportunities
Equal opportunities are offered to all, regardless of race, colour, nationality, ethnic origin, religion, sex, marital status, sexual orientation, disability or age. All applicants and employees are treated equally in respect of recruitment, promotion, training, pay and other employment policies and practices. All decisions are based on merit. Reasonable adjustments will be made to accommodate those with special needs. Under no circumstances will discrimination against any individual or group be tolerated. All employees have access to confidential counselling provided by trained counsellors as part of our special complaints procedure.

The Group is conscious of its responsibility to society and to the local community in particular. Management is required to apply all of the Group's policies fully and diligently to ensure that the highest standards are maintained.

Disability
The Group gives full and fair consideration to applications for employment made by people with disabilities. Where an employee becomes disabled whilst in employment, every effort will be made to look at appropriate and reasonable adjustments and to offer suitable employment together with assistance in retraining.

Auditors

In accordance with Sections 385 and 390A of the Companies Act 1985, a resolution to re-appoint KPMG Audit Plc as auditors and to authorise the Directors to set their remuneration is to be proposed at the forthcoming Annual General Meeting.

Borrowing powers

The Articles of Association of the Company restrict the borrowings of the Company and its subsidiary undertakings to a maximum amount equal to twice the share capital and consolidated reserves.

Annual General Meeting

12 ordinary and 3 special resolutions will be proposed at the Annual General Meeting. Details of these resolutions are set out in the notice of meeting. The Directors believe each of these resolutions is in the best interests of the Group and recommend shareholders to vote in favour of all of them as they intend to do in respect of their personal beneficial holdings of 113,248,544 ordinary shares of the Company.

Share capital

The following resolutions will be proposed at the Annual General Meeting:

- Resolution 13 (a special resolution) to renew until the close of the next Annual General Meeting the authority given at the Annual General Meeting held on 26 May 2005 for the Company to buy its ordinary and convertible preference shares on the London Stock Exchange up to a maximum of 151,900,000 ordinary shares of 10p each ("ordinary shares") and 42,061 5¼% cumulative redeemable convertible preference shares of £1 each ("convertible preference shares") representing approximately 5.7% and 10% respectively of the issued share capital in each class of shares.

- Resolutions 14 (an ordinary resolution) and 15 (a special resolution) to enable the Directors to continue to exercise existing powers to allot unissued shares and to allot shares for cash otherwise than to existing shareholders pro-rata to their holdings. These resolutions replace the resolutions passed at the Annual General Meeting of the Company held on 26 May 2005 and will run until the close of the next Annual General Meeting. The intention is to renew and roll them forward by one year at each future Annual General Meeting. Under resolution 14 the Directors will be authorised to allot the unissued ordinary share capital of the Company (representing approximately 30% of the issued ordinary share capital). Resolution 15 authorises the Directors to allot equity shares for cash otherwise than pro-rata to ordinary shareholders. They may do so only in respect of shares representing up to 5% of the issued ordinary share capital, in connection with the conversion of the convertible preference shares or to facilitate rights issues of ordinary shares.

Save for the issues of shares under the share option schemes or on conversion of the convertible preference shares, there is no present intention to make use of either authority and the resolutions are being proposed only to ensure that the Directors are able to act in the best interests of the Company should a requirement arise. Any shares purchased pursuant to the authority contained on resolution 13 will be cancelled or held in treasury (see note 24).

Regulations introduced in 2003 enable listed companies to hold their own shares, once purchased, in treasury, as an alternative to cancelling them. Shares held in treasury may be cancelled, sold for cash or used to satisfy share options and share awards under employee share schemes. The Company is not entitled to exercise any rights, including the right to attend and vote at meetings in respect of the shares and no dividend or other distribution may be made in respect of the shares. It may be appropriate for the Company to hold its own ordinary shares in treasury, rather than cancelling them if the Directors exercise the authority conferred by resolution 13. Your Board will have regard to any guidelines which may be published by investor groups in considering any purchase, holding or resale of treasury shares.

The approval of the holders of the convertible preference shares to the purchase of shares pursuant to the authority contained in resolution 13, and any renewal of further grant of that authority on like terms, was given at a separate meeting held on 13 May 1999.

Under provisions of the Company's Articles of Association, the holders of convertible preference shares in the Company have the right to convert such shares during June in each year up to 2006 into ordinary shares. The convertible preference shareholders will shortly receive a letter regarding their rights of conversion in 2006.

During the period a total of 83,184 convertible preference shares were converted into 279,498 ordinary shares on the basis of 336 ordinary shares for every £100 nominal amount of convertible preference shares in accordance with the terms of issue of the convertible preference shares. In addition, 14,719,881 ordinary shares were issued to employees exercising share options. In the period 30 January 2006 to 22 March 2006 options in respect of 1,169,423 ordinary shares were exercised.

At the Annual General Meeting of the Company held in 2005, a special resolution was passed to authorise the purchase by the Company of up to 151,900,000 ordinary shares and 50,379 convertible preference shares representing approximately 5.7% and 10% of the issued share capital of each class of shares respectively at that time. This authority remained valid on 29 January 2006. The Company has not purchased any of its own shares pursuant to that authority which will expire at the close of the 2006 Annual General Meeting.

At 22 March 2006 options to subscribe for shares in respect of 19,468,288 ordinary shares of 10p each in the company were outstanding, representing 0.73% of the issued ordinary share capital at that date and 0.77% of the issued ordinary share capital assuming exercise in full by the Company of its authority (both current and that being sought at the Annual General Meeting) to purchase its own shares and cancellation of such shares on purchase.

Substantial shareholdings

As at 22 March 2006 the Company was aware that the following shareholders (excluding Directors) had interests in 3% or more of the issued share capital of the Company:

Ordinary shares

As at 22 March 2006 the Company had been notified of the following notifiable interests in its ordinary shares:

Brandes Investment Partners LLC 372,263,113 (14.0%), Franklin Resources Inc. 98,206,056 (3.7%), Walter Scott & Partners Ltd approximately 89,000,000 (3.3%) and Zurich Financial Services 80,233,241 (3.0%).

In addition, Mr A R Wilson has an interest in 235,026,149 (8.8%) of which he has a beneficial interest in 21,628 ordinary shares. His interest in the remaining 235,004,521 ordinary shares is purely as a trustee and includes 11,991,012 ordinary shares shown under the beneficial holding of K Morrison.

K Morrison is interested as a trustee in 170,764,597 of the ordinary shares held by Mr A R Wilson as a trustee.

Directors' report continued

Directors and their interests

The Executive and Non Executive Directors of the Group during the period were:

Executive Directors

Sir Kenneth Morrison CBE (b 20.10.1931)
Executive Chairman
Has been with the Group, which bears the name of his father, since finishing national service in 1952 and was Chairman and Managing Director from 1956 to 1997 at which time he relinquished the Managing Director's role. During his period in charge the Group has grown from a small market trader to one of the leading superstore operators in the country. Sir Kenneth was awarded the CBE in 1990 and knighted in the 2000 New Year's honours list for services to the food retailing industry. He is the Chair of the Nomination Committee.

Robert Stott (b 22.03.1943)
Chief Executive
Originally joined the Group in 1973 after 10 years with Pedigree Petfoods. He was appointed to the Board in 1977 and became Deputy Managing Director in 1983. In 1987 he left to become Managing Director at Geest Wholesale Services and later Geest UK Banana Division before returning to the Group in 1996. He was re-appointed to the Board in 1997 as Buying Director and became Joint Managing Director in March 2002. In March 2005 he was appointed as the Group's first ever Chief Executive.

Marie Melnyk (b 10.06.1958)
Managing Director
Joined the Group in 1975 and became Produce Director when appointed to the board of management in 1987. She was closely involved with the setting up of the central grocery facility at Wakefield, becoming Trading Director in 1988 and was appointed, to the Board in 1993 being responsible for buying and marketing. She was appointed Deputy Managing Director in 1997, became Joint Managing Director in March 2002, and was appointed as sole Managing Director in March 2005.

Mark Gunter (b 01.07.1958)
Store Operations Director
Mark joined the Group in 1986 after gaining wide experience in UK food retailing, including working for Iceland, Fine Fare, Tesco and Argyll Foods. He moved into superstore management at Asda before joining Morrisons as a Store General Manager and progressing to District Manager. In 1993 he was appointed Regional Director and subsequently Stores Director in 1999. He was appointed to the Board of the Group in 2000 as Store Operations Director with additional responsibility for retail operations, retail projects and company wide security.

David Hutchinson (b 24.12.1948)
Production Director
Joined the Group in 1986 and spent 7 years helping to build up the produce business at Cutler Heights. In 1993 he was appointed to the board of management in charge of all manufacturing and pack house activities. He was appointed to the Board of the Group in 2002 adding warehouse and distribution functions to his responsibilities.

Roger Owen (b 21.10.1948)
Property Director
Has been with the Group since 1975 and was appointed Building and Services Director in 1979. He joined the Board in 1987 as Property Director and has full responsibility for site acquisition, construction and estate management.

Richard Pennycook (b 26.02.1964)
Group Finance Director
Joined the Group in October 2005 after working as Group Finance Director of RAC Plc, the quoted specialist motoring and vehicle management company. A qualified accountant and member of the Society of Turnaround Professionals, he has been involved as Finance Director in turnarounds of H P Bulmer Holdings plc, Welcome Break Holdings Ltd and Laura Ashley plc. Other previous roles include Finance Director of J D Wetherspoon plc and various senior positions in Allders plc.

Non Executive Directors

David Jones CBE (b 02.02.1943)
David Jones was appointed Chief Executive of Next Plc in 1988, becoming Deputy Chairman in 2001 and Chairman in 2002. His previous experience includes twenty years with Great Universal Stores and five years as Chief Executive of Grattan. He joined the Board in May 2004 and was appointed Deputy Chairman in March 2005. He is a member of the Audit, Nomination and Remuneration Committees.

Brian Flanagan (b 03.08.1952)
Brian Flanagan joined the Group as a Non Executive Director in July 2005. He is a member of the Audit, Nomination and Remuneration Committees. Previously he has worked for the Mars Corporation for twenty six years and possesses a broad international business experience. He has held senior management positions in finance, information systems, manufacturing, purchasing and was, most recently, the global Vice President of Business Transformation for Mars Inc. He is also a Non Executive Director of PNSL Ltd.

Paul Manduca (b 15.11.1951)
Paul Manduca joined the Group as a Non Executive Director in September 2005. He is a member of the Audit, Nomination and Remuneration Committees and became the Chair of the Audit Committee from 20 October 2005. Most recently he was Deutsche Asset Management's European Chief Executive. He was previously Chief Executive of Rothschild Asset Management and the founding Chief Executive of Threadneedle Asset Management. He is a former director of MEPC plc and a current director of Development Securities Plc and Aon UK as well as a number of other companies.

Susan Murray (b 16.01.1957)
Susan Murray joined the Group as a Non Executive Director in July 2005. She is a member of the Audit, Nomination and Remuneration Committees and became the Chair of the Remuneration Committee from 20 October 2005. Currently she is a Non Executive director of SSL International Plc, Enterprise Inns Plc, and Imperial Tobacco Group Plc. She was formerly Chief Executive of Littlewood Stores Ltd.

Nigel Robertson (b 16.11.1959)
Nigel Robertson joined the Group as a Non Executive Director in July 2005. He is a member of the Audit, Nomination and Remuneration Committees. Currently he is the Chief Executive Officer of Chelsea Stores Holdings Ltd. He was previously Managing Director of Ocado, the online grocery shopping business set up in partnership with Waitrose. Prior to this he held senior positions in Marks and Spencer Plc both in the UK and USA.

M Gunter (aged 47) and R Stott (aged 63) each retire by rotation and R Pennycook (aged 42), B Flanagan (aged 53), P Manduca (aged 54), S Murray (aged 49) and N Robertson (aged 46) retire at the first Annual General Meeting following their appointment. Each of them, being eligible, offer themselves for re-election at the Annual General Meeting.

Directors' interests

The interests of the Directors and their families in the shares of the Company (including percentages where holdings are over 3%) were as follows:

	29 January 2006		30 January 2005	
Beneficial	Ordinary shares	Options to purchase ordinary shares	Ordinary shares	Options to purchase ordinary Shares
M Gunter	38,492	880,000	12,200	914,300
D Hutchinson	99,812	680,000	85,512	694,300
M Melnyk	668,714	1,120,000	494,414	1,294,300
K Morrison	111,721,737 (4.2%)	1,110,000	109,723,887 (4.1%)	1,110,000
R Owen	482,178	880,000	582,178	880,000
R Pennycook	–	–	–	–
R Stott	192,611	710,000	174,844	724,300
D Jones	45,000	–	45,000	–
B Flanagan	–	–	–	–
S Murray	–	–	–	–
P Manduca	–	–	–	–
N Robertson	–	–	–	–
Non Beneficial				
K Morrison	159,045,864 (6.0%)		159,109,829 (6.0%)	

There were no changes in the above interests in the period from 30 January 2006 to 22 March 2006.

Political and charitable donations

During the period the Group made charitable donations amounting to £0.2m. In addition the Group sponsored various charities and in the year over £1.7m was raised by customers and staff. No political donations were made, which is Group policy.

Going concern

After reviewing the Group's funding arrangements, Optimisation Plan and other medium term plans, the Directors are confident that the Company and the Group have adequate financial resources to continue in operational existence for the foreseeable future. The going concern basis has continued to be adopted in the preparation of the financial statements.

Payment to creditors

Supplier credit is an important factor in the success of the business. The Company will, as previously acknowledged, work within the spirit and letter of the supermarkets' code of practice. The Company will continue with its policy to ensure all payments are made within mutually agreed credit terms. Where disputes arise the Company attempts to sort these out promptly and amicably to ensure delays in payment are kept to a minimum. Creditor days outstanding for the Company at 29 January 2006 were 37 (2005: 39).

Directors' report continued

Health and safety policy

It is the Group's intention, so far as is reasonably practicable, to ensure the health, safety and welfare of all its employees, customers and visitors to its premises. In order to achieve this, a comprehensive health and safety manual is in place for each division of the Company and subsidiary companies within the Group. Each health and safety manual contains the policy and procedures for complying with the Health and Safety at Work Act 1974, including the provision, based on risk assessment, of safe working practices for all work activities across the Group.

The Group's health and safety policy is approved by the Executive Board. The Group has adopted the national targets set by the Health and Safety Commission for the reduction of workplace accidents and work-related ill health, and is on course to meet or exceed these targets. Health and safety performance is monitored to ensure continuous improvement in all areas.

Post balance sheet events

The Directors are proposing a final dividend in respect of the financial period ending 29 January 2006 of 3.075p per share which will absorb an estimated £82.2m of shareholders' funds. It will be paid on 30 May 2006 to shareholders who are on the register of members on 28 April 2006.

8 properties were disposed between 29 January 2006 and 22 March 2006, realising disposal proceeds of £44.9m.

By the order of the Board
Jonathan Burke
Company Secretary

22 March 2006

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the Group and Parent Company financial statements, in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Parent Company financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the Parent Company financial statements in accordance with UK Accounting Standards.

The Group financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and performance of the Group; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The Parent Company financial statements are required by law to give a true and fair view of the state of affairs of the Parent Company.

In preparing each of the Group and Parent Company financial statements, the Directors are required to:

- Select suitable accounting policies and then apply them consistently.
- Make judgments and estimates that are reasonable and prudent.
- For the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU.
- For the Parent Company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Parent Company financial statements.
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the Parent Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Parent Company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that comply with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Corporate governance report

This report explains the Board's application of the principles contained within the Combined Code and the interpretations that form best practice in governance matters. The composition of the Board changed significantly during the year, enabling progress to be made in the establishment of good practice principles of governance. This report highlights the improvements made and, where non-compliance continues, provides an explanation for the non-compliance and a statement of the Board's intentions in this regard.

The Board

The Board has adopted a formal schedule of matters reserved for it. These include:

> Responsibility for setting the strategic direction of the Group.

> Approval of the annual budget.

> Material changes to the Group's overall management and control structure.

> Approval of the Annual Report and Interim Report.

> Approval of all circulars, listing particulars, resolutions and correspondence sent to shareholders.

> Approval of any material capital projects, investments, acquisitions or disposals.

> Approval of any significant changes to accounting policies or practices.

> Approval of any material changes to capital structures and issue of equity securities.

> Approval of dividend policy.

> Approval of treasury policy including foreign currency and interest exchange risk.

> Approval of any material changes to the pension scheme rules including any changes to funding and management arrangements.

> Making recommendations to the shareholders for the appointment, re-appointment or removal of the external auditors, having considered proposals put forward by the Audit Committee.

> Oversight of the Group's risk management and internal control strategy including consideration of recommendations put forward by the Audit Committee.

> Review of the Group's overall corporate governance strategy and structure.

> Approval of the Group's corporate principle policies.

In previous years, when the Board comprised only long serving executive directors, many of these matters were dealt with informally. With the arrival of new directors it has been recognised that good governance principles require the adoption of more formal policies and procedures, and these are being put in place. Of the matters set out above, the Board is awaiting the appointment of a new Chief Executive prior to developing a strategic plan for the Group. Work is under way, but not complete, in developing an investment appraisal process (including capital) and in defining a treasury policy.

Day to day management of the Group is delegated to the Executive Chairman and Chief Executive, the Executive Board and an operations board of other senior managers. Matters regularly covered at Board meetings include reports from each of the main departments of the business – Store Operations, Trading, Property, Personnel, Information Technology, Finance and Legal. Subsidiary company board meetings are held frequently and attended by at least one executive member of the Board.

The split of Chairman's and Chief Executive's roles is not formally defined, reflecting the long working relationship between the two incumbents (Combined Code A.2.1). The Board has agreed that formal role definitions will be put in place ahead of the appointment of a new Chief Executive.

Board balance and independence

The Board currently comprises the Executive Chairman, an independent non executive Deputy Chairman, four other independent Non Executive Directors and six Executive Directors. Details of these Executive and Non Executive Directors, together with biographical details, are set out in the Directors' report on pages 14 to 16.

The Board is mindful of Section A.3.2 of the Combined Code, and its recommendation that independent non executives should comprise a majority of the Board. The Board intends to build on the progress that has been made in the past year towards full compliance, and will pay regard to the current lack of recent and relevant financial experience amongst the Non Executives.

The Board considers all its Non Executive Directors to be independent in character and judgement. No Non Executive Director:

> Has been employed by the Group within the last five years.

> Has had a material business relationship with the Group within the last three years.

> Receives remuneration other than director's fees.

> Has close family ties with any of the Group's advisers, directors or senior employees.

> Holds cross-directorships or has significant links with other directors through involvement in other companies or bodies.

> Represents a significant shareholder.

> Has served on the Board for more than nine years.

Corporate governance report continued

The engagement letters for Non Executive Directors stipulate that their minimum time commitment is based on one day per month attendance of meetings, attendance at the AGM, Board away days and site visits plus adequate preparation time. No Non Executive Directors hold other positions that mean that they will not be able to fulfill these commitments and to contribute to the governance and operations of the Group.

The intention of implementing a formal assessment process of the Board, its Chairman, members and committees as reported last year has been deferred for completion in the coming year (Combined Code A.6.1). This year's focus was diverted to recruiting and inducting sufficient numbers of Non Executive Directors to provide the Board with appropriate experience and challenge, and to ensure that all the committees of the Board comply with the principles of the Combined Code.

With the appointment of four Non Executive Directors, Brian Flanagan, Paul Manduca, Susan Murray and Nigel Robertson the composition of the Board's committee membership is as follows:

		Current committee membership and role		
Name	Status	Nomination	Audit	Remuneration
Sir Kenneth Morrison	Chairman Executive Director	X		
David Jones	Deputy Chairman, Non Executive, Independent Director	X	X	X
Brian Flanagan	Non Executive Director	X	X	X
Paul Manduca	Non Executive Director	X	X	X
Susan Murray	Non Executive Director	X	X	X
Nigel Robertson	Non Executive Director	X	X	X

The Board met 15 times in the year. The Directors attended the following numbers of Board meetings and committees:

	Board	Nomination	Audit	Remuneration
Number of meetings	15	1	6	3
Sir Kenneth Morrison	15/15	1/1		1/1
David Jones	11/15	1/1	3/6	1/3
Robert Stott	14/15			1/1
Marie Melnyk	15/15			
Martin Ackroyd	5/6			
Mark Gunter	14/15			
David Hutchinson	14/15			
Roger Owen	14/15			
Richard Pennycook	4/4			
Duncan Davidson	0/3			
Brian Flanagan	7/7	1/1	6/6	2/2
Paul Manduca	4/4	1/1	6/6	2/2
Susan Murray	7/7	1/1	6/6	2/2
Nigel Robertson	7/7	1/1	5/6	1/2

Nominations Committee

During the year the Nominations Committee had to fill a number of positions on the Board – both executive and non executive. In its selection process for all positions, recruitment agencies were used to provide short-lists of suitable candidates that met the requirements of the Group's business and the need to move towards a balanced board.

Richard Pennycook was appointed as Group Finance Director, and Brian Flanagan, Paul Manduca, Susan Murray and Nigel Robertson as Non Executive Directors.

The terms and conditions of appointment of each Director will be available for inspection at the AGM, and they are also available for inspection during normal business hours at the Company's registered office.

From October 2005, with the recruitment of additional Non Executive Directors, the Nominations Committee is now formed of the Non Executive Directors (Brian Flanagan, David Jones, Paul Manduca, Susan Murray and Nigel Robertson) and chaired by Sir Kenneth Morrison. The terms of reference for this committee were formalised in October 2005 and are available on the Group's website.

The activities of this committee are currently focused on searching and selecting a new Chief Executive.

Remuneration Committee

From October 2005 the members of the Remuneration Committee are Susan Murray (Chairman), Brian Flanagan, David Jones, Paul Manduca and Nigel Robertson. The Board is satisfied that the composition of the Remuneration Committee meets the requirements of the Combined Code.

Details of the activities of the Remuneration Committee are included in its separate report on pages 22 to 29.

Audit Committee

From October 2005 the members of the Audit Committee are Paul Manduca (Chairman), Brian Flanagan, David Jones, Susan Murray and Nigel Robertson. Robert Stott (Chief Executive), Richard Pennycook (Group Finance Director) and the external auditors also attend as required. The Board is satisfied that all members of the Audit Committee are independent as defined by the Combined Code.

The Combined Code C.3.1 defines that at least one of the members of the Audit Committee should have recent and relevant financial experience. None of the Audit Committee members meet the current interpretation of the required criteria. The Company Secretary, at the request of the Chairman of the Audit Committee, has engaged PricewaterhouseCoopers (PwC) to advise the Audit Committee on the various papers submitted for their consideration, until such time as this issue is addressed within the longer term objective of Board balance. The Board considers that the composition of the Audit Committee, combined with the level of support given by PwC, is sufficient to review adequately the financial position and governance of the Group.

The core remit of the Audit Committee, which is set out in the terms of reference, is to review and report to the Board on:

- The integrity of the Group's financial statements and any announcements relating to the Group's financial performance, including reviewing any significant financial judgements and critical accounting policies contained in them.
- All material information presented within the financial statements, such as the financial review and this governance statement.
- Its recommendation for the appointment, re-appointment and/or removal of the external auditor and approving their remuneration.
- The terms of engagement of the external auditor in the supply of non-audit services.
- The external auditor's independence and the effectiveness of the audit process.
- The effectiveness of the Group's Internal Audit and Risk Function (once it has been established – Combined Code C.3.5).
- Complaints of a financial, audit or risk nature and the treatment of these complaints that have been raised through the Group's "Whistleblower" processes (once these have been established – Combined Code C.3.4).

The full terms of reference are posted on the Group's website www.morrisons.co.uk.

The Committee reports its activities and makes recommendations to the Board. Since October 2005 the Audit Committee has discharged its responsibilities as described above by:

- Accepting the Group Finance Director's recommendation for the formation of an Internal Audit and Risk function which was authorised by the Board in September 2005. This function will be responsible for:
  - formalising the audit and risk framework that supports the Audit Committee.
  - developing a formal audit programme for the review of internal control procedures and processes throughout the Group.
  - implementing Whistleblower processes.
- Assisting with the recruitment for the Head of Internal Audit and Risk function by assessing and recommending suitable candidates through the selection process.
- Implementing policy for the pre-approval of all audit services, non audit-related services to be provided by the external auditor and tax services. The principle purpose of these policies and procedures is to ensure that the independence of the external auditor is not impaired. These procedures, which will be fully adopted from 30 January 2006, permit certain audit, audit-related and tax services to be performed by the external auditor, subject to fee limits agreed with the Audit Committee in advance.
- Recommending the engagement of PwC to assist with the preparation of the Annual Report in the required format under International Financial Reporting Standards (IFRSs), in line with the non-audit services policy.
- Reviewing the financial disclosures contained in the Group's Annual Report.
- Reviewing the Group's critical accounting policies including the changes required in order to implement IFRS.
- Reviewing reports from the external auditors concerning their audit of the financial statements of the Group and its subsidiaries.
- Reviewing reports from management on the Group's general financial risk in completing the financial statements and the management of that risk.

In line with normal practice, the Audit Committee holds private meetings with the external auditors, without management present. The purpose of these meetings is to understand their views on the control and governance environment and management's effectiveness within it.

Internal control

As reported last year, the impact of the Safeway acquisition put significant strain on the existing financial resource and control environment. This made it more difficult for the Board to forecast reliably likely trends in profitability and to obtain a full understanding of some underlying trading balances. The auditors were appointed to investigate these issues and to support the Board in its obligation to provide adequate financial guidance to the markets. The Board provided profit guidance in June 2005 relating to the year to 29 January 2006, and the actual results set out in these financial statements are consistent with that guidance.

The Directors are responsible for setting a system of internal controls for the Group and reviewing their effectiveness.

The new Group Finance Director identified the need to strengthen the structure and quality of the team within Finance. A new, deeper Finance structure has been authorised and is being implemented. This incorporates five new senior positions including an internal audit and risk function. Experienced interim managers have initially filled these positions as well as giving the additional support required for the change activities within Finance. The new top team in Finance will formalise a risk assessment and management process for the Group, will review and upgrade the quality of financial reporting, will develop formal treasury policies and, in due course, will implement robust accounting systems.

During the year the Finance function successfully dealt with the integration of accounting systems as part of the stores conversion programme, implemented a new forecasting and planning process (initially commenced following the KPMG review notified at last year's AGM and leading to completion of the Group's Optimisation Plan), converted the Group's financial statements to IFRSs (conversion announcement 17 November 2005), implemented a new process to identify, mitigate and report to the Audit Committee risks that arise in financial processes and implemented a new, Board approved, format for management accounts.

These activities combined with the normal process for identifying and evaluating the significant risks in the Group means that the Board has reviewed the internal control processes of the Group during the year and is satisfied that the systems are designed to provide the Board with accurate and timely information as to the financial performance of the Group, and to reduce, as far as possible, the risk of failure to achieve business objectives and of material misstatement or loss.

Auditors' independence

In December 2005 the Audit Committee implemented a new policy that defines the non-audit services that the auditor may perform. This policy is effective from the new financial year and will mean that the Group is compliant with the APB's Ethical Standard no.5. The non-audit services work is split into:

- Work where the auditor is preferred supplier (e.g. reports on internal controls or governance where they do not have to investigate their own work).
- Work where the auditor is one of many potential suppliers (e.g. certain corporate finance services).
- Work where the auditor will only be used in exceptional circumstances and there is no practical alternative (e.g. assisting in forecasting work).
- Work where the auditor cannot be used (e.g. support to the Audit Committee).

KPMG have confirmed to the Audit Committee that they were compliant with APB's Ethical Standards in relation to the audit engagement throughout the year. Non-audit services provided in the year that could be perceived to impact independence were:

- The review of the Group's forecasting procedures announced at the time of the AGM.
- Assistance with the financial modelling of the Group's Optimisation Plan.
- Tax compliance.

To ensure independence was maintained for non-audit work the auditors put in place the following safeguards:

- Use of separate engagement directors and teams.
- Use of senior independent consultation partners.
- Regular reporting to informed management.
- No audit reliance on outputs.

Shareholder relations

The Group maintains regular contact with institutional shareholders throughout the year. To support and improve this communication process the position of Investor Relations Director was created and filled in October 2005. This role is responsible for understanding the requirements of institutional and major investors, reporting them to the Board and ensuring that these information requirements are reasonably met.

During the year the Senior Independent Director and other Non Executive Directors held a number of meetings with major shareholders in order to develop a balanced understanding of their views and concerns. These were reported back to the Chairman and the Board.

All Directors, Executive and Non Executive Directors attend the AGM. The Chairmen of the Audit, Nominations and Remuneration committees are available to answer questions.

Directors' remuneration report

The Group is required by the Companies Act 1985 to prepare a Directors' remuneration report for the 52 weeks ended 29 January 2006 and to put that report to a shareholder vote. A resolution to approve this report will be proposed at the Annual General Meeting of the Group to be held on 25 May 2006.

The auditors are required to report on part of the Directors' remuneration report and to state whether in their opinion that part of the report has been properly prepared in accordance with the Companies Act 1985. The report has therefore been divided into separate sections for audited and unaudited information.

Unaudited information

Remuneration Committee membership, advisers and terms of reference

Following the appointment of four new Non Executive Directors, from 20 October 2005, the committee has been constituted in accordance with the Combined Code and is now composed entirely of independent Non Executive Directors. The terms of reference of the committee are available from the Company Secretary on request and on the website – www.morrisons.co.uk.

The committee is chaired by Susan Murray, with its other members comprising Brian Flanagan, David Jones, Paul Manduca and Nigel Robertson. No member has any personal financial interest in the matters being considered. Sir Kenneth Morrison and the Chief Executive attend meetings at the invitation of the committee except if their own remuneration is being discussed. Details of attendance at the committee meetings are shown on page 18.

During the year, the committee received independent advice from Jardine Lloyd Thompson in respect of pensions; Ashurst and Gordons in respect of Executive Directors' contracts; and from November 2005 New Bridge Street Consultants LLP in connection with all remuneration related matters.

Remuneration policy

The committee's key objectives are to: determine and recommend to the Board, within the agreed terms of reference, an overall remuneration package for the Executive Directors (a reference which includes the Chairman throughout this report) and to monitor the level and structure of remuneration for senior management.

Historically, Executive Directors have received a base salary and certain other benefits, including pensions. In addition, they participate in the Group's profit sharing scheme along with all employees and were granted options under the 1995 Senior Executive Share Option Scheme.

In June 2005, the committee identified that the Directors' remuneration packages were not fully competitive and that it was necessary to make some adjustments to ensure that the Directors were retained and motivated to drive the Group's recovery. At this time the Directors' responsibilities and workloads had increased significantly and the Group faced particular challenges integrating Safeway and retaining key members of the executive team. The committee was also mindful that it had found it necessary to offer extra contractual protection to the incoming Group Finance Director for a limited period, and it considered that the task of integrating the senior executive team could be made more difficult if his terms were substantially different to other Executive Directors. Accordingly, base salaries were increased and the Directors' service contracts were amended so that they would receive two times the annual value of certain elements of their remuneration and benefits in the event of a termination of their employment in certain circumstances before 1 July 2007.

In October 2005, after the committee had been reconstructed and was fully independent, it reconsidered the remuneration policy with full reference to Schedule A of the Combined Code on Directors' Remuneration. In particular, in setting pay levels and structures it gave regard to:

- What comparable companies were paying.
- Pay and employment conditions elsewhere in the Group.
- Avoiding paying more than is necessary.

The committee commissioned a comprehensive and independent review of the Directors' individual remuneration packages with comparisons made against listed retailers and other plc's of broadly similar size. The review identified that most Directors have above mid-market base salaries, but total remuneration is below mid-market due to the absence of an executive annual bonus plan and a long term incentive plan. As a result, the committee decided that going forward it wished to put in place remuneration structures which will enable the company to recruit, retain and motivate high calibre senior executives and that those structures will be more performance related. This will be achieved by moving progressively over time to:

- Base salaries around the mid-market starting with no further increases in the current financial year for Executive Directors.
- Introduce a competitive suite of annual and long-term incentives.
- Remove two times annual compensation provisions in contracts; replacing them with new 1 year service agreements.
- Limit pensionable pay to base salary only (see further below).

Base salary and benefits

Base salary is a fixed cash sum payable monthly in arrears.

Base salary levels changed with effect from 1 March 2005 following the review in June 2005 (unless otherwise indicated), and are as follows:

Sir Kenneth Morrison	£675,000
Robert Stott	£650,000
Marie Melnyk	£650,000
Mark Gunter	£500,000
David Hutchinson	£480,000
Roger Owen	£480,000
Richard Pennycook (with effect from 1 February 2006)	£480,000

Mindful of the need to set the right balance in Executive Directors' packages, and to ensure the ability to attract, retain and motivate the quality of management required by the business, the policy is, in the future, to move towards setting around mid-market salaries in the context of fully competitive total packages with a substantial proportion being subject to the performance of the business and individuals. The committee will have regard to the following when reviewing salary levels:

- The performance of the individual concerned, together with any change in responsibilities that may have occurred.
- The rates for similar roles in comparator companies (both direct retail competitors and more generally in UK based companies of a similar size and complexity).
- Avoiding where possible the automatic ratcheting effects of following "median" or "upper quartile" levels of salary derived from comparator company analyses.

Benefits include health insurance, vehicle running costs, telephone expenses and relocation expenses in connection with Executive Directors relocating to the Yorkshire area.

Annual bonus

The committee has developed a bonus plan appropriate for Executive Directors for the 2006/07 financial year to reinforce the strategy identified in the Optimisation Plan.

For 2006/07 the maximum bonus will be no more than 100% of base salary for those Executive Directors selected, at the discretion of the committee, for inclusion in the plan. Measurements will be based upon profit before taxation and personal objectives, as set out below:

Measures	% of Bonus Potential
Profit before tax, excluding exceptionals	80%
Personal objectives set by the committee	20%

In addition, no bonus will be payable for the achievement of personal objectives unless the minimum profit target has been achieved.

The committee will determine which Executive Directors will participate in the bonus plan and their level of participation. Future bonus plan design and participation will be determined after a review to be conducted by the committee when the new Chief Executive has been appointed.

All Employee Sharesave Scheme

The Group also operates a Sharesave Scheme approved by HM Revenue & Customs under which all eligible employees (including Executive Directors) may be invited to participate on similar terms. The Scheme allows participants to save up to a maximum of £250 each month for a fixed period of three or five years. At the end of the savings period, individuals may use their savings plus a tax free bonus to buy ordinary shares in the Company at a discount capped at 20% of the market price, set at the launch of the Scheme. It is intended that invitations will be made under the Scheme during the first half of the current financial year 2006/07.

Long-term incentives

No further grants of share options under the 1995 Senior Executive Share Option Scheme will be made as the Scheme terminated at the end of its 10 year life on 25 May 2005. Over the last 10 years the Company has issued options over 3.55% of the issued share capital.

During the transition to International Financial Reporting Standards (IFRS), the committee will ensure that a consistent basis is used in the measurement of performance conditions for all incentive plans.

The committee intends to develop a long term incentive plan when the new Chief Executive has been appointed and will seek shareholder approval for it in due course.

In the event that no such plan has been adopted and approved by shareholders in time for awards to be granted in the 2006/07 financial year, then to fulfil promises made to Richard Pennycook at the time of his recruitment, the annual bonus award made to him for 2006/07 will include, in addition to the cash element, a deferred share award. That award will be over shares in the Company with a value (using the average of the share price over the five dealing days prior to making the award) equal to two times the amount of any cash bonus he earns for the 2006/07 financial year. The deferred share award will normally vest on 1 April 2009 provided Richard Pennycook is then still an employee of the Group. Richard Pennycook will also be entitled on the vesting of his deferred share award to a payment in cash or shares equivalent to the dividends which would have been payable on the shares during the deferral period.

Directors' remuneration report continued

Pension arrangements
Each Executive Director (including the Chairman) is entitled to a pension equal to ⅔ of pensionable pay provided he or she has served on the Board of the Group for at least 20 years at normal retirement date, which in each case is on his or her 62nd birthday.

For periods of less than 20 years service, pension entitlement is accrued at the rate of 1/360th of pensionable pay for each month of service as a Director. This is in addition to any entitlement built up prior to being appointed to the board up to a maximum of ⅔ pensionable salary at age 62.

Pensionable pay is the Director's annual salary as at 6 April each year plus the amount of profit share earned in the tax year just ended but excluding any bonuses earned under the annual bonus plan for Executive Directors.

The accrued pension is that which would be paid annually on retirement at 62, based on service to 29 January 2006.

In the case of members joining the pension scheme prior to 1 June 1989 the pension payable is based on final pensionable pay calculated as the average of the highest 3 years pensionable pay in the Director's last 10 years of employment. For members joining the scheme after 31 May 1989 final pensionable pay is the lower of the average of the highest 3 years pensionable pay in the Director's last 10 years of employment and the maximum earnings limit which in 2005/06 is £105,600.

Marie Melnyk, Martin Ackroyd, David Hutchinson and Roger Owen joined the scheme prior to 1 June 1989. Mark Gunter and Robert Stott became members subsequent to that date. Richard Pennycook joined the scheme after year end but his contributions will be backdated to the commencement of his employment with the Company. Kenneth Morrison is in receipt of a pension from the scheme, in addition to his total emoluments shown on page 26. His pension amounted to £170,000 in the period.

In the event of death in service, a lump sum death benefit equal to three times the Director's pensionable pay at the date of death is payable. In addition, a spouse's pension equal to one quarter of the pensionable pay at the date of death will be paid. If a former Director in receipt of pension dies before the fifth anniversary of his retirement a lump sum equal to the payments he would have received over that period will be paid. If a former Director who dies is survived by a spouse that spouse will continue to receive a pension equal to one half of the pension payable at the time of death.

The pension arrangements for the Directors ensure that benefits provided are consistent with those provided by other companies in the market place. The expected cost of providing retirement benefits to the Directors is assessed in accordance with the advice of independent qualified actuaries. The pension arrangements include life assurance cover whilst in employment, an entitlement to a pension in the event of ill health or disability and a pension for the spouse and any dependant children on death. Profit share is included in the definition of pensionable pay for all members of the Group's pension scheme. This element of the Directors' remuneration is pensionable to ensure they receive benefits on the same basis as other members of the scheme.

No contributions were paid or are payable by any Directors under the terms of the scheme. There are no enhanced early retirement rights. Post-retirement pensions increase in line with the annual increase in the retail price index or by 5% per annum compound, whichever is the lower.

In addition to participating in the scheme, Richard Pennycook will receive a contribution of 10% of his base salary above the HM Revenue and Customs earnings limit.

Robert Stott will receive a pension payment for service from the age of 62 based upon a payment of 16% of pensionable pay into the scheme.

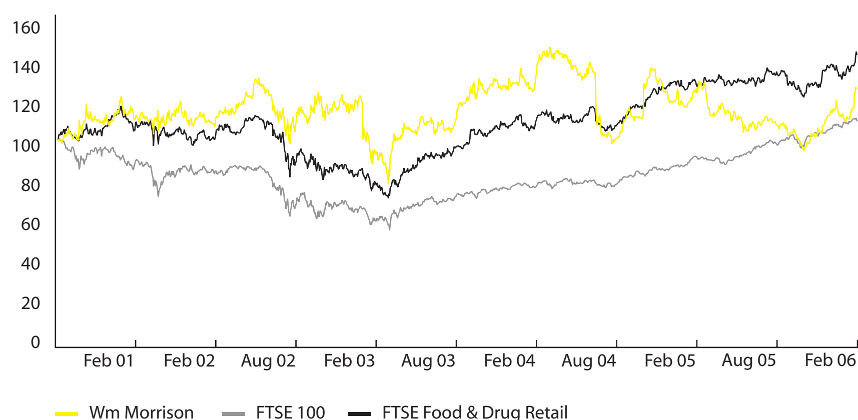
The committee will be reviewing the pension policy during the course of the year with particular reference to the impending changes in legislation. The committee is committed to following a policy of no greater cost to the Group of operating its pension arrangements for Executive Directors as a result of any changes felt to be necessary to deal with changes in pensions legislation. However, where relevant, greater flexibility may be built into the pension arrangements. Other than the Group-wide profit share scheme, pension is limited to annual salary, the Group's new annual bonus scheme for Executive Directors is not pensionable.

Principally as a result of the salary increases in the year and changes in actuarial assumptions, increases in what is known as the pension transfer value have taken place. These are set out in the table on page 27.

Performance graph

The graph shows the Group's performance measured by total shareholder return, compared with the performance of the FTSE 100 and FTSE Food & Drug Retailers indices, also measured by total shareholder return. These indices have been selected as being appropriate in giving a broad equity view and the Group is a constituent of both indices.

Group performance TSR



Directors' contracts

Executive Directors

As part of a package of measures approved by the Board in June 2005, liquidated damages provisions in Executive Directors' contracts were extended to two times the annual value of certain elements of their remuneration and benefits for terminations before 1 July 2007. This change and the increased salaries were felt necessary to protect the Group at a time of great uncertainty and in the face of attempts by other companies to recruit key members of the executive team.

The committee has reviewed these contracts and determined that from 1 July 2007 any compensation provisions for termination without notice will only extend to 12 months of pay. Going forward, all new Director contracts will be for a 12 month notice period. Also going forward, any deferred share awards and any long-term incentive plan will be excluded from the definition of "pay".

The departure of Robert Stott was announced in October 2005 as part of the restructuring of the Board and the implementation of a succession planning strategy leading to the recruitment of a replacement Chief Executive. Robert Stott has agreed to stay with the Group until a handover has been achieved following the appointment of a suitable replacement. Pursuant to his contract, he will receive a payment worth two times his salary, profit share and certain benefits. Following cessation of employment he has agreed to work on a consultancy basis for 12 months at an appropriate market rate.

On 31 May 2005 Martin Ackroyd's position as Finance Director ceased. Under a compromise agreement he received a payment of £505,796 plus 12 months of normal pension scheme funding. Options granted under the 1995 Executive Share Option Scheme lapsed on his departure. As part of his termination agreement he agreed to make his services available for a year, as required, at an hourly rate of £125.

On 25 May 2005 outline terms were agreed with Richard Pennycook such that he would be appointed to the position of Group Finance Director from 1 October 2005 with the details of his contractual terms to be agreed in due course. Details concerning his salary, incentives and pension are set out above. In order to recruit him, it was necessary to offer him extra protection on termination of his employment, in particular that he would receive two times the annual value of certain elements of his remuneration and benefits in the event of a termination in certain circumstances before 1 July 2007.

Executive Directors are permitted to accept outside appointments on external boards or committees as long as these are not deemed to interfere with the business of the Group. Any fees received in respect of these appointments are retained by the Executive Directors concerned.

Non Executive Directors

The Non Executive Directors have been appointed for a three year period from their dates of appointment, unless otherwise terminated earlier by, and at the discretion of, either party upon one month's written notice.

Name	Current term commenced	Date of most recently amended letter of appointment	Expected date of expiry of current term
B Flanagan	01.07.05	07.07.05	01.07.08
D Jones	21.05.04	21.10.05	21.05.07
P Manduca	06.09.05	21.10.05	06.09.08
S Murray	01.07.05	21.10.05	01.07.08
N Robertson	01.07.05	07.07.05	01.07.08

Directors' remuneration report continued

The Board makes the initial appointment of Directors who are then subject to re-election by the shareholders at the first Annual General Meeting following appointment and thereafter at three yearly intervals.

The remuneration for the Non Executive Directors is determined by the full Board and is reviewed from time to time and has regard to the time commitment required and the level of fees paid in comparable companies. Non Executive Directors receive no benefits from their office other than fees and are not eligible to participate in Group pension arrangements. During the year, David Jones' remuneration was increased in March 2005 to £460,000 when he temporarily increased his time commitment and became Deputy Chairman of the Group. His annual remuneration was revised in November 2005 to the level shown in the following table.

The current levels are as follows:

Name	Base £'000	Committee Chairmanship £'000	Deputy Chairman £'000	Total £'000
B Flanagan	40	–	–	40
D Jones	10	–	60	70
P Manduca	40	10	–	50
S Murray	40	10	–	50
N Robertson	40	–	–	40
Total	170	20	60	250

Audited information

Directors' emoluments and pension entitlements

The emoluments of the Directors were as follows:

Name	Directors salaries/fees £'000	Benefits £'000	Annual Bonus £'000	Compen-sation for loss of office £'000	Total year to 29 Jan 2006 £'000	Total year to 30 Jan 2005 £'000
Executive Directors						
M Ackroyd	131	10	–	506	647	439
M Gunter	492	37	24	–	553	442
D Hutchinson	466	28	24	–	518	345
M Melnyk	642	27	31	–	700	592
K Morrison	667	39	32	–	738	635
R Owen	473	35	24	–	532	440
R Pennycook	133	8	–	–	141	–
R Stott	638	29	31	–	698	539
Non Executive Directors						
D Davidson	7	–	–	–	7	28
B Flanagan	23	–	–	–	23	–
D Jones	282	–	–	–	282	28
P Manduca	19	–	–	–	19	–
S Murray	26	–	–	–	26	–
N Robertson	23	–	–	–	23	–
Total	4,022	213	166	506	4,907	3,488

Benefits in kind comprise vehicle running costs, health insurance and telephone expenses.

None of the Directors has a material interest in any contract significant to the Group's business.

The following Directors had accrued entitlements under defined benefit schemes as follows:

Name	Accrued pension at 30 Jan 2005 £'000	Increase in accrued pension (excluding inflation) year ended 29 Jan 2006 £'000	Transfer value of the increase in accrued pension during the year £'000	Accrued pension at 29 Jan 2006 £'000	Transfer value of accrued pension at 30 Jan 2005 £'000	Transfer value of accrued pension at 29 Jan 2006 £'000	Movement in transfer value during the year £'000
Executive Directors							
M Ackroyd	181	37[2]	414[1]	218[1]	2,068	2,434[1]	366[1]
M Gunter	33	3	27	37	272	337	65
D Hutchinson	89	45	688	136	1,201	2,080	879
M Melnyk	236	60	586	302	2,074	2,952	878
R Owen	200	50	769	255	2,691	3,923	1,232
R Stott	28	–	–	28	545	555	10
Total	767	195	2,484	976	8,851	12,281	3,430

1 At 31 May 2005.
2 At 31 May 2005. The increase in accrued pension does not exclude inflation.

The accrued pension at 30 January 2005 has been restated following a review of the calculations performed for last year's accounts. This has not affected either the cost to the Group or the value available to any Executive Director.

Directors’ remuneration report continued

Directors’ Share Options

Options granted to Directors to acquire ordinary shares in the Company which are still outstanding are as follows:

	Number of options during the 52 weeks ended 29.01.06								
						Market price	Gain on	Exercisable	
Date of grant	At 30.01.05	Exercised	Lapsed	At 29.01.06	Exercise price	on day of exercise	exercise £’000	From	To
M Ackroyd									
28.06.00	14,300*	14,300	–	–	118p	181.5p	9	01.09.05	01.03.06
05.04.02	150,000	–	150,000	–	209p	–	–	05.04.05	05.04.12
02.04.03	260,000	–	260,000	–	175p	–	–	02.04.06	02.04.13
12.11.04	220,000	–	220,000	–	222p	–	–	12.11.07	12.11.14
	644,300	14,300	630,000	–	–	–	9	–	–
M Gunter									
30.04.96	20,000	20,000		–	77.5p	191.5p	23	30.04.99	30.04.06
31.03.00	50,000	–	–	50,000	123p	–	–	31.03.03	31.03.10
28.06.00	14,300*	14,300	–	–	118p	181.5p	9	01.09.05	01.03.06
05.04.01	200,000	–	–	200,000	187p	–	–	05.04.04	05.04.11
05.04.02	150,000	–	–	150,000	209p	–	–	05.04.05	05.04.12
02.04.03	260,000	–	–	260,000	175p	–	–	02.04.06	02.04.13
12.11.04	220,000	–	–	220,000	222p	–	–	12.11.07	12.11.14
	914,300	34,300	–	880,000	–	–	32	–	–
D Hutchinson									
28.06.00	14,300*	14,300	–	–	118p	181.5p	9	01.09.05	01.03.06
05.04.01	50,000	–	–	50,000	187p	–	–	05.04.04	05.04.11
05.04.02	150,000	–	–	150,000	209p	–	–	05.04.05	05.04.12
02.04.03	260,000	–	–	260,000	175p	–	–	02.04.06	02.04.13
12.11.04	220,000	–	–	220,000	222p	–	–	12.11.07	12.11.14
	694,300	14,300	–	680,000	–	–	9	–	–
M Melnyk									
30.04.96	160,000	160,000	–	–	77.5p	191.5p	182	30.04.99	30.04.06
16.04.99	160,000	–	–	160,000	148p	–	–	16.04.02	16.04.09
31.03.00	50,000	–	–	50,000	123p	–	–	31.03.03	31.03.10
28.06.00	14,300*	14,300	–	–	118p	181.5p	9	01.09.05	01.03.06
05.04.01	200,000	–	–	200,000	187p	–	–	05.04.04	05.04.11
05.04.02	150,000	–	–	150,000	209p	–	–	05.04.05	05.04.12
02.04.03	260,000	–	–	260,000	175p	–	–	02.04.06	02.04.13
12.11.04	300,000	–	–	300,000	222p	–	–	12.11.07	12.11.14
	1,294,300	174,300	–	1,120,000	–	–	191	–	–

Directors' Share Options continued

Date of grant	Number of options during the 52 weeks ended 29.01.06 At 30.01.05	Exercised	Lapsed	At 29.01.06	Exercise price	Market price on day of exercise	Gain on exercise £'000	Exercisable From	To
K Morrison									
05.04.01	200,000	–	–	200,000	187p	–	–	05.04.04	05.04.11
05.04.02	150,000	–	–	150,000	209p	–	–	05.04.05	05.04.12
02.04.03	260,000	–	–	260,000	175p	–	–	02.04.06	02.04.13
12.11.04	500,000	–	–	500,000	222p	–	–	12.11.07	12.11.14
	1,110,000	–	–	1,110,000	–	–	–	–	–
R Owen									
31.03.00	50,000	–	–	50,000	123p	–	–	31.03.03	31.03.10
05.04.01	200,000	–	–	200,000	187p	–	–	05.04.04	05.04.11
05.04.02	150,000	–	–	150,000	209p	–	–	05.04.05	05.04.12
02.04.03	260,000	–	–	260,000	175p	–	–	02.04.06	02.04.13
12.11.04	220,000	–	–	220,000	222p	–	–	12.11.07	12.11.14
	880,000	–	–	880,000	–	–	–	–	–
R Pennycook									
	–	–	–	–	–	–	–	–	–
R Stott									
28.06.00	14,300*	14,300	–	–	118p	181.5p	9	–	–
05.04.02	150,000	–	–	150,000	209p	–	–	05.04.05	05.04.12
02.04.03	260,000	–	–	260,000	175p	–	–	02.04.06	02.04.13
12.11.04	300,000	–	–	300,000	222p	–	–	12.11.07	12.11.14
	724,300	14,300	–	710,000	–	–	9	–	–

* Options granted under the Sharesave Scheme.

There were no new options granted in the period.

The ordinary share mid market price ranged from 161.5p to 224.0p and averaged 189.3p during the period. The price on 29 January 2006 was 189p compared to 203p on 30 January 2005.

No further options may be granted under the Executive Share Option Scheme as it expired on 25 May 2005.

The performance condition, attached to options under the Executive Share Option Scheme, is as follows:

The operating profit of the Group (as detailed in the audited report and financial statements) must increase by at least 20% between the Base Year and its third or succeeding anniversary. Once an option is exercisable it will remain so until it lapses (in accordance with the rules of the Scheme) even if on a future anniversary the operating profit does not exceed the Base Year by 20%.

Approval

This report was approved by the Board of Directors on 22 March 2006 and signed on its behalf by

Susan Murray
Chair of the Remuneration Committee

Corporate social responsibility report

Our approach to CSR is driven by our Company vision and values, which cover the interests of our key stakeholders – customers, suppliers, colleagues and shareholders – and are supported by Group-wide policies for corporate governance, employment, health, safety and welfare, ethical trading and responsible business practice.

Our aim is to reduce the impact of our business on the environment in which we operate through a programme of continuous improvement that minimises risks and negative impacts and adds value to our business by enabling us to enhance our commercial operations.

A clear understanding of the CSR issues facing the Company and a focus on the risks that are material to our business has determined the following priorities:

- Product Integrity
- Supply Chain Management & Labour Standards
- Community Investment
- Operational Environmental Management
- Employment Policies

These CSR priorities and any topical issues arising are addressed through a cross functional 'Steering Committee' of senior executives (formerly the Business Ethics Working Group). Reporting directly to the Main Board, this group provides leadership on CSR matters and defines strategy, while also being responsible for overseeing the development and implementation of policies. The on-going work programme is co-ordinated through the CSR arm of our Public Relations department, with delivery of activities undertaken through line management in each of the business divisions.

During the past year, taking into account that this was a period of great change in the business and following appropriate stakeholder engagement, we have concentrated our resources for CSR matters on the priority areas of Environmental Management, with a view to fulfilling our commitment to reporting on emissions; and Product Integrity, particularly with regard to healthy eating and sustainability. This report primarily covers progress made in these areas and marks the start of working to provide more quantifiable data for reporting in the future. Other aspects of our CSR programme, such as implementation of our ethical trading code and the maintenance, engineering and efficiency programmes aimed at helping to reduce the environmental impact of our transport fleet, have been maintained and continue in line with business as usual.

Environment: Energy efficiency and greenhouse gas emissions

We recognise that Carbon Dioxide (CO_2) emissions and their effect on the climate are the most significant environmental impact associated with our energy use. In addition, reducing the energy used for power, heating and refrigeration in our stores, offices, factories and depots is an important economic priority, as well as being of environmental benefit.

Our policy is to reduce carbon dioxide emissions from energy used for building services through responsible energy sourcing; in our specification for construction, installation, maintenance and monitoring of plant; and also by minimising demand and promoting efficient consumption.

We measure energy use across our business, including our manufacturing and production facilities, and in-house distribution, and will be able to report comparatively on CO_2 equivalent emissions going forward.

- The total CO_2 equivalent emissions from energy used by the Group is 764,221 tonnes; or 63.1 tonnes of CO_2/£m. (Calculated using DEFRA reporting guidelines).

All energy data has been migrated to the Group's new energy management system, Optima, which has extensive monitoring and targeting abilities based on sub-metered energy use enabling additional savings in terms of both cost and consumption. For example, the first site identified has already achieved an 8% saving of electricity. We are also using Optima to identify consumption trends, incorporating building and lighting control information and refrigeration data. Pioneering work already carried out is being pursued to take us to new levels of savings.

We are participating in long-term Climate Change Agreements for 202 stores and seven production facilities. As part of these agreements we monitor the energy used in food preparation, with the aim of reducing carbon emissions associated with this activity. In addition, energy 'Good Practice Guides' have been issued to all stores, to reduce consumption.

We have also continued to invest in energy saving initiatives in order to achieve further relative reductions in our energy consumption. We are working with the Carbon Trust and Future Energy Solutions on a number of projects to identify opportunities for improvements in efficiency and to eliminate waste energy. One of these is assessing the feasibility and viability of using energy generated by wind turbine.

> **Case study:**
> Energy Saving Initiative – "Trend". Installation of the "Trend" automatic lighting control system has been extended to all former Safeway stores and is now established in 245 petrol filling stations. On average this has reduced electricity consumption per site by 66%.

As a result of the store conversion programme, all refrigeration systems have been re-commissioned to run at peak efficiency. By monitoring against these efficiencies we are able to quickly identify and address any shortfalls. Having phased out the use of all CFC refrigerants, we are now in the process of replacing HCFCs with HFCs. All new refrigeration systems are assessed using Total Equivalent Warming Impact and for all new tenders we specify equipment from the DEFRA Enhanced Capital Allowance list.

> **Case study:**
> Equipment Specification – Refrigeration. Refrigeration accounts for approximately 50% of a store's total energy consumption. A variety of proven energy saving technologies and methods covering engineering design, controls and equipment specification are used to reduce this consumption. For the seven new stores opened last year, these savings amounted to 1,218 tonnes CO_2 per annum.

Waste management

Our prime objective is to prevent the generation of waste, wherever possible. Where this is unavoidable, we apply the waste management hierarchy of reduce, re-use, recover, recycle, dispose. Where disposal is the only practical option available, we use appropriately licensed waste management facilities in accordance with relevant legislation.

Our priority over the past year has been to ensure compliance with changing legislation whilst ensuring that conversion stores fully adapt to Morrisons policy on waste management. As we now have fewer stores, absolute volumes of material recovered for recycling have decreased compared to the previous year but the tonnage of material recovered per store has increased by 23%.

All of our stores have the capability to recover cardboard and polythene, which are the largest contributors to waste produced in store. We continually review our systems and processes in order to identify new ways to recover more and reduce landfill. We operate a programme to monitor recycling levels from stores and provide support and training, where required, to help increase recovery levels. Currently 72% of all store generated waste is recovered for recycling.

We carefully monitor the number and frequency of waste collections from each store. Calculations based upon industry standard container weights indicate a figure of around 2.5 tonnes of waste per store per week being sent to landfill. In addition to recovering cardboard, paper and plastics, we also recover Animal By-Products (ABP), which are not fit for human consumption, and waste cooking oils and fats. ABP waste is processed and used in the generation of renewable energy, whilst waste cooking oils and rotisserie fats from stores are currently being used in the manufacture of bio-diesel.

Wherever possible we aim to offer our customers the chance to recycle. This is achieved by working in partnership with Local Authorities to provide recycling facilities at our stores. Currently these facilities are available at 329 stores.

Avoiding generating waste is always preferable to recycling it. We have an extensive system of returnable baskets for both internal and external stock movements, which are continually reused through our distribution network and between suppliers.

	Annual tonnes	Tonnes per store per week			
Name	(Total)	Card/Paper	Plastic	Total	% change
2004	135,670	n/a	n/a	4.50	–
2005	121,925	5.13	0.41	5.54	+23%

	Waste analysis 2005/06	
Material	Tonnes	%
Cardboard/paper	112,982	63.48
Plastics	8,322	4.68
Other recovered	7,268	4.08
Landfill	49,400	27.76
Totals	177,972	100.00

Corporate social responsibility report continued

During the first quarter of 2005 we undertook a trial offering customers the facility to return their carrier bags for recycling. Initially conducted in 15 stores, mainly in the South and South East of England, the trial has proved successful, indicating the potential to recover approximately 60kg per week in materials, which equates to over 3 tonnes over a 52 week period from each participating store. We are currently considering extending this trial.

In addition to complying with the Producer Responsibility (Packaging Waste) Regulations, we are working to find innovative packaging solutions to eliminate or reduce the need for packaging, in line with meeting the shared objectives of the Courtauld Commitment. To this end we are currently pursuing a number of projects with the Waste and Resources Action Programme (WRAP).

Product integrity

Throughout the year we have taken on board our customers' comments, enhancing our range in accordance with their requirements. Action resulting from this process has included extending our premium 'Best' range, introducing more organic foods and increasing the supply of locally sourced produce. In recognition of our role in the health debate, our 'Eat Smart' range continues to develop and we are also further developing our 'Free From' range to include Morrisons brand products.

More than 4,000 changes to product packaging and presentation have included a review of our on-pack labelling to include energy, protein, carbohydrates, sugar, fat, saturated fat, fibre, sodium and salt, together with Guideline Daily Amounts (GDAs). Our on-going salt reduction programme has achieved lower salt levels for hundreds of products, including ready meals, bread, soups, cooking sauces, cereals, snacks, and sandwich fillings.

Sustainability issues have also been high on our agenda with significant work involved in further developing our fish procurement policy to ensure we are buying from the most sustainable sources and finding the least depleted stocks. This has resulted in some change to our range during the past year and we continue to review our policy as we address relevant issues. We will also be working with our suppliers to address sustainability issues concerning the supply of palm oil as a commodity ingredient in many popular products.

Community investment

Fundraising for our Charity of the Year, Breast Cancer Campaign broke all previous records, with over £1 million being donated. Initiatives included a mobile phone recycling scheme, offering charity Christmas cards and selling a reusable carrier bag. Also with the generous support of our customers, we raised £65,000 for the Asian Earthquake Appeal, which was donated to the Shelterbox Trust, and over £197,000 for Children in Need. Donations to local and national causes, including through Morrisons Charitable Trust and excluding gifts in kind totalled £678,000.

Further details on our CSR programme and related company policies can be found on our website www.morrisons.co.uk

Independent auditors' report to the members of Wm Morrison Supermarkets PLC

We have audited the Group and Parent Company financial statements (the "financial statements") of Wm Morrison Supermarkets PLC for the 52 weeks ended 29 January 2006 which comprise the Consolidated income statement, the Consolidated and Parent Company balance sheets, the Consolidated cash flow statement, the Consolidated statement of recognised income and expense and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, and for preparing the Parent Company financial statements and the Directors' remuneration report in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the Statement of Directors' responsibilities on page 16.

Our responsibility is to audit the financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and whether, in addition, the group financial statements have been properly prepared in accordance with Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate governance statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' remuneration report to be audited.

Opinion

In our opinion:

- The Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the group's affairs as at 29 January 2006 and of its loss for the 52 week period then ended.
- The Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.
- The Parent Company financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the Parent Company's affairs as at 29 January 2006.
- The Parent Company financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor
Leeds

22 March 2006

Consolidated financial statements

Under International Financial Reporting Standards

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Accounting policies

Basis of preparation
These accounts have been prepared in accordance with International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) as adopted by the European Union and with the Companies Act 1985.

The accounts are prepared on the historical cost basis of accounting, except for share based payment charges and derivative financial instruments, which are measured at fair value.

These are the Group's first consolidated financial statements prepared in accordance with adopted IFRS and IFRS 1 *First-time Adoption of International Financial Reporting Standards*. The Group's transition date for adoption of IFRS is 2 February 2004. An explanation of how the transition to IFRS has affected the reported financial position and the options that IFRS 1 permits companies to take are described in note 34.

The Group has revised its accounting policies where applicable to conform with IFRS and these are set out below. These policies have been applied consistently to all the years presented and in preparing the opening balance sheet at 2 February 2004 for the purpose of transition to IFRS, except for those relating to financial instruments.

The Group has early adopted the amendment to IAS19 *Employee Benefits* permitting recognition of actuarial gains and losses immediately in equity, and as explained in note 34 has adopted IAS 39 *Financial Instruments: Recognition and Measurement* from 31 January 2005 with respect to the recognition and measurement of financial instruments.

Basis of consolidation
The consolidated accounts incorporate the accounts of the Company and its subsidiaries, being those undertakings that it controls, made up for 52 weeks each year. Control is achieved where the Company has the power to govern the financial and operating policy of an investee entity so as to obtain benefits from its activities.

A joint venture is an undertaking over which the Group exercises joint control, established by contractual agreement. The Group's share of the profits and losses of joint ventures is included in the consolidated income statement and its interest in their net assets is included in investments in the consolidated balance sheet.

The results of subsidiaries acquired or disposed of during the period are included in the consolidated income statement on the equity accounting basis from the effective date of acquisition up to the effective date of disposal, as appropriate.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Significant accounting policies
The Directors consider the following to be the most important accounting policies in the context of the Group's operations:

Turnover
Turnover represents sales to customers excluding value added tax, intra-group transactions, staff discounts, coupons and the free element of multi-save transactions.

Supplier income
Supplier incentives, rebates and discounts are recognised on an accruals basis based on the expected entitlement which has been earned up to the balance sheet date for each relevant supplier contract.

Segmental reporting
Based on the sources of risks and returns impacting the Group's activities, the Directors consider that the primary reporting format is by business segment. The Directors consider that there is only one business segment being grocery and related retailing and vertically integrated manufacturing. The disclosures for the primary segment are therefore given by the primary financial statements and related notes.

Since the Group's business operations are conducted almost exclusively in the UK, a geographical segment report is not required.

Borrowing costs
All borrowing costs are recognised in the Group's income statement on an accruals basis except for interest costs that are directly attributable to the construction of buildings which are capitalised and included within the initial cost of a building. Capitalisation ceases when the property is ready for use.

Business combinations and goodwill
The assets, liabilities and contingent liabilities of subsidiaries are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill.

Goodwill is recognised as an asset and reviewed for impairment annually as detailed in 'Impairment of non-financial assets' below.

Property, plant and equipment

a) **Property, plant and equipment** are carried at cost less accumulated depreciation. Costs include directly attributable costs. Annual reviews are made of estimated useful lives and material residual values.
b) **Depreciation rates** used to write off cost less residual value are straight line:

Freehold land	0%
Freehold and long leasehold buildings	2.5%
Short lease buildings	Over lease period
Plant, equipment and vehicles	15 -33%
Assets held under a finance lease	Shorter of life of lease or asset
Assets under construction	0%

Impairment of non-financial assets
Goodwill is tested annually for impairment, or more frequently if there are any changes in circumstances or events that indicate that a potential impairment may exist. Goodwill impairments cannot be reversed.

For other intangible assets, property, plant and equipment individual assets are reviewed for indications of impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

Accounting policies continued

If there are indications then a test is performed on the asset affected to assess its recoverable amount against carrying value.

An asset impaired is written down to the higher of value in use or its fair value less costs to sell.

Stocks
Stocks are valued at the lower of cost and net realisable value. Cost comprises purchase price, import duties, rebates and other non-recoverable taxes. Stocks are primarily goods for resale.

Cash and cash equivalents
Cash and cash equivalents for cash flow purposes includes cash-in-hand, cash-at-bank and bank overdrafts together with short term, highly-liquid investments that are readily convertible into known amounts of cash, with an insignificant risk of a change in value, within three months from the date of acquisition. In the balance sheet bank overdrafts are presented within current liabilities.

Non-current assets held for sale
Where there is a committed plan to sell and it is highly probable that a sale will be achieved, assets are reclassified as non-current assets held for sale. On reclassification, non-current assets held for sale are recognised at the lower of carrying amount and the fair value less costs to sell. Impairment losses on initial classification as held for sale are included in the income statement, as are gains or losses on subsequent remeasurement. The depreciation of the asset ceases on reclassification. Assets are reclassified from non-current assets held for sale when the above criteria cease to be met. Additional depreciation is charged where appropriate.

Leases
Leases in which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases; all other leases are classified as finance leases.

a) **Finance leases:** The present value, calculated using the interest rate implicit in the lease, of the future minimum lease payments is included within fixed assets and financial liabilities as an obligation to pay future rentals. Depreciation is provided at the same rates as for owned assets, or over the lease period if shorter.

   Rental payments are apportioned between the finance charge and the outstanding obligation so as to produce a constant rate of charge on the remaining balance.

b) **Operating leases:** Rental payments are taken to the income statement on a straight line basis over the life of the lease. Leases that contain predetermined, fixed rental increases are accounted for such that the predetermined, fixed rental increases are recognised on a straight line basis over the life of the lease.

   Property leases are analysed into separate components for land and buildings and tested to establish whether the components are operating leases or finance leases. Premiums paid for land are treated as a prepayment of an operating lease rental and recognised on a straight line basis over the life of the lease.

Deferred and current taxation
The charge for taxation is based on the profit or loss for the period and takes into account taxation deferred because of differences between the treatment of certain items for taxation and for accounting purposes. Full provision is made for the tax effects of these differences. However, deferred taxation is not accounted for if it arises from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred taxation is measured using tax rates that have been enacted or substantially enacted by the balance sheet date.

The carrying amount of deferred tax assets is reviewed at each balance sheet date to ensure that sufficient taxable profits will be available to allow the asset to be recovered.

Deferred tax is charged or credited in the income statement except when it relates to items charged directly to equity in which case the deferred tax is also dealt with in equity.

Provisions
Provisions are created where the Group has a present obligation (legal or constructive) as a result of a past event, where it is probable that it will result in an outflow from the Group, and where it can be reliably measured. The nature of these provisions are:

a) **Property provisions:** Provisions made in respect of individual properties where there are obligations for onerous contracts, dilapidations and certain decommissioning obligations for petrol filling stations. The amounts provided are based on the Group's best estimate of the committed net present cash flows.

b) **Restructuring provisions:** Provisions are established in respect of announced restructuring programmes. The provision includes costs of severance to the affected employees and of property closure and other costs. Provisions not utilised will be reviewed in future years.

Foreign currencies
Transactions in foreign currencies are recorded at the rates of exchange at the dates of the transactions.

At each balance sheet date, monetary assets and liabilities that are denominated in foreign currency are retranslated at the rates of exchange at the balance sheet date. Gains and losses arising on retranslation are included in the income statement for the period.

Retirement benefits
The Group operates defined benefit and defined contribution schemes. A defined contribution scheme is a pension scheme under which the Group pays fixed contributions into a separate entity. A defined benefit scheme is one that is not a defined contribution scheme. Pension benefits under defined benefit schemes are defined on retirement based on age at date of retirement, years of service and employee's final compensation package.

The Group operates two defined benefit retirement schemes which are funded by contributions from the Group and members.

The defined benefit schemes are not generally open to new members. Pension scheme assets, which are held in separate trustee administered funds, are valued at market rates. Pension scheme obligations are measured at discounted present value. The operating and financing costs of the scheme are recognised in the period in which they arise. Death-in-service costs are recognised on a straight line basis over their vesting period. Actuarial gains and losses are recognised immediately in the statement of recognised income and expense.

Payments by the Group to the defined contribution scheme are charged to the income statement as they arise.

Share-based payments
The Group issues equity share-based payments to certain employees. The fair value of the employee services received is expensed on a straight line basis over the vesting period, based on the Group's estimate of share options that will eventually vest.

Fair value is measured by use of a binomial stochastic model. The expected life used in the model has been adjusted, based on management's best estimate, for effects of non-transferability, exercise restrictions and behavioural considerations.

The fair value charge of share-based payments that are settled by cash are credited to the balance sheet and are included within creditors.

The Group has fair valued all grants of equity instruments after 7 November 2002 which were unvested as of 1 January 2005, and cash settled equity instruments.

Financial instruments
Financial assets and liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Derivative financial instruments are initially measured at cost and are remeasured at fair value for reporting purposes.

Financial liabilities
Financial liabilities are recognised initially and subsequently at amortised cost using the effective interest rate method.

Net debt
Net debt is cash and cash equivalents, bank and other current loans, bonds and derivative financial instruments stated at current fair value.

Safeway integration and conversion costs
The integration and conversion of the Safeway stores and associated distribution and administration processes has given rise to significant incremental one-off costs. The Group views restructuring costs as costs associated with investment in the future performance of the business and not part of the Group's trading performance. These costs have a material impact on the absolute amount of, and trend in the Group operating profit. These restructuring costs are shown in a separate column on the face of the income statement. Any provisions relating to these costs are disclosed within "Provisions".

Investment property
Investment properties are recorded at cost less accumulated depreciation and any recognised impairment loss. Depreciation used is the same method and rates as for other group properties.

Income from investment properties is disclosed in "Other operating income" and details are shown in note 11 Investment property. Costs are included within "Other operating expenses".

Treasury shares
The Group has an employee trust for the granting of group shares to executives and members of the employee share plans. Shares in the Group held by the employee share trust are treated as treasury shares and presented in the balance sheet as a deduction from retained earnings.

The finance and administration costs relating to the Executive Share Option Scheme are charged to the income statement. The shares are ignored for the purpose of calculating the Group's earnings per share.

Use of critical accounting assumptions and estimates
Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have significant risk of causing a material adjustment to the carrying value of assets and liabilities are discussed below.

a) **Estimated impairment of goodwill and other non-financial assets**
The Group tests for impairment annually for goodwill, and as required when there are indications of impairment for other non-financial assets. The recoverable amounts of cash generating units have been determined based on value in use calculations using forecasts. These calculations require the use of estimates based on financial forecasts, budgets and assumptions about the future.

b) **Pension scheme assumptions and mortality tables**
The carrying value of defined benefit pension schemes is valued using actuarial valuations. These valuations are based on assumptions including the selection of the correct mortality tables for the profile of members in each scheme. All these are estimates of future events. These choices will be based on advice received from the scheme actuaries which are checked from time to time with benchmark surveys.

c) **Deferred taxation**
By far the most significant component of deferred tax relates to property acquired with Safeway. The calculation is dependent on whether it is expected that the carrying value will be recovered through use or sale.

Consolidated income statement

52 weeks ended 29 January 2006

	Note	2006 Before Safeway integration & conversion costs £m	2006 Safeway integration & conversion costs £m	2006 Total £m	2005 Before Safeway integration & conversion costs £m	2005 Safeway integration & conversion costs £m	2005 Total £m
Turnover	1	12,114.8	–	12,114.8	12,103.7	–	12,103.7
Other operating income		18.5	–	18.5	18.3	–	18.3
Raw materials and consumables		(9,155.5)	–	(9,155.5)	(9,110.3)	–	(9,110.3)
Gross profit		2,977.8	–	2,977.8	3,011.7	–	3,011.7
Staff costs	2	(1,630.8)	(86.1)	(1,716.9)	(1,536.9)	(31.4)	(1,568.3)
Depreciation	3	(256.9)	–	(256.9)	(259.2)	–	(259.2)
Impairment and other asset write offs	4	–	(124.2)	(124.2)	–	(40.0)	(40.0)
Profit/(loss) on sale of property, plant and equipment		7.5	(16.7)	(9.2)	14.5	(14.9)	(0.4)
Other operating expenses	4	(986.1)	(147.4)	(1,133.5)	(834.7)	(52.9)	(887.6)
Operating profit/(loss)		111.5	(374.4)	(262.9)	395.4	(139.2)	256.2
Finance costs	5	(73.2)	–	(73.2)	(86.5)	–	(86.5)
Finance income	5	21.0	–	21.0	21.1	–	21.1
Share of post tax profits from BP joint venture	12	2.2	–	2.2	2.2	–	2.2
Profit/(loss) before taxation	3	61.5	(374.4)	(312.9)	332.2	(139.2)	193.0
Taxation	6	(15.6)	78.2	62.6	(112.4)	24.4	(88.0)
Profit/(loss) for the period		45.9	(296.2)	(250.3)	219.8	(114.8)	105.0
Earnings/(loss) per share (pence)	7						
– Basic		1.73		(9.46)	8.66		4.14
– Diluted		1.73		(9.46)	8.62		4.12
Ordinary dividends (pence per share)							
Interim – paid				0.625			0.625
Final – proposed				3.075			–
– paid				–			3.075

Consolidated statement of recognised income and expense (SORIE)

52 weeks ended 29 January 2006

	Note	2006 £m	2005 £m
(Loss)/profit for the financial period		(250.3)	105.0
Actuarial loss arising in the pension scheme (net of taxation)	28	(28.2)	(56.5)
Total recognised income and expense for the financial period		(278.5)	48.5
Prior year impact on retained earnings of first time adoption of IAS 39		3.4	–
Attributable to equity shareholders		(275.1)	48.5

Consolidated balance sheet

29 January 2006

	Note	2006 £m	2005 £m
Assets			
Non-current assets			
Goodwill and other intangibles	8	–	103.2
Property, plant and equipment	9	6,143.9	5,708.1
Lease prepayments	10	217.8	230.5
Investment property	11	225.3	218.5
Investment in Joint Venture	12	–	78.4
Financial assets	19	36.4	37.0
		6,623.4	6,375.7
Current assets			
Stocks	14	399.4	424.6
Debtors	15	157.4	224.2
Cash and cash equivalents	16	135.3	93.5
		692.1	742.3
Non-current assets classified as held for sale	13	128.6	582.5
		820.7	1,324.8
Liabilities			
Current liabilities			
Creditors	17	(1,471.2)	(1,437.2)
Other financial liabilities	18	(296.6)	(274.7)
Current tax liabilities		(39.0)	(0.5)
		(1,806.8)	(1,712.4)
Non-current liabilities			
Other financial liabilities	18	(1,022.7)	(1,016.7)
Deferred tax liabilities	21	(422.6)	(501.6)
Pension liabilities	28	(416.2)	(408.1)
Provisions	20	(127.2)	(55.8)
		(1,988.7)	(1,982.2)
Net assets		3,648.6	4,005.9
Shareholders' equity			
Called up share capital	22	267.3	265.8
Share premium	22	36.9	20.1
Merger reserve	24	2,578.3	2,578.3
Retained earnings	24	766.1	1,141.7
Total equity		3,648.6	4,005.9

The financial statements on pages 34 to 66 were approved by the Board of Directors on 22 March 2006 and were signed on its behalf by:

Robert Stott
Chief Executive

Richard Pennycook
Group Finance Director

Consolidated cash flow statement

52 weeks ended 29 January 2006

	Note	2006 £m	2005 £m
Cash flows from operating activities			
Cash generated from operations	25	311.0	448.0
Interest paid		(74.9)	(96.9)
Taxation received/(paid)		33.3	(171.5)
Net cash inflow from operating activities		269.4	179.6
Cash flows from investing activities			
Interest received		23.2	21.1
Acquisition of subsidiaries (net of cash acquired)	27	(15.6)	(831.4)
Proceeds on the sale of BP joint venture assets	27	87.0	–
Proceeds from the sale of subsidiaries	27	49.1	–
Proceeds from sale of property, plant and equipment		324.1	903.0
Purchase of property, plant and equipment		(635.4)	(428.3)
Net cash outflow from investing activities		(167.6)	(335.6)
Cash flows from financing activities			
Net proceeds from issue of ordinary shares		18.3	3.8
Treasury shares		–	12.0
Finance lease principal payments		(2.6)	(3.4)
New borrowings		100.0	1,000.0
Repayment of borrowings		–	(1,003.9)
Dividends paid to shareholders		(97.8)	(87.7)
Net cash inflow/(outflow) from financing activities		17.9	(79.2)
Net increase/(decrease) in cash and cash equivalents		119.7	(235.2)
Cash and cash equivalents at start of period		(28.6)	206.6
Cash and cash equivalents at end of period	16	91.1	(28.6)

Reconciliation of net cash flow to movement in net debt in the period

	Note	2006 £m	2005 £m
Net increase/(decrease) in cash and cash equivalents		119.7	(235.2)
Cash outflow from decrease in debt and lease financing		2.6	1,007.3
Cash inflow from increase in loans		(100.0)	(1,000.0)
Other non cash movements		(9.0)	11.6
Loans and finance leases acquired with subsidiary		–	(1,149.8)
Opening net (debt)/funds		(1,160.9)	205.2
Closing net (debt)	26	(1,147.6)	(1,160.9)

1 Turnover	2006 £m	2005 £m
Sale of goods in stores	10,540.5	10,939.7
Fuel	2,515.7	2,051.9
Total sales including VAT	13,056.2	12,991.6
VAT	(1,026.6)	(995.3)
Third party sales by subsidiaries	33.1	41.4
Income from concessions	48.9	53.6
Other	3.2	12.4
Total turnover	12,114.8	12,103.7

2 Employees and directors	2006 £m	2005 £m
Employee benefit expense for the Group during the period		
Wages and salaries	1,524.1	1,389.6
Profit related pay	33.4	19.7
Social security costs	96.0	83.5
Share-based payment	4.0	2.6
Pension costs (note 28)	58.9	58.7
Other staff costs	0.5	14.2
	1,716.9	1,568.3

	2006 No.	2005 No.
Average monthly number of people (including Executive Directors) employed		
By business group		
Stores	120,313	128,006
Manufacturing	4,028	2,417
Distribution	6,325	4,256
Centre	3,671	6,222
	134,337	140,901

Key management represent Directors. The aggregate remuneration paid to or accrued for the Directors for services in all capacities during the period is as follows:

	2006 £m	2005 £m
Directors		
Short-term employee benefits	4.4	3.5
Pension costs	0.2	–
Termination payment	0.5	–
Share-based payments	0.3	0.4
	5.4	3.9

5 Directors (2005: 6) have retirement benefits accruing under the Company's defined benefit pension scheme.

3 Profit/(loss) before taxation

The following items have been included in arriving at operating profit/(loss):

	2006 £m	2005 £m
Depreciation:		
– Owned assets	250.4	252.9
– Assets held under finance leases	2.1	2.1
Property, plant and equipment	252.5	255.0
Investment property	4.4	4.2
Charge in the income statement	256.9	259.2
Operating lease rentals payable		
– Plant and machinery	6.8	38.5
– Property	38.9	56.7
Repairs and maintenance expenditure on property, plant and equipment	95.6	96.3
Accounting estimation technique revisions	–	(89.0)

The accounting estimation technique revisions relate to supplier income and various other individually immaterial accounting practices that affected the result for last year.

Services provided by the Group's auditor

During the period KPMG Audit Plc, the Group's auditor, provided the following services:

	2006 £m	2005 £m
Audit services		
– Statutory audit	1.0	0.7
– Audit – related regulatory reporting	0.3	–
Tax services		
– Compliance services	1.0	1.0
Other		
– Forecasting procedures review	1.0	–
– Planning and reporting due diligence	1.7	2.2
	5.0	3.9

4 Safeway integration and conversion costs

Costs relating to the integration of Safeway Limited (note 27 (b)) are analysed as follows:

	2006 £m	2005 £m
Redundancy costs	75.5	23.8
Store conversion costs	10.6	7.6
Staff costs	86.1	31.4
Impairment of depots closed	21.0	–
Goodwill impaired	103.2	–
Write off brand not used	–	40.0
Impairment and other asset write offs	124.2	40.0
Divestment costs	11.0	2.7
Acquisition costs	–	0.3
Store conversion costs	136.4	49.9
Other expenses	147.4	52.9

4 Safeway integration and conversion costs continued

Since the acquisition in March 2004, 220 stores have been converted from the Safeway format to Morrisons, 302 stores (including joint venture properties with BP) have been disposed and a number of administration and distribution functions either closed or merged. The resulting costs, and profits and losses on disposal of properties, are included within Safeway integration and conversion costs. Any impact on trading is included within operating profit.

On acquisition the Safeway brand was valued as required under IFRS 3 *Business Combinations*. The Directors decided not to use this name as part of the continuing business and the value was written off in the period ended 30 January 2005.

5 Finance costs and income	2006 £m	2005 £m
Interest payable on short term loans and bank overdrafts	**(11.1)**	(33.4)
Interest payable on bonds	**(58.1)**	(52.8)
Interest capitalised	**11.8**	6.4
Fair value costs of derivative instruments	**(8.4)**	–
Pension liability interest cost	**(86.2)**	(70.2)
Expected return on pension assets	**83.2**	64.1
Net pension liability interest	**(3.0)**	(6.1)
Other finance costs	**(4.4)**	(0.6)
Finance costs	**(73.2)**	(86.5)

Interest is capitalised at the bank overdraft rate incurred before taxation which varies in line with the prevailing base rate. Taxation relief is obtained on interest paid and this reduces the tax charged for the period.

	2006 £m	2005 £m
Bank interest received	**18.8**	21.1
Fair value income of derivative instruments	**2.2**	–
Finance income	**21.0**	21.1
Net finance cost	**(52.2)**	(65.4)

6 Taxation		2006 £m	2005 £m
Analysis of charge in period			
Current tax	– current period	**4.3**	116.7
	– adjustment in respect of prior period	**3.8**	4.8
		8.1	121.5
Deferred tax	– current period	**(74.8)**	(30.2)
	– adjustment in respect of prior period	**4.1**	(3.3)
		(70.7)	(33.5)
Tax (credit)/charge for the period		**(62.6)**	88.0

	2006 £m	2005 £m
Tax on items charged directly to equity		
Current tax (charge)/credit on actuarial movements	**(1.2)**	1.0
Deferred tax credit on actuarial loss	**13.3**	23.0
Tax credit on actuarial movements taken to SORIE (note 28)	**12.1**	24.0
Share-based payments – taken directly to equity	**3.3**	–

6 Taxation continued

The tax for both periods is higher than the standard rate of corporation tax in the UK (30%). The differences are explained below:

	2006 £m	2005 £m
Tax reconciliation		
(Loss)/profit before tax	(312.9)	193.0
(Loss)/profit before tax at 30%	(93.9)	57.9
Effects of:		
Expenses not deductible for tax purposes	4.6	12.9
Goodwill impaired	31.0	–
Non-qualifying depreciation	19.6	37.2
Divestment profits not taxable	(32.5)	(23.5)
Overseas tax rates/dividends	0.7	2.0
Prior period adjustments	7.9	1.5
Tax (credit)/charge for the period	(62.6)	88.0

7 Earnings per share

Basic earnings per share are calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period, excluding those held by the Company as treasury shares (note 24), which are treated as cancelled.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Company has three classes of dilutive potential ordinary shares: those share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the period, the contingently issuable shares under the Group's long-term incentive plan and convertible preference shares. At 29 January 2006, the performance criteria for the vesting of the awards under the incentive scheme had not been met and consequently the shares in question are excluded from the diluted EPS calculation.

Reconciliations of the earnings and weighted average number of shares used in the calculations are set out below.

	Earnings £m	2006 Weighted average number of shares millions	EPS pence	Earnings £m	2005 Weighted average number of shares millions	EPS pence
Unadjusted EPS						
Basic EPS						
Earnings attributable to ordinary shareholders	(250.3)	2,646.9	(9.46)	105.0	2,538.1	4.14
Effect of dilutive shares						
Options	–	–	–	–	10.6	(0.02)
Preference share conversion	–	–	–	–	1.7	–
Diluted EPS	(250.3)	2,646.9	(9.46)	105.0	2,550.4	4.12

	Earnings £m	2006 Weighted average number of shares millions	EPS pence	Earnings £m	2005 Weighted average number of shares millions	EPS pence
Adjusted EPS						
Basic EPS						
Earnings attributable to ordinary shareholders	(250.3)	2,646.9	(9.46)	105.0	2,538.1	4.14
Integration costs[1]	296.2	–	11.19	114.8	–	4.52
	45.9	2,646.9	1.73	219.8	2,538.1	8.66
Effect of dilutive shares						
Options	–	5.9	–	–	10.6	(0.04)
Preference share conversion	–	1.6	–	–	1.7	–
Diluted EPS	45.9	2,654.4	1.73	219.8	2,550.4	8.62

1 Integration costs comprise the Safeway integration and conversion costs shown on the income statement.

8 Goodwill and other intangibles	Goodwill £m	Safeway brand £m	Total £m
Current year			
Cost			
At 30 January 2005 and at 29 January 2006	**103.2**	**40.0**	**143.2**
Aggregate amortisation and impairment			
At 30 January 2005	–	40.0	40.0
Goodwill impaired	103.2	–	103.2
At 29 January 2006	**103.2**	**40.0**	**143.2**
Net book amount at 29 January 2006	**–**	**–**	**–**
	£m	£m	£m
Prior year			
Cost			
At 1 February 2004	–	–	–
Acquisition (note 27 (b))	103.2	40.0	143.2
At 30 January 2005	**103.2**	**40.0**	**143.2**
Aggregate amortisation and impairment			
At 1 February 2004	–	–	–
Write off brand (note 4)	–	40.0	40.0
At 30 January 2005	**103.2**	**40.0**	**40.0**
Net book amount at 30 January 2005	**103.2**	**–**	**103.2**

The goodwill of £103.2m shown above arose on the Safeway acquisition in the year ended 30 January 2005. No goodwill arose on the acquisition of the Rathbones business (note 27 (a)).

Goodwill is tested for impairment annually and whenever there is an indication of impairment. The Directors do not consider that goodwill can be allocated to individual stores (cash generating unit level) on a meaningful basis. Goodwill is consequently allocated to the portfolio of stores representing the lowest level within the group at which the goodwill is monitored for internal management purposes. Goodwill is tested at this level.

The annual loss for the year is an indication of impairment. Goodwill has been tested at this balance sheet date.

The goodwill impairment test is performed by comparing the carrying value of the portfolio of stores and associated goodwill with their aggregate recoverable amount. Recoverable amount is estimated by calculating value in use on a discounted cash flow basis. The key assumptions used in this calculation are estimates of sales growth, operating margins and the residual value of land.

The assumptions used are based on the Group's Optimisation Plan, which was finalised near the year end, and includes detailed budgets and forecasts prepared on a store by store basis covering the period 2006 to 2008. Cash flows after 2008 have been estimated by applying a long term growth rate of 1.5%. Cash flows have been discounted at 8.8%.

As the result of the impairment test indicated that nearly all of the £103.2m was impaired, the Directors have decided that given the sensitivities of the calculation, that a provision for the whole of the goodwill is made. A charge for impairment of goodwill of £103.2m (2005: £nil) has been included in the results. The impairment charge arises principally due to changes in assumptions regarding how long profit recovery will take. The events and circumstances that led to the recognition of this impairment loss are discussed further in the Financial review.

9 Property, plant and equipment	Land and buildings Freehold £m	Land and buildings Long leasehold £m	Land and buildings Short leasehold £m	Plant, equipment & vehicles £m	Total £m
Current year					
Cost					
At 30 January 2005	5,592.5	411.6	12.6	583.6	6,600.3
Additions at cost	367.8	3.4	–	283.8	655.0
Interest capitalised	11.8	–	–	–	11.8
Acquired from Joint Venture	61.3	1.6	–	4.8	67.7
Assets held for disposal transfer	55.5	(37.2)	1.8	2.5	22.6
Disposals	(10.1)	–	(0.2)	(58.8)	(69.1)
At 29 January 2006	**6,078.8**	**379.4**	**14.2**	**815.9**	**7,288.3**
Accumulated depreciation					
At 30 January 2005	438.7	27.6	7.8	418.1	892.2
Charge for the period	108.9	15.6	4.7	123.3	252.5
Assets held for disposal transfer	(3.1)	–	–	(1.2)	(4.3)
Disposals	(1.9)	–	(0.2)	(14.9)	(17.0)
Impairment (note 20)	21.0	–	–	–	21.0
At 29 January 2006	**563.6**	**43.2**	**12.3**	**525.3**	**1,144.4**
Net book amount at 29 January 2006	**5,515.2**	**336.2**	**1.9**	**290.6**	**6,143.9**
Assets under construction included above	**185.6**	**1.2**	**–**	**3.5**	**190.3**

	Land and buildings Freehold £m	Land and buildings Long leasehold £m	Land and buildings Short leasehold £m	Plant, equipment & vehicles £m	Total £m
Prior year					
Cost					
At 1 February 2004	1,743.2	129.2	3.0	365.9	2,241.3
Additions at cost	291.4	24.3	0.4	90.7	406.8
Acquisitions	4,488.6	422.3	255.5	284.0	5,450.4
Interest capitalised	4.8	1.6	–	–	6.4
Assets held for disposal transfer	(921.7)	(164.6)	(246.3)	(137.5)	(1,470.1)
Disposals	(13.8)	(1.2)	–	(19.5)	(34.5)
At 30 January 2005	**5,592.5**	**411.6**	**12.6**	**583.6**	**6,600.3**
Accumulated depreciation					
At 1 February 2004	357.1	11.4	3.0	284.5	656.0
Charge for the period	94.4	18.2	4.8	137.6	255.0
Disposals	(12.8)	(2.0)	–	(4.0)	(18.8)
At 30 January 2005	**438.7**	**27.6**	**7.8**	**418.1**	**892.2**
Net book amount at 30 January 2005	**5,153.8**	**384.0**	**4.8**	**165.5**	**5,708.1**
Assets under construction included above	130.1	–	–	–	130.1

The Group adopts a policy of including the cost of financing property developments prior to their opening date in the cost of the project. Interest capitalised in the period is £11.8m (2005: £6.4m).

9 Property, plant and equipment continued

Assets held under finance leases have the following net book amounts:

	2006 Vehicles and office equipment £m	2005 Vehicles and office equipment £m
Cost	21.8	21.8
Aggregate depreciation	(14.4)	(12.3)
Net book amount	7.4	9.5

10 Lease prepayments	2006 £m	2005 £m
Long lease land premiums	217.8	230.5

The current element of long lease land premiums is included within debtors (note 15).

11 Investment property	2006 £m	2005 £m
Cost		
At start of period	249.3	102.4
Acquisitions	–	139.1
Additions	3.3	7.8
Transfer from assets held for resale	8.4	–
At end of period	261.0	249.3
Accumulated depreciation		
At start of period	30.8	26.6
Charge for the period	4.4	4.2
Transfer from assets held for resale	0.5	–
At end of period	35.7	30.8
Net book amount at end of period	225.3	218.5

Included in other operating income is £13.0m (2005: £12.4m) of rental income generated from investment properties.

The fair value of investment properties at 29 January 2006 was £277.7m. This valuation has been determined by the Directors.

12 Investments in Joint Venture	2006 £m	2005 £m
Net assets at start of period	78.4	–
Acquisitions	–	74.8
Profit for the year	2.9	3.6
Dissolution (note27 (d))	(81.3)	–
Net assets at end of period	–	78.4

In relation to the Group's investment in joint ventures, the assets, liabilities, income and expenses are shown below.

	2006 £m	2005 £m
Current assets	–	42.8
Non-current assets	–	69.0
Current liabilities	–	(33.4)
Net assets	–	78.4
Income	66.4	180.0
Expenses	(63.5)	(176.4)
Share of pre-taxation results from joint ventures	2.9	3.6
Taxation	(0.7)	(1.4)
Share of post taxation results from joint ventures	2.2	2.2

The investment in joint ventures represents the Group's investment in the BP joint venture which was acquired as part of the Safeway acquisition. The joint venture owned and operated a number of petrol filling stations. This was dissolved on 7 June 2005. The details of this transaction are set out in note 27 (d).

13 Non-current assets classified as held for sale	2006 £m	2005 £m
Property	128.6	582.5

Non-current assets classified as held for sale represent stores and other administration and distribution buildings being marketed for sale. The amount reclassified from property, plant and equipment is all freehold and leasehold land and buildings including associated fixtures and fittings. The stock for those stores still trading is not reclassified as it will be immaterial at the time of sale. The results of any stores still trading continue to be included within trading results before Safeway integration and conversion costs.

14 Stocks	2006 £m	2005 £m
Materials and work in progress	9.1	8.3
Finished goods	390.3	416.3
	399.4	424.6

During the year write-downs of stocks to net realisable value were expensed to cost of sales as incurred. At year end the stocks write-down provision was reviewed and the decrease in that provision was £6.2m (2005: £3.8m).

15 Debtors	2006 £m	2005 £m
Trade debtors	88.6	83.5
Less: Provision for impairment of trade debtors	(4.3)	(3.0)
Trade debtors – net	84.3	80.5
Amounts due from Joint Venture	–	9.2
Lease prepayments – long lease land premiums	1.6	1.6
Other debtors	2.8	9.7
Prepayments and accrued income	66.8	115.1
Other taxes	1.9	8.1
	157.4	224.2

The Group has recognised a provision of £4.3m (2005: £3.0m) for the impairment of its trade debtors during the year ended 29 January 2006. The creation and usage of the provision for impaired debtors have been included in other expenses in the income statement.

16 Cash and cash equivalents	2006 £m	2005 £m
Cash and cash equivalents	135.3	93.5

Cash and cash equivalents include the following for the purposes of the cash flow statement:

	2006 £m	2005 £m
Cash and cash equivalents	135.3	93.5
Bank overdrafts (note 18)	(44.2)	(122.1)
	91.1	(28.6)

The effective interest rate on short-term deposits was 4.43% (2005: 4.25%) and these deposits have an average maturity of 1 day (2005: 1 day).

17 Creditors – current	2006 £m	2005 £m
Trade creditors	1,202.6	1,123.3
Amounts owed to Joint Venture (all trading balances)	–	42.8
Other tax and social security payable	52.6	60.0
Other creditors	101.2	86.5
Accruals and deferred income	97.2	107.5
Interest accrual	17.6	17.1
	1,471.2	1,437.2

18 Other financial liabilities – borrowings

The Group had the following current and non-current borrowings:

	2006 £m	2005 £m
Current		
Bank loans and overdrafts due within one year or on demand:		
Bank overdraft	44.2	122.1
Loans	250.0	150.0
	294.2	272.1
Finance lease obligations	2.4	2.6
	296.6	274.7

	Effective interest rate	2006 £m	2005 £m
Non-current			
£250m Sterling bonds August 2007	5.88%	251.9	253.0
£150m Sterling bonds August 2014	6.50%	157.1	157.9
£200m Sterling bonds January 2017	6.00%	202.9	203.1
£200m Sterling bonds December 2018	6.12%	205.3	205.6
€250m Euro bonds April 2010	6.50%	195.8	184.9
Total Sterling and Euro bonds		1,013.0	1,004.5
Other loan notes	4.20%	4.0	4.1
Finance lease obligations	5.01%	5.7	8.1
		1,022.7	1,016.7

The Sterling and Euro bonds are carried at amortised cost. The Euro bonds are retranslated at balance sheet date spot rates. The bonds had a fair value of £1,015.5m (2005: £1,041.0m).

Borrowings are denominated in Sterling and Euros and bear either fixed or variable interest based on LIBOR. All borrowings are unsecured.

In the event of default of covenants on the bank loan and bonds, the principal amounts and any interest accrued are repayable on demand.

18 Other financial liabilities – borrowings continued

Borrowing facilities

The Group has the following undrawn floating committed borrowing facilities available at 29 January 2006 in respect of which all conditions precedent had been met at that date:

	2006 £m	2005 £m
Expiring between 1 and 2 years	500.0	850.0

Payments under finance lease obligations fall due as follows:

	2006 £m	2005 £m
Not later than one year	2.8	3.1
Later than one year but not more than five years	6.2	8.6
More than five years	–	0.3
	9.0	12.0
Future finance charges on finance lease obligations	(0.9)	(1.3)
Present value of finance lease obligations	8.1	10.7

The maturity of the Group's non-current borrowings is as follows:

	2006 £m	2005 £m
Less than 1 year	–	–
1 to 2 years	254.7	3.2
2 to 3 years	5.5	255.1
3 to 4 years	197.2	5.8
5+ years	565.3	752.6
Total	1,022.7	1,016.7

Liquidity risk

The Group's policy is that to ensure continuity of funding, its borrowings are split between short-term overdraft facilities, deposits made overnight and longer-term loans. Short-term flexibility is achieved using overdraft facilities.

Foreign currency risk

The Group has various subsidiaries overseas but due to their size there is no material currency risk. Goods purchased in foreign currencies are paid for at the exchange rate ruling at the time of payment. There continues to be a small amount of exports by the Group but there is no material exchange rate risk associated with this.

19 Financial assets

	2006 £m	2005 £m
Interest rate swaps maturing 2007	1.6	6.3
Interest rate swaps maturing 2008	2.2	1.4
Cross-currency interest swap maturing 2010	32.6	29.3
	36.4	37.0

The interest rate and currency swaps cover the Group from the currency and fixed interest exposure arising from the Sterling and Euro bonds. During 2006 none of the derivatives were accounted for as hedges as defined by IAS 39 *Financial instruments: Recognition and measurement*.

There are no contracts with embedded derivatives that have been identified to be accounted for separately as required by IAS 39.

The notional principal amount of the outstanding interest rate swap contracts at 29 January 2006 was £350m (2005: £350m).

At 29 January 2006 the fixed interest rates of interest rate swaps vary from 5.875% to 6.50% (2005: 5.875% to 6.50%) and floating rates are 5.32% to 5.44% (based on six month LIBOR plus costs).

20 Provisions	Restructuring £m	Property provisions £m	Total £m
At 30 January 2005	–	55.8	55.8
Charged to profit and loss account	53.7	23.9	77.6
Utilised in period	–	(10.4)	(10.4)
Unwinding of discount	–	4.2	4.2
At 29 January 2006	**53.7**	**73.5**	**127.2**

The non-current portion of the provision has not been separated as the current portion is immaterial.

Restructuring

As a result of the takeover of Safeway, there are 3 distribution centres which are surplus to the requirements of the Group. A provision has been made to cover the expected costs to close the centres. It is anticipated that the costs will be incurred in the forthcoming year. In addition to the above, a further £21m has been provided for impairment in value to the buildings and fittings. The impairment is based on estimated sale proceeds as valued by the Directors.

Property provisions

Property disposal provisions comprise petrol filling station decommissioning reserve, onerous leases provision and provisions for dilapidations on leased buildings.

Decommissioning costs are incurred when the petrol filling station tanks have reached the end of their useful life or when they become redundant. A provision is recognised for the present value of costs to be incurred to decommission the petrol tanks.

Onerous leases relate to sublet properties. Where the rent receivable is less than the rent payable, a provision based on present value of the net cost is made to cover the expected shortfall. The lease commitments range from 1 to 67 years.

Dilapidation costs are incurred to bring a leased building back to the condition to which it was originally leased. The costs are due to the landlord on termination of the lease.

21 Deferred tax	2006 £m	2005 £m
Deferred tax liability	**609.1**	719.5
Deferred tax asset	**(186.5)**	(217.9)
Net deferred tax liability	**422.6**	501.6

All of the deferred tax assets were available for offset against deferred tax liabilities.

Deferred tax assets have been recognised in respect of differences between accounting and tax carrying values where it is probable that these assets will be recovered.

The movements in deferred tax assets and liabilities (prior to the offsetting of balances within the same jurisdiction as permitted by IAS 12 *Income Taxes*) during the period are shown below.

	Property, plant and equipment £m	Pensions £m	Share-based payments £m	Provisions £m	Total £m
At 30 January 2005	(719.5)	122.4	4.4	91.1	(501.6)
Credited/(charged) to income statement	112.1	(10.8)	1.7	(32.3)	70.7
Credited directly to equity	–	13.3	–	–	13.3
Share-based payments	–	–	(3.3)	–	(3.3)
Other	(1.7)	–	–	–	(1.7)
At 29 January 2006	**(609.1)**	**124.9**	**2.8**	**58.8**	**(422.6)**
At 1 February 2004	(58.0)	23.1	3.8	19.2	(11.9)
Credited to income statement	0.1	0.9	1.1	31.4	33.5
Credited directly to equity	–	23.0	–	–	23.0
Acquisition of subsidiary	(661.6)	75.4	–	40.5	(545.7)
Other	–	–	(0.5)	–	(0.5)
At 30 January 2005	**(719.5)**	**122.4**	**4.4**	**91.1**	**(501.6)**

21 Deferred tax continued

The deferred income tax credited/(charged) to equity during the period is as follows:

	2006 £m	2005 £m
Actuarial gains/losses – taken through the SORIE	13.3	23.0
Share options	(3.3)	–

22 Called up share capital	Number of shares millions	Share capital £m	Share premium £m	Total £m
At 30 January 2005	2,658	265.8	20.1	285.9
Share options exercised	15	1.5	16.8	18.3
At 29 January 2006	**2,673**	**267.3**	**36.9**	**304.2**
At 1 February 2004	1,574	157.4	15.9	173.3
Share options exercised	2	0.2	3.6	3.8
Acquisition of subsidiary (note 27 (b))	1,079	107.9	–	107.9
Shares issued	3	0.3	0.6	0.9
At 30 January 2005	**2,658**	**265.8**	**20.1**	**285.9**

The total authorised number of ordinary shares is 4,000m shares (2005: 4,000m shares) with a par value of 10p per share (2005: 10p per share). All issued shares are fully paid.

Potential issues of ordinary shares

Certain eligible employees hold options to subscribe for shares in the Company at prices ranging from 77.5p to 239.3p under the share option schemes approved by shareholders. Options on 15m shares were exercised in 2006. The number of shares subject to options, the periods in which they were granted and the periods in which they may be exercised are given in note 23.

23 Share-based payments

(a) Share-based payments

The Group operates a number of share-based payments schemes; the Executive share option scheme, the Sharesave scheme, the Safeway Customer Care Performance Share Ownership Plan ("CCPSOP") and a Long Term Incentive Plan ("LTIP"). In line with IFRS 2 *Share-based payment*, the Group has fair valued all grants of equity instruments and shadow equity instruments after 7 November 2002 which were unvested as of 1 January 2005.

The total charge for the period relating to employee share-based payment plans was £4.0m (2005: £2.6m), of which £0.7m (2005: £0.4m) related to equity-settled share-based payment transactions. After deferred tax, the total charge was £2.3m (2005: £1.5m).

Executive share option scheme

In May 1995 the Group adopted the 1995 Senior Executive Share Option Scheme which is available to Directors and other senior employees. The scheme offers options at the market price two weeks prior to the date of the grant which are normally exercisable between three and ten years from the date of grant. The maximum exercise value of the ordinary shares subject to options held by an individual must not exceed the greater of four times earnings and £100,000. The exercise of options under the scheme is subject to performance criteria broadly requiring an increase in Group operating profits of at least 20% between the year prior to the date of the grant and its third or any succeeding anniversary. The scheme is equity settled.

Those options which have been granted after 7 November 2002 have been fair valued using the Binomial stochastic option pricing model. The fair value per option granted and the assumptions are as follows:

Grant date	12/11/2004	02/04/2003
Share price at grant date	£2.33	£1.81
Fair value of options granted	£1,427,070	£1,886,816
Exercise price	£2.22	£1.75
Dividend yield	1.43%	1.49%
Annual risk free interest rate	4.61%	4.12%
Expected volatility*	29.4%	29.4%

* The volatility measured at the standard deviation of expected share price returns is based on statistical analysis of weekly share prices over the last six years.

23 Share-based payments continued

The fair value calculations do not incorporate the effects of non-market vesting conditions.

	2006		2005	
	Weighted average exercise price in £ per share	Options thousands	Weighted average exercise price in £ per share	Options thousands
Outstanding at start of period	1.86	9,255	1.72	8,237
Granted	–	–	2.22	1,980
Exercised	1.08	(360)	1.40	(962)
Expired	1.96	(744)	–	–
Outstanding at end of period	1.89	8,151	1.86	9,255
Exercisable at end of period	1.85	3,195	1.78	3,705

	2006				2005			
	Weighted average exercise price	Number of shares	Weighted average remaining life years		Weighted average exercise price	Number of shares	Weighted average remaining life years	
Range of exercise price			Expected	Contractual			Expected	Contractual
£1.68 – £1.95	190.00p	360,000	1.7	6.7	191.13p	962,492	2.0	6.8

Sharesave scheme

The Sharesave scheme has been in operation since 18 May 2000 and is eligible for all employees (including Directors) once the necessary service requirements have been met. Options are offered at a discount of 20% to the mid-market closing price on the day prior to the offer and are exercisable for a period of 6 months commencing 5 years after the savings contract commencement date. The maximum term of the option is 5 years. The exercise of options under this scheme is not subject to any performance conditions and is equity settled.

	2006		2005	
	Weighted average exercise price in £ per share	Options thousands	Weighted average exercise price in £ per share	Options thousands
Outstanding at start of period	1.55	31,143	1.39	23,651
On acquisition of Safeway*	–	–	1.90	13,283
Exercised	1.24	(14,360)	1.67	(1,479)
Expired	2.01	(4,904)	1.68	(4,312)
Outstanding at end of period	1.74	11,879	1.55	31,143
Exercisable at end of period	1.01	10,302	1.55	30,516

* Options granted by Safeway plc under the Safeway Sharesave Scheme and rolled over into ordinary shares of 10p each in the Company following the acquisition of Safeway plc by the Company.

	2006				2005			
	Weighted average exercise price	Number of shares	Weighted average remaining life years		Weighted average exercise price	Number of shares	Weighted average remaining life years	
Range of exercise price			Expected	Contractual			Expected	Contractual
£1.65 – £2.23	181.34p	14,359,881	1.0	1.0	197.00p	1,497,318	1.1	1.1

The Group has not fair valued the Sharesave plan since the grants of the options were all made before 7 November 2002 and remained unvested as at 1 January 2005.

23 Share-based payments continued

Safeway Customer Care Performance Share Ownership Plan ("CCPSOP")

Awards under the Safeway Customer Care Performance Share Ownership Plan ("CCPSOP") were made between 1997 and 1999. Options granted to employees under the plan are exercisable normally between 3 and 6½ years after the date of the grant. The maximum term of the option is 5 years and the scheme is equity settled. Following the acquisition of Safeway plc by the Company, options under CCPSOP were rolled over into options over shares in the Company. The Group has not fair valued the CCPSOP since the grants of the options were all made before 7 November 2002 and remained unvested as at 1 January 2005.

	2006		2005	
	Weighted average exercise price in £ per share	Options thousands	Weighted average exercise price in £ per share	Options thousands
Outstanding at start of period	2.30	6,247	–	–
At 8 March 2004*	–	–	2.39	12,644
Exercised	2.37	(5,615)	2.47	(6,397)
Outstanding at end of period	1.66	632	2.30	6,247
Exercisable at end of period	1.66	632	2.30	6,247

* Acquisition of Safeway.

Data in respect of the range of exercise prices and weighted average contractual lives are not given in respect of the CCPSOP scheme in isolation on the grounds of materiality.

(b) Long Term Incentive Plan ("LTIP")

The Group's LTIP scheme was made available to certain employees prior to the Safeway integration. Shadow shares were awarded to 684 employees as at 1 September 2004. The cash payment will be made on 1 September 2007 based on the number of shares multiplied by the average share price of the preceding week. The scheme is cash settled.

Options are valued using the Binomial stochastic option pricing model. The fair value per option granted and the assumptions are as follows:

Remeasurement/grant date	29/1/2006	30/1/2005	1/9/2004
Share price at grant date	£1.87	£2.03	£1.82
Fair value of options granted	£17,979,079	£19,633,823	£17,728,401
Exercise price	£nil	£nil	£nil
Dividend yield	1.98%	1.64%	1.79%

The fair value calculations do not incorporate the effects of non-market vesting conditions.

The total charge for the period relating to the cash settled LTIP was £3.3m (2005: £2.2m). After deferred tax, the total charge was £2.3m (2005: £1.5m).

24 Statement of changes in shareholders' equity	Share capital £m	Share premium £m	Retained earnings £m	Merger reserve £m	Total £m
Current year					
At 30 January 2005	265.8	20.1	1,141.7	2,578.3	4,005.9
Total recognised income and expense	–	–	(278.5)	–	(278.5)
Prior year impact of adoption of IAS 39	–	–	3.4	–	3.4
Share issues	1.5	16.8	–	–	18.3
Share option charge	–	–	0.6	–	0.6
Deferred tax on options	–	–	(3.3)	–	(3.3)
Dividends	–	–	(97.8)	–	(97.8)
At 29 January 2006	**267.3**	**36.9**	**766.1**	**2,578.3**	**3,648.6**

24 Statement of changes in shareholders' equity continued	Share capital £m	Share premium £m	Retained earnings £m	Merger reserve £m	Total £m
Prior year					
At 1 February 2004	157.4	15.9	1,223.9	–	1,397.2
Total recognised income and expense	–	–	48.5	–	48.5
Conversion of preference share capital	0.3	0.6	–	–	0.9
Acquired treasury shares	–	–	(43.7)	–	(43.7)
Share issues	108.1	3.6	–	2,578.3	2,690.0
Share option charge	–	–	0.7	–	0.7
Dividends	–	–	(87.7)	–	(87.7)
At 30 January 2005	**265.8**	**20.1**	**1,141.7**	**2,578.3**	**4,005.9**

Included in retained earnings is a deduction of £43.7m (2005: £43.7m) in respect of treasury shares held at balance sheet date.

Interests in own shares represent the cost of 17,761,844 of the Company's ordinary shares (nominal value of £1.8m) purchased in March 2004 as part of the Safeway acquisition. These shares are held by a trust using funds provided by the Group and were acquired to meet obligations under the share option schemes. The costs of funding and administering the scheme are charged to the profit and loss account of the Company in the period to which they relate. The market value of the shares at 29 January 2006 was £33.6m (2005: £36.2m). The ESOS waiver of their rights to dividends is set out in the accounting policy note on Treasury Shares.

25 Cash flow from operating activities	2006 £m	2005 £m
(Loss)/profit for the period	**(250.3)**	105.0
Adjustments for:		
Taxation	**(62.6)**	88.0
Depreciation and amortisation	**256.9**	299.2
Impairment of assets to be disposed	**124.2**	–
Loss on disposal of property, plant and equipment	**9.2**	0.4
Net finance cost (note 5)	**52.2**	65.4
Other non-cash changes	**0.7**	0.9
Share of results of joint ventures after taxation	**(2.2)**	(2.2)
Excess of contributions over pension service cost	**(35.2)**	(6.2)
Decrease/(increase) in stocks	**25.2**	(11.7)
Decrease/(increase) in debtors	**52.2**	(79.7)
Increase/(decrease) in creditors	**73.5**	(6.9)
Increase/(decrease) in provisions	**67.2**	(4.2)
Cash generated from operations	**311.0**	448.0

26 Analysis of net debt	2006 £m	2005 £m
Cash and cash equivalents (note 16)	**135.3**	93.5
Bank overdrafts (note 18)	**(44.2)**	(122.1)
Cash and cash equivalents per cash flow	**91.1**	(28.6)
Interest and cross-currency swaps	**36.4**	37.0
Financial assets (note 19)	**36.4**	37.0
Loans	**(250.0)**	(150.0)
Finance lease obligations	**(2.4)**	(2.6)
Current financial liabilities (note 18)	**(252.4)**	(152.6)
Bonds	**(1,013.0)**	(1,004.5)
Other unsecured loans	**(4.0)**	(4.1)
Finance lease obligations	**(5.7)**	(8.1)
Non-current financial liabilities (note 18)	**(1,022.7)**	(1,016.7)
Net debt	**(1,147.6)**	(1,160.9)

27 Acquisitions and disposals

(a) Acquisition of trade and assets of the Rathbones business

In April 2005 the Group created a company called Rathbone Kear Limited. The Group owns 80% of the share capital of this company; the other 20% being owned by Mr H Kear. Rathbone Kear Limited purchased the trade and assets of a bakery business from the Receiver of Rathbones Bakeries Limited. The Group also purchased other bakery property and assets from the Receiver of Rathbones Bakeries Limited for £9.5m. The Group allows Rathbone Kear Limited to use these assets in return for a commercial rent. The trade of Rathbone Kear Limited is that of a bakery business and distributor of pre-packaged bakery products.

	Book value £m	Fair value at acquisition £m
Acquisition		
Property, plant and equipment	4.6	**6.1**
Inventories	0.2	**0.2**
Payables	(0.2)	**(0.2)**
Cash and cash equivalents	–	**–**
Net assets acquired	4.6	**6.1**
Consideration satisfied by:		
Cash		6.1

A full year's results for Rathbone Kear Limited for 2006 would have been £31.7m of turnover and £1.5m of loss before taxation.

(b) Acquisition in prior year – Safeway Limited

On 8 March 2004, the group acquired the entire issued share capital of Safeway Limited (formerly Safeway plc) for a total consideration of £3,351.3m comprising £665.2m cash and the issue of approximately 1,079m ordinary shares at a fair value of £2,686.1m.

	On acquisition £m	Fair value £m
Property, plant and equipment acquired at written down value	3,820.9	5,450.5
Intangible brand	–	40.0
Investments	127.5	130.5
Investment property	64.9	139.1
Lease prepayments	95.9	133.4
Stocks	312.6	262.6
Financial assets	–	40.2
Debtors	117.3	117.3
Creditors	(885.6)	(875.6)
Provisions for liabilities and charges	(158.2)	(593.4)
Pension liability	(251.0)	(251.0)
Other financial liabilities	(1,284.0)	(1,345.5)
Net assets acquired	1,960.3	3,248.1
Satisfied by:		
Cash paid to shareholders		647.3
Associated fees		17.9
Monetary consideration		665.2
Share issue		2,686.1
Total consideration		3,351.3
Goodwill created		103.2

27 Acquisitions and disposals continued

(c) Disposal of Safeway Stores (Jersey) Limited and Safeway Stores (Guernsey) Limited

On 30 April 2005 the Group disposed of its investments in Safeway Stores (Jersey) Limited and Safeway Stores (Guernsey) Limited for a consideration of £49.1m.

	£m
Property, plant and equipment	**50.6**
Current assets	**1.4**
Total assets	**52.0**
Creditors	**(2.9)**
Net assets disposed	**49.1**
Profit on disposal	**–**

The proceeds arising from the sale of Safeway Stores (Jersey) Limited and Safeway Stores (Guernsey) Limited were £49.1m, all of which were settled by cash. No cash or cash equivalents were disposed as part of the transaction.

The results of Safeway Stores (Jersey) Limited and Safeway Stores (Guernsey) Limited were not material to the Group.

(d) Dissolution of the BP Joint Venture

On 7 June 2005, the Group dissolved its joint venture with BP (BP and Safeway partnership). The 61 petrol filling stations were divided between the Group and BP.

	£m
Share of net assets	**81.3**
Dissolution	**(81.3)**
Profit on dissolution	**–**

The dissolution comprised fixed assets valued at £67.7m and sundry other assets and liabilities. These fixed assets were subsequently sold to third parties for £87.0m for a profit of £19.3m.

The proceeds arising from the dissolution of the BP and Safeway partnership were not settled by cash. No cash or cash equivalents were disposed as part of the transaction.

28 Pension liabilities

Defined benefit pension schemes

The Group operates two pension schemes, the ‘Morrison’ and ‘Safeway’ schemes, providing benefits based on final pensionable pay. The assets of the schemes are held in separate trustee administered funds and no part of the schemes is wholly unfunded. The latest full actuarial valuations, which were carried out at 6 April 2005 and 1 April 2004 for the Morrison and Safeway schemes respectively, were updated for IAS 19 *Employee benefits* purposes for the periods to 29 January 2006 and 30 January 2005 by a qualified independent actuary.

The current joint employer/employee contribution rate of 14.0 – 16.8% of pensionable pay that applied in 2005 /06 will continue to apply until the review following the next valuation of the schemes. This is due on 6 April 2006 for the Morrison scheme and 1 April 2007 for the Safeway scheme. Additional voluntary augmentation payments are currently also being made in respect of the Safeway scheme. As the schemes are closed to new entrants, the current service cost as a percentage of pensionable payroll is likely to increase as the membership ages, although it will be applied to a decreasing pensionable payroll.

The current best estimate of employer contributions to be paid for the year commencing 30 January 2006 is £92m.

28 Pension liabilities continued

Assumptions

The major assumptions used in this valuation to determine the present value of the schemes' defined benefit obligations were as follows:

	2006	2005
Rate of increases in salaries	**4.25 – 5.25%**	4.25 – 5.25%
Rate of increase in pensions in payment and deferred pensions	**3.00%**	3.00%
Discount rate applied to scheme liabilities	**4.75%**	5.25%
Inflation assumption	**3.00%**	3.00%

Assumptions regarding future mortality experience are set based on advice in accordance with published statistics. The current mortality table used is PA92 C2020.

The average life expectancy in years of a pensioner retiring at the age of 65 is as follows:

	2006	2005
Male	**19.9**	19.9
Female	**22.8**	22.8

The major assumptions used to determine the expected future return on the schemes' assets were as follows:

	2006	2005
Long term rate of return on:		
Equities	**7.00%**	7.00%
Bonds	**4.25%**	5.00%
Property	**7.00%**	7.00%
Cash	**4.50%**	4.75%

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescales covered, may not necessarily be borne out in practice. The expected return on plan assets is based on market expectation at the beginning of the period for returns over the entire life of the benefit obligation.

Valuations

The fair value of the schemes' assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the schemes' liabilities which are derived from cash flow projections over long periods and are inherently uncertain, were as follows:

	2006 £m	2005 £m
Equities	**1,190.3**	958.1
Bonds	**211.2**	163.7
Property	**54.0**	12.5
Cash	**80.3**	82.6
Total fair value of plan assets	**1,535.8**	1,216.9
Present value of defined benefit funded obligation	**(1,952.0)**	(1,625.0)
Deficit in the scheme – pension liability in the balance sheet	**(416.2)**	(408.1)
Related deferred tax asset (note 21)	**124.9**	122.4
Net deficit	**(291.3)**	(285.7)

28 Pension liabilities continued

The movement in the fair value of the schemes' assets over the year is as follows:

	2006 £m	2005 £m
Fair value of plan assets at start of period	1,216.9	1,035.4
Expected return on plan assets	83.2	64.1
Actuarial gains	165.3	59.9
Employer contributions	92.1	63.4
Employee contributions	12.9	16.7
Benefits paid	(34.6)	(22.6)
Fair value of plan assets at end of period	1,535.8	1,216.9

The above pension scheme assets do not include any investments in the parent company's own shares or property occupied by the Company or its subsidiaries at either period end.

The movement in the present value of the defined benefit obligation during the period was as follows:

	2006 £m	2005 £m
Defined benefit obligation at start of period	(1,625.0)	(1,363.1)
Current service cost	(55.0)	(55.9)
Past service cost	(1.9)	(1.3)
Employee contributions	(12.9)	(16.7)
Interest on defined benefit obligation	(86.2)	(70.2)
Actuarial loss recognised in the SORIE	(205.6)	(140.4)
Benefits paid	34.6	22.6
Defined benefit obligation at end of period	(1,952.0)	(1,625.0)

Income statement

The following amounts have been charged in employee benefits in arriving at operating profit as set out in note 2:

	2006 £m	2005 £m
Current service cost	(55.0)	(55.9)
Past service cost	(1.9)	(1.3)
	(56.9)	(57.2)

The following amounts have been included in finance income and finance costs respectively:

	2006 £m	2005 £m
Expected return on pension scheme assets	83.2	64.1
Interest on pension scheme liabilities	(86.2)	(70.2)
	(3.0)	(6.1)

Actuarial gains and losses recognised in the statement of recognised income and expense (SORIE)

The amounts included in the statement of recognised income and expense were:

	2006 £m	2005 £m
Actual return less expected return on scheme assets	165.3	59.9
Experience gains and losses arising on plan obligation	13.3	(33.4)
Changes in demographic and financial assumptions underlying the present value of plan obligations	(218.9)	(107.0)
Actuarial loss recognised in the SORIE	(40.3)	(80.5)
Taxation on actuarial loss in the SORIE	12.1	24.0
Net actuarial loss recognised in the SORIE	(28.2)	(56.5)
Cumulative net actuarial loss recognised in the SORIE	(84.7)	(56.5)

28 Pension Liabilities continued

The actual return on plan assets can therefore be summarised as follows:

	2006 £m	2005 £m
Expected return on plan assets	83.2	64.1
Actuarial gain recognised in the SORIE reflecting the difference between expected and actual return on assets	165.3	59.9
Actual return on plan assets	248.5	124.0

The expected return on plan assets was determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields as at the balance sheet date. Expected returns on equity and property investments reflect long term real rates of return experienced in the respective markets.

History of experience gains and losses	2006 £m	2005 £m
Difference between the expected and actual return on scheme assets:		
Amount	165.3	59.9
Percentage of scheme assets	10.8%	4.9%
Experience gains and losses arising on scheme liabilities:		
Amount	13.3	(33.4)
Percentage of present value of plan obligation	0.7%	(2.1%)
Effects of changes in the demographic and financial assumptions underlying the present value of the scheme liabilities:		
Amount	(218.9)	(107.0)
Percentage of present value of plan obligation	(11.2%)	(6.6%)
Total amount recognised in the SORIE:		
Amount	(40.3)	(80.5)
Percentage of present value of plan obligation	(2.1%)	(5.0%)

Defined contribution pension scheme

Employees joining the company after September 2000 are no longer eligible to gain automatic entry into the final salary pension scheme. In June 2001 the company established a stakeholder pension scheme, open to all employees, to which the company makes matching contributions of a maximum of 5% of eligible earnings. Pension costs for the defined contribution scheme are as follows:

	2006 £m	2005 £m
Stakeholder pension scheme	1.1	1.0
Life assurance scheme	0.9	0.5
Total costs	2.0	1.5

29 Operating lease arrangements

Lessee arrangements

The Group has outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2006 Property £m	2006 Vehicles, plant and equipment £m	2005 Property £m	2005 Vehicles, plant and equipment £m
Within one year	0.3	0.3	8.2	15.4
Later than one year and less than five years	6.0	4.8	9.8	34.9
After five years	602.3	–	817.5	–
	608.6	5.1	835.5	50.3

The Group leases various offices, stores and warehouses under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The Group also leases plant and machines under non-cancellable operating lease agreements.

29 Operating lease arrangements continued

Lessor arrangements

The Group has non-cancellable agreements with tenants and the future minimum lease income is as follows:

	2006 £m	2005 £m
Within one year	0.5	0.1
More than one year and less than five years	9.3	10.2
After five years	198.6	217.3
	208.4	227.6

The Group sub-lets buildings of various nature under non-cancellable agreements. The leases have various terms, escalation clauses and renewal rights.

30 Capital and other financial commitments	2006 £m	2005 £m
Contracts placed for future capital expenditure not provided in the financial statements	74.3	36.5

31 Related party transactions

The following transactions were carried out with related parties:

(a) BP Joint Venture	2006 £m	2005 £m
Sales	36.2	86.6
Management charges	8.5	24.4
	44.7	111.0

Goods are bought on the basis of the price lists in force with non-related parties.

(b) Period-end balances arising from sales/purchases of goods	2006 £m	2005 £m
Receivables from related parties (note 15)	–	9.2
Payables to related parties (note 17)	–	(42.8)

Key management compensation is disclosed in note 2.

32 Post balance sheet events

The Directors are proposing a final dividend in respect of the financial period ending 29 January 2006 of 3.075p per share which will absorb an estimated £82.2m of shareholders' funds. This amount will be charged to retained earnings when authorised by the shareholders at the AGM on 25 May 2006. It will be paid on 30 May 2006 to shareholders who are on the register of members on 28 April 2006.

8 properties were disposed between 29 January 2006 and 22 March 2006, realising disposal proceeds of £44.9m.

33 Principal subsidiaries and joint ventures

Subsidiaries of Wm Morrison Supermarkets PLC	Principal activity	% equity holding
Bos Brothers Fruit and Vegetables BV	produce wholesaler	100
Farmers Boy Limited	manufacture and distribution of fresh food products	100
Farock Insurance Company Limited	captive insurance	100
Holsa Limited	packaging manufacturer	100
Nathanspire Limited	financial services	100
Neerock Limited	fresh meat processor	100
Wm Morrison Produce Limited	produce packer	100
Safeway Limited	holding company	100
Rathbone Kear Limited	baker	80
Subsidiaries of Safeway Limited		
Safeway Overseas Limited	grocery retailing	100
Safeway Stores Limited	grocery retailing	100
Safeway Stores (Ireland) Limited	grocery retailing	100
Safeway Stores (Card Services) Limited	financial services	100

All the above companies are registered in England and Wales except Bos Brothers Fruit and Vegetables BV which is incorporated in The Netherlands and Farock Insurance Company Limited which is incorporated in the Isle of Man.

The principal area of trading for all the above companies is the United Kingdom apart from Bos Brothers Fruit and Vegetables BV and Safeway Overseas Limited who also trade in the rest of Europe.

In addition to the above, the Company has a number of other subsidiary companies, particulars of which will be annexed to the next annual return.

The Joint Venture with BP was dissolved on 7 June 2005.

34 Reconciliation of net assets and profit under UK GAAP to IFRS

Wm Morrison Supermarkets PLC reported under UK GAAP in its previously published financial statements for the 52 weeks ended 30 January 2005. The analysis below shows a reconciliation of net assets and profit as reported under UK GAAP as at 30 January 2005 to the revised net assets and profit under IFRS as reported in these financial statements as required by IFRS 1. There is a reconciliation of net assets under UK GAAP to IFRS at the transition date for this company, being 2 February 2004.

Reconciliation of profit for the 52 weeks ended 30 January 2005

	UK GAAP[1] £m	IFRS 2 Share-based payment £m	IAS 19 Employee benefits £m	IAS 17 Leases £m	IFRS 3 Bus Combs/ IAS 38 Intangibles £m	IAS 10 Events after balance sheet date £m	Other Reclass-ifications £m	Other items[2] £m	IFRS £m
Turnover	12,116.1	–	–	–	–	–	(12.4)	–	**12,103.7**
Other operating income	5.9	–	–	–	–	–	12.4	–	**18.3**
Raw materials and consumables	(9,168.0)	–	–	–	–	–	–	57.7	**(9,110.3)**
Gross profit	2,954.0	–	–	–	–	–	–	57.7	**3,011.7**
Staff costs	(1,583.2)	(2.6)	(1.1)	–	–	–	–	50.0	**(1,536.9)**
Depreciation and amortisation	(264.9)	–	–	2.3	–	–	3.4	–	**(259.2)**
Net profit on sale of property, plant and equipment	–	–	–	–	–	–	14.5		**14.5**
Other operating expenses	(725.6)	–	–	(1.4)	–	–	–	(107.7)	**(834.7)**
Negative goodwill amortisation	58.2	–	–	–	(58.2)	–	–	–	**–**
Profit on divestment of assets	17.9	–	–	–	–	–	(17.9)	–	**–**
Safeway integration costs	(99.2)	–	–	–	(40.0)	–	–	–	**(139.2)**
Operating profit	357.2	(2.6)	(1.1)	0.9	(98.2)	–	–	–	**256.2**
Finance costs	(84.8)	–	(1.7)	–	–	–	–	–	**(86.5)**
Finance income	21.1	–	–	–	–	–	–	–	**21.1**
Share of post tax BP joint venture profit	3.6	–	–	–	–	–	(1.4)	–	**2.2**
Profit before taxation	297.1	(2.6)	(2.8)	0.9	(98.2)	–	(1.4)	–	**193.0**
Taxation	(91.4)	1.1	0.9	–	–	–	1.4	–	**(88.0)**
Profit for the period	205.7	(1.5)	(1.9)	0.9	(98.2)	–	–	–	**105.0**

1 As previously reported, adjusted only to extract Safeway integration costs to a separate line.

2 Reclassification under UK GAAP to reallocate distribution costs.

34 Reconciliation of net assets and profit under UK GAAP to IFRS continued

Reconciliation of equity at 30 January 2005

	UK GAAP[1] £m	IFRS 2 Share-based payment £m	IAS 19 Employee benefits £m	IAS 17 Leases £m	IFRS 3 Bus Combs/ IAS 38 Intangibles £m	IAS 10 Events after balance sheet date £m	Other Reclass-ifications £m	Other items £m	IFRS £m
Non-current assets									
Intangible assets	(262.9)	–	–	–	366.2	–	–	(0.1)	**103.2**
Property, plant and equipment	6,824.0	–	–	(224.7)	(75.2)	–	(815.9)	(0.1)	**5,708.1**
Lease prepayments	–	–	–	230.5	–	–	–	–	**230.5**
Investment property	–	–	–	–	–	–	218.5	–	**218.5**
Investment in Joint Venture	67.4	–	–	–	11.0	–	–	–	**78.4**
Financial assets	–	–	–	–	10.6	–	26.3	0.1	**37.0**
	6,628.5	–	–	5.8	312.6	–	(571.1)	(0.1)	**6,375.7**
Current assets									
Stocks	424.6	–	–	–	–	–	–	–	**424.6**
Debtors	222.6	–	–	1.6	–	–	–	–	**224.2**
Cash and cash equivalents	93.5	–	–	–	–	–	–	–	**93.5**
	740.7	–	–	–	–	–	–	–	**742.3**
Non-current assets classified as held for sale	–	–	–	–	–	–	582.5	–	**582.5**
	740.7	–	–	1.6	–	–	582.5	–	**1,324.8**
Liabilities									
Current liabilities									
Creditors	(1,536.6)	(2.2)	(0.3)	–	5.0	82.0	14.9	–	**(1,437.2)**
Other financial liabilities	(274.7)	–	–	–	–	–	–	–	**(274.7)**
Current tax liabilities	(0.5)	–	–	–	–	–	–	–	**(0.5)**
	(1,811.8)	(2.2)	(0.3)	–	5.0	82.0	14.9	–	**(1,712.4)**
Non-current liabilities									
Other financial liabilities	(990.4)	–	–	–	(0.1)	–	(26.3)	0.1	**(1,016.7)**
Deferred tax liabilities	(206.3)	4.4	9.6	–	(422.2)	–	112.9	–	**(501.6)**
Pension liabilities	(263.5)	–	(31.7)	–	–	–	(112.9)	–	**(408.1)**
Provisions	(80.2)	(0.1)	–	–	24.4	–	–	0.1	**(55.8)**
	(1,540.4)	4.3	(22.1)	–	(397.9)	–	(26.3)	0.2	**(1,982.2)**
Net assets	4,017.0	2.1	(22.4)	7.4	(80.3)	82.0	–	0.1	**4,005.9**
Shareholders' equity									
Called up share capital	265.8	–	–	–	–	–	–	–	**265.8**
Share premium	20.1	–	–	–	–	–	–	–	**20.1**
Merger reserve	2,578.3	–	–	–	–	–	–	–	**2,578.3**
Retained earnings	1,152.8	2.1	(22.4)	7.4	(80.3)	82.0	–	0.1	**1,141.7**
Total equity	4,017.0	2.1	(22.4)	7.4	(80.3)	82.0	–	0.1	**4,005.9**

1 As previously reported.

34 Reconciliation of net assets and profit under UK GAAP to IFRS continued

Reconciliation of equity at 2 February 2004 (date of transition to IFRS)

	UK GAAP[1] £m	IFRS 2 Share-based payment £m	IAS 19 Employee benefits £m	IAS 17 Leases £m	IAS 10 Events after balance sheet date £m	Other Reclass-ifications £m	Other items £m	IFRS £m
Non-current assets								
Intangible assets	–	–	–	–	–	–	–	**–**
Property, plant and equipment	1,738.7	–	–	(85.3)	–	(75.8)	7.7	**1,585.3**
Lease prepayments	–	–	–	91.8	–	–	–	**91.8**
Investment property	–	–	–	–	–	75.8	–	**75.8**
Investment in Joint Venture	–	–	–	–	–	–	–	**–**
Financial assets	–	–	–	–	–	–	–	**–**
	1,738.7	–	–	6.5	–	–	7.7	**1,752.9**
Current assets								
Stocks	150.3	–	–	–	–	–	–	**150.3**
Debtors	26.3	–	–	–	–	–	–	**26.3**
Cash and cash equivalents	315.4	–	–	–	–	–	–	**315.4**
	492.0	–	–	–	–	–	–	**492.0**
Liabilities								
Current liabilities								
Creditors	(652.2)	–	(0.6)	–	71.6	–	–	**(581.2)**
Other financial liabilities	(108.8)	–	–	–	–	–	–	**(108.8)**
Current tax liabilities	(53.3)	–	–	–	–	–	–	**(53.3)**
	(814.3)	–	(0.6)	–	71.6	–	–	**(743.3)**
Non-current liabilities								
Other financial liabilities	–	–	–	–	–	–	–	**–**
Pension liabilities	(47.5)	–	(8.8)	–	–	(20.4)	–	**(76.7)**
Deferred tax liabilities	(38.9)	3.8	2.8	–	–	20.4	(1.8)	**(13.7)**
Provisions	(12.6)	–	–	–	–	–	–	**(12.6)**
	(99.0)	3.8	(6.0)	–	–	–	(1.8)	**(103.0)**
Net assets	1,317.4	3.8	(6.6)	6.5	71.6	–	5.9	**1,398.6**
Shareholders' equity								
Called up share capital	158.8	–	–	–	–	–	–	**158.8**
Share premium	15.9	–	–	–	–	–	–	**15.9**
Merger reserve	–	–	–	–	–	–	–	**–**
Retained earnings	1,142.7	3.8	(6.6)	6.5	71.6	–	5.9	**1,223.9**
Total equity	1,317.4	3.8	(6.6)	6.5	71.6	–	5.9	**1,398.6**

1 As previously reported.

34 Reconciliation of net assets and profit under UK GAAP to IFRS continued

Explanation of reconciling items between UK GAAP and IFRS

Listed below are the various options that were chosen from those available under IFRS 1 *First-time Adoption of IFRS* with a brief description of material differences between IFRS and UK GAAP:

IFRS 1 First-time adoption options

IAS 19 *Employee Benefits* – all cumulative actuarial gains and losses are recognised at date of transition. This is similar to the UK GAAP approach with FRS 17 *Retirement Benefits*.

IFRS 2 *Share-based payment* – the recommended approach of only valuing share-based payments that have been granted post-November 2002 has been followed.

IAS 39 *Financial Instruments: Recognition and Measurement* – implementation deferred to 31 January 2005. Comparative figures for the 52 weeks ended 30 January 2005 are accounted for under UK GAAP.

The impact of IAS 39 is therefore not reflected in the tables in this note. Instead the adoption impact is shown in the current year SORIE.

IFRS 3 *Business Combinations* – there was no need to consider acquisitions prior to the conversion date as the only material acquisition to be considered was the Safeway acquisition on 8 March 2004.

IAS 21 *Foreign Exchange* – nil balance brought forward on translation of foreign subsidiaries at the transition date.

Material differences

The key differences between UK GAAP and IFRS are:

Share-based payments

The fair value expense is charged to the income statement for executive share options and share-based incentive payments to employees. FRS 20 *Share-based payment* is effective for these financial statements and has been applied to the holding company balance sheet under UK GAAP. To show the impact of this change of accounting in the Group financial statements, the UK GAAP is that prior to the introduction of FRS 20 shown in this note.

Pensions

In the financial statements for the 52 weeks ended 1 February 2004, the Group adopted early the full requirements of FRS 17 *Retirement Benefits*.

The differences that exist between FRS 17 and IAS 19 are:

- IAS 19 requires a reserve to be held on the balance sheet in respect of accrued death in service benefits. Under FRS 17 death in service benefits are expensed to the income statement as incurred. This is the major factor explaining the opening and acquisition adjustments and the service cost differences in the tables above.
- IAS 19 requires pension scheme assets to be valued at bid value rather than at mid market values. This has the effect of marginally increasing the deficit in the balance sheet and the associated finance charges in the income statement.

Leases – Long leasehold land

Under UK GAAP the Group's long leasehold land and buildings were treated as fixed assets and depreciated over the lives of the buildings, which in some cases is less than the length of the lease. Under IFRS long leasehold land is treated as an operating lease with all lease premiums included as long term non-current assets rather than fixed assets. This prepayment is released on a straight line basis over the lives of the leases giving rise to a reduction of the charge and a commensurate increase in the net assets of the Group.

Business combinations

Under UK GAAP goodwill is generated on an acquisition where the fair value of assets is different from the fair value of the consideration. Where goodwill is negative, as with the acquisition of Safeway, it is amortised over the life of the non-monetary assets acquired. Under IFRS negative goodwill is replaced by positive goodwill as outlined in note 27 (b). Under IFRS positive goodwill is taken to the balance sheet and not amortised but is subject instead to annual impairment testing.

Fair values are applied differently under IFRS as a result of a number of standards. These impacts are laid out below:

Financial instruments

Under IFRS derivative instruments are included on the balance sheet at fair value with movements being taken to the SORIE provided the hedges qualify for hedging. Movements on hedges that are ineffective or do not qualify are posted to the income statement.

The Group's derivatives are those that cover the interest and currency movements of the bonds that formed the major part of the Safeway debt. These were brought on at fair value at the date of acquisition under UK GAAP.

These were not turned into "IAS hedges" in the 52 weeks ended 29 January 2006 as they did not qualify, and consequently the fair value movement has been taken through the income statement rather than the SORIE.

Taxation

The majority of the adjustment to the balance sheet for tax relates to deferred tax on the fair value uplift of the Safeway properties.

In addition there are tax effects from the other IFRS adjustments which have been taken at 30% where the adjustment represents a taxable temporary difference. The exception to this is the tax impact of the share-based payments.

Dividends

IAS 10 *Events after the balance sheet date* prohibits the provision for dividends until they are either authorised at the AGM (for final dividends) or paid (for interim dividends). This treatment is the same as that under FRS 21 *Events after the balance sheet date* which is effective under UK GAAP from 1 January 2005. Again the reconciliation table shows UK GAAP as if FRS 21 had not been adopted.

Reclassifications

The format of financial statements and classification of items is slightly different. Under IFRS, items are generally shown gross and not netted-off. This results in some reclassifications.

Wm Morrison Supermarkets PLC Company balance sheet

Under UK GAAP

68 Company accounting policies

70 Wm Morrison Supermarkets PLC company balance sheet

71 Notes to the financial statements

Company accounting policies

The term 'Company' refers to Wm Morrison Supermarkets PLC. The separate financial statements of the Company are presented as required by the Companies Act 1985. As permitted by the Act, the separate financial statements have been prepared in accordance with UK Generally Accepted Accounting Principles ("UK GAAP").

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements, except for the first time adoption of FRS 20 *Share-based payment* and FRS 21 *Events after the balance sheet date* which have been accounted for as prior period adjustments and FRS 25 *Financial instruments: disclosure and measurement* which has been accounted for prospectively from 31 January 2005.

Basis of preparation
The accounting period of the Company ends on the Sunday falling between 29 January and 4 February each year. The financial statements presented under UK GAAP are prepared under the historical cost convention and in accordance with applicable accounting standards.

Investments
Investments in subsidiary undertakings are stated at cost less provision for impairment.

Depreciation
The policy of the Company is to provide depreciation at rates which are calculated to write off the cost less residual value of tangible fixed assets by equal annual instalments.

Freehold land	0%
Freehold and long leasehold buildings	2.5%
Short lease buildings	Over lease period
Plant, equipment and vehicles	15-33%
Assets held under a finance lease	Shorter of life of lease or asset
Assets under construction	0%

Income generating units are reviewed for indications of impairment when events or changes in circumstances indicate that their carrying amount may not be recoverable. If there are indications then a test is performed on the unit affected to assess its recoverable amount against carrying value. A unit impaired is written down to the higher of value in use or its fair value less costs to sell.

Pension costs
The Company operates defined benefit and defined contribution schemes. The defined benefit scheme is not generally open to new members. A defined contribution scheme is a pension scheme under which the Company pays fixed contributions into a separate entity. A defined benefit scheme is one that is not a defined contribution scheme. Pension benefits under defined benefit schemes are defined on retirement, based on age at date of retirement, years of service and employee's final compensation package.

The Company defined benefit retirement scheme is funded by contributions from the Company and members. Pension scheme assets, which are held in separate trustee administered funds, are valued at market rates. Pension scheme obligations are measured at discounted present value. The operating and financing costs of the scheme are recognised in the period in which they arise.

The Company also operates a stakeholder pension scheme and contributions are charged to the profit and loss account as they arise.

Capitalisation of interest
The cost of financing property developments prior to their opening date is included in the cost of the project.

Leases

Leases in which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases; all other leases are classified as finance leases.

a) **Finance leases:** The present value, calculated using the interest rate implicit in the lease, of the future minimum lease payments is included within fixed assets and financial liabilities as an obligation to pay future rentals. Depreciation is provided at the same rates as for owned assets, or over the lease period if shorter.

   Rental payments are apportioned between the finance charge and the outstanding obligation so as to produce a constant rate of charge on the remaining balance.

b) **Operating leases:** Rental payments are taken to the income statement on a straight line basis over the life of the lease. Leases that contain predetermined, fixed rental increases are accounted for such that the predetermined, fixed rental increases are recognised on a straight-line basis over the life of the lease.

Deferred and current taxation

Full provision is made without discounting for deferred taxation, except as otherwise required by FRS 19 *Deferred tax*.

Stocks

Stocks are valued at the lower of cost and net realisable value. Cost comprises purchase price, import duties, rebates and other non-recoverable taxes. Stocks are primarily goods for resale.

Share-based payments

The Company issues equity share-based payments to certain employees. The fair value of the employee services received is expensed on a straight line basis over the vesting period, based on the Company's estimate of share options that will eventually vest.

Fair value is measured by use of a binomial stochastic model. The expected life used in the model has been adjusted, based on management's best estimate, for effects of non-transferability, exercise restrictions and behavioural considerations.

The fair value charge of share-based payments that are settled by cash are credited to the balance sheet and are included within accruals in creditors.

The Company has fair valued all grants of equity instruments and cash settled equity instruments after 7 November 2002 which were unvested as of 1 January 2005.

Cash flow and related party transactions

Under the provisions of FRS 1 *Cash flow statements (revised)*, the Company has not presented a cash flow statement because the consolidated accounts contain a cash flow statement.

Under the provisions of FRS 8 *Related party disclosures*, the Company has not disclosed details of inter-group transactions because consolidated accounts have been prepared.

Wm Morrison Supermarkets PLC company balance sheet

29 January 2006

	Note	2006 £m	As restated 2005 £m
Fixed assets			
Tangible assets	37	**2,055.1**	1,906.4
Investments	38	**3,366.4**	3,360.2
		5,421.5	5,266.6
Current assets			
Stocks – goods for resale		**276.5**	221.3
Debtors	39	**309.1**	109.8
Cash in hand		**59.6**	12.0
		645.2	343.1
Creditors – amounts falling due within one year	40	**(1,760.8)**	(1,276.3)
Net current liabilities		**(1,115.6)**	(933.2)
Total assets less current liabilities		**4,305.9**	4,333.4
Provisions for liabilities and charges	41	**(34.8)**	(62.4)
Net assets – excluding pension liability		**4,271.1**	4,271.0
Pension liabilities	42	**(52.4)**	(50.4)
Net assets – including pension liability	43	**4,218.7**	4,220.6
Capital and reserves			
Called up share capital	46	**267.3**	266.3
Share premium	47	**36.9**	20.1
Merger reserve	47	**2,578.3**	2,578.3
Profit and loss account	44	**1,336.2**	1,355.9
Equity shareholders' funds		**4,218.7**	4,220.6

The accounting policies on pages 68 and 69 and notes on pages 71 to 77 form part of these financial statements.

The 2005 comparatives have been restated as the Company has adopted FRS 20 *Share-based payment* and FRS 21 *Events after the balance sheet date*. Further information on the prior year adjustments are shown in notes 45 and 48 of these accounts.

The financial statements on pages 67 to 77 were approved by the Board of Directors on 22 March 2006 and signed on its behalf by:

Robert Stott
Chief Executive

Richard Pennycook
Group Finance Director

35 Profit and loss account

A profit of £85.7 million (2005: £287.3 million) is dealt with in the accounts of Wm Morrison Supermarkets PLC. The Directors have taken advantage of the exemption available under section 230 of the Companies Act 1985 and not presented a profit and loss account for the company alone. Audit fees and expenses paid to the Group's auditor were £0.5m (2005: £0.2m).

36 Employees and directors

Employee benefit expense for the Company during the period	2006 £m	2005 £m
Wages and salaries	**587.0**	511.8
Profit related pay	**26.8**	16.2
Social security costs	**38.5**	33.8
Share-based payment costs	**4.0**	2.6
Pension costs	**23.6**	21.0
Other staff costs	**0.2**	0.8
	680.1	586.2

Average monthly number of people (including Executive Directors) employed	2006 No.	2005 No.
	54,199	56,343

Key management represent Directors. The aggregate remuneration paid to or accrued for the Directors for services in all capacities during the period is the same as the Group and is shown in note 2.

5 Directors (2005: 6) have retirement benefits accruing under the Company's defined benefit pension scheme.

37 Tangible fixed assets	Land and buildings				
	Freehold £m	Long leasehod £m	Short leasehold £m	Plant, equipment & vehicles £m	Total £m
Cost					
At 30 January 2005	2,027.1	261.8	3.0	343.3	2,635.2
Additions at cost	187.5	3.4	–	33.9	224.8
Interest capitalised	7.5	–	–	–	7.5
Disposals	(10.3)	–	(0.2)	(3.5)	(14.0)
At 29 January 2006	**2,211.8**	**265.2**	**2.8**	**373.7**	**2,853.5**
Accumulated depreciation					
At 30 January 2005	412.9	33.7	3.0	279.2	728.8
Disposals	(1.9)	–	(0.2)	(3.4)	(5.5)
Charged in the period	34.7	6.6	–	33.8	75.1
At 29 January 2006	**445.7**	**40.3**	**2.8**	**309.6**	**798.4**
Net book value					
At 29 January 2006	**1,766.1**	**224.9**	**–**	**64.1**	**2,055.1**
At 30 January 2005	1,614.2	228.1	–	64.1	1,906.4
Assets under construction included above					
At 29 January 2006	**120.4**	**1.2**	**–**	**3.5**	**125.1**
At 30 January 2005	130.1	–	–	–	130.1

Included above is an amount of £603.6m relating to non-depreciable land (2005: £564.3m).

The cost of property assets held as lessor included in the above figures is £194.1m at 29 January 2006 (2005: £143.7m). The related accumulated depreciation is £29.1m (2005: £24.5m).

Since 3 February 1985 the cost of financing property developments prior to their opening date has been included in the cost of the project. Accumulated interest capitalised is £73.4m (2005: £65.9m).

38 Investments	Equity investments £m	Investment in subsidiary undertakings £m	Total £m
Cost			
At 30 January 2005	0.1	3,361.5	3,361.6
Additions	–	6.2	6.2
At 29 January 2006	**0.1**	**3,367.7**	**3,367.8**
Provision for impairment			
At 30 January 2005 and 29 January 2006	**(0.1)**	**(1.3)**	**(1.4)**
Net book value			
At 29 January 2006	**–**	**3,366.4**	**3,366.4**
At 30 January 2005	–	3,360.2	3,360.2

Additions relate to the purchase of 80% of the share capital of Rathbone Kear Limited, purchased at its nominal value of £1.2m and further consideration for Safeway Limited. For more information relating to this see note 27(a) above. A list of subsidiary undertakings is presented in note 33.

39 Debtors	2006 £m	2005 £m
Trade debtors	**83.4**	37.4
Amounts owed by subsidiary undertakings	**190.7**	–
Other debtors	**3.7**	0.8
Prepayments	**30.6**	64.3
Other taxes	**0.7**	7.3
	309.1	109.8

40 Creditors – amounts falling due within one year	2006 £m	As restated 2005 £m
Bank loans and overdrafts	**291.5**	268.0
Trade creditors	**1,081.8**	698.0
Amounts owed to subsidiary undertakings	**283.5**	234.6
Other taxes	**35.1**	10.3
Corporation tax	**8.4**	12.5
Other creditors	**25.7**	14.9
Accruals and deferred income	**34.8**	38.0
	1,760.8	1,276.3

The Company adopted FRS 20 and FRS 21 in the year. This has led to a decrease in creditors of £79.7m in 2005.

41 Provision for liabilities and charges	Deferred taxation £m	Property provisions £m	Total £m
At 30 January 2005 as previously stated	51.2	15.6	66.8
Prior year adjustment – FRS 20	(4.4)	–	(4.4)
At 30 January 2005 as restated	46.8	15.6	62.4
Charge for period	(22.0)	–	(22.0)
Utilisation of provisions	–	(5.6)	(5.6)
At 29 January 2006	**24.8**	**10.0**	**34.8**

Further detail on property provisions is provided in note 20 above.

The potential deferred taxation on timing differences, calculated at 30%, is set out below and has been provided for in full.

	2006 £m	2005 £m
Excess of capital allowances over depreciation	**49.3**	65.0
Other timing differences	**(24.5)**	(13.8)
	24.8	51.2

It is considered that as realised capital gains will be rolled over they do not constitute timing differences and therefore the potential liability is not disclosed.

42 Pension liabilities

Defined benefit pension scheme

The Company operates a pension scheme providing benefits based on final pensionable pay. The assets of the scheme are held in a separate trustee administered fund. The latest full actuarial valuations were carried out at 6 April 2005 and were updated for FRS 17 *Retirement benefits* purposes for the periods to 29 January 2006 and 30 January 2005 by a qualified independent actuary.

The current joint employer/employee contribution rate of 16.8% of pensionable pay that applied from 6 April 2005 will continue to apply until the review following the next annual valuation of the scheme due as at 6 April 2006. As the scheme is closed to new entrants, the current service cost as a percentage of pensionable payroll is likely to increase as the membership ages, although it will be applied to a decreasing pensionable payroll.

Assumptions

The major assumptions used in this valuation to determine the present value of the scheme's liabilities were as follows:

	2006	2005	2004
Rate of increases in salaries	**4.25 – 5.25%**	4.25 – 5.25%	4.25 – 5.25%
Rate of increase in pensions in payment and deferred pensions	**3.00%**	3.00%	3.00%
Discount rate applied to scheme liabilities	**4.75%**	5.25%	5.50%
Inflation assumption	**3.00%**	3.00%	3.00%

Assumptions regarding future mortality experience are set based on advice in accordance with published statistics. The current mortality table used is PA92 C2020.

The major assumptions used to determine the expected future return on the scheme's assets, were as follows:

	2006	2005	2004
Long term rate of return on:			
Equities	**7.00%**	7.00%	7.00%
Bonds	**4.25%**	5.00%	5.25%
Property	**7.00%**	N/A	N/A
Cash	**4.50%**	4.75%	4.00%

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions which, due to the timescales covered, may not necessarily be borne out in practice.

Valuations

The fair value of the scheme's assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the scheme's liabilities which are derived from cash flow projections over long periods and are inherently uncertain, were as follows:

	2006 £m	2005 £m	2004 £m
Equities	**252.4**	205.2	163.9
Bonds	**34.4**	11.5	11.4
Property	**0.7**	–	–
Cash	**18.9**	10.9	3.5
Total market value of assets	**306.4**	227.6	178.8
Present value of scheme liabilities	**(381.3)**	(299.6)	(246.7)
Deficit in the scheme – pension liability	**(74.9)**	(72.0)	(67.9)
Related deferred tax asset	**22.5**	21.6	20.4
Net pension liability in the balance sheet	**(52.4)**	(50.4)	(47.5)

42 Pension liabilities continued

The movement in the deficit during the period was as follows:

	2006 £m	2005 £m	2004 £m
Deficit in the scheme at start of the period	(72.0)	(67.9)	(28.7)
Current service cost	(21.6)	(19.5)	(13.6)
Contributions	24.9	24.1	23.6
Other finance income/(costs)	0.8	(1.1)	(0.1)
Actuarial loss	(7.0)	(7.6)	(49.1)
Deficit in the scheme at end of period	**(74.9)**	(72.0)	(67.9)

Profit and loss account impact

The following amounts have been charged in arriving at operating profit in respect of pension costs:

	2006 £m	2005 £m
Current service cost	(21.6)	(19.5)

The following amounts have been included in other finance income:

	2006 £m	2005 £m
Expected return on pension scheme assets	17.2	13.1
Interest on pension scheme liabilities	(16.4)	(14.2)
	0.8	(1.1)

Amounts recognised in statement of total recognised gains and losses

The amounts included in the statement of total recognised gains and losses were:

	2006 £m	2005 £m
Actual return less expected return on scheme assets	35.4	7.5
Experience gains and losses arising on scheme liabilities	4.2	1.8
Changes in assumptions underlying the present value of scheme liabilities	(46.6)	(16.9)
Actuarial loss recognised in the statement of total recognised gains and losses	(7.0)	(7.6)

History of experience gains and losses	2006 £m	2005 £m	2004 £m	2003 £m	2002 £m
Difference between the expected and actual return on scheme assets:					
Amount	35.4	7.5	24.9	(44.0)	(29.4)
Percentage of scheme assets	11.6%	3.3%	13.9%	(37.3%)	(21.8%)
Experience gains and losses arising on scheme liabilities:					
Amount	4.2	1.8	(3.4)	2.6	(2.4)
Percentage of present value of scheme liabilities	1.1%	0.6%	(1.4%)	1.8%	(1.9%)
Effects to changes in the demographic and financial assumptions underlying the present value of the scheme liabilities:					
Amount	(46.6)	(16.9)	(70.6)	–	4.4
Percentage of present value of scheme liabilities	(12.2%)	(5.6%)	(28.6%)	0.0%	3.4%
Total amount recognised in statement of total recognised gains and losses:					
Amount	(7.0)	(7.6)	(49.1)	(41.4)	(27.4)
Percentage of present value of scheme liabilities	(1.8%)	(2.5%)	(19.9%)	(28.3%)	(21.5%)

42 Pension liabilities continued

Defined contribution pension scheme

Employees joining the company after September 2000 are no longer eligible to gain automatic entry into the final salary pension scheme. In June 2001 the Company established a stakeholder pension scheme, open to all employees, to which the company makes matching contributions of a maximum of 5% of eligible earnings. Pension costs for the defined contribution scheme are as follows:

	2006 £m	2005 £m
Stakeholder pension scheme	1.1	1.0
Life assurance scheme	0.9	0.5
Total costs	2.0	1.5

43 Reconciliation of movements in equity shareholders' funds	2006 £m	As restated 2005 £m
Profit before intra group dividends	85.7	255.8
Intra group dividends received	–	31.5
Profit for the period	85.7	287.3
Dividends	(97.8)	(87.7)
Retained profit for the period	(12.1)	199.6
Share option charge	0.6	0.5
Deferred tax on options	(3.3)	–
Actuarial loss on pension scheme	(7.0)	(7.6)
Preference shares transferred to current liabilities at start of period	(0.5)	–
Movement in deferred tax relating to pension scheme	2.1	2.2
New share capital subscribed*	18.3	2,690.0
Net addition to equity shareholders' funds	(1.9)	2,884.7
Opening shareholders' funds as previously stated	4,136.5	1,260.5
Prior year adjustments:		
FRS 20 *Share-based payment*	2.1	3.8
FRS 21 *Events after the balance sheet date*	82.0	71.6
Opening shareholders' funds as restated	4,220.6	1,335.9
Closing equity shareholders' funds	4,218.7	4,220.6

The prior year adjustment shows the impact on opening shareholders' funds in both periods.

* Details on new share capital subscribed are provided in note 22.

44 Profit and loss account	2006 £m	As restated 2005 £m
At 30 January 2005 as previously reported	1,271.8	1,085.8
Prior year adjustment		
– FRS 20 *Share-based payment*	2.1	3.8
– FRS 21 *Events after the balance sheet date*	82.0	71.6
At 30 January 2005 as restated	1,355.9	1,161.2
Retained in the period	(12.1)	199.6
Share option charge	0.6	0.5
Deferred tax on options	(3.3)	–
Actuarial loss recognised	(7.0)	(7.6)
Tax arising on actuarial loss	2.1	2.2
At 29 January 2006	1,336.2	1,355.9
Pension liability	52.4	50.4
Profit and loss account excluding pension liability	1,388.6	1,406.3

45 Prior year adjustment and new standards

The prior year adjustment relates to the implementation of FRS 20 *Share-based payment* and FRS 21 *Events after the balance sheet date*.

The adoption of FRS 20 has resulted in an increase in shareholders funds of £2.1m at 30 January 2005. The adjustment to opening reserves as at 1 January 2004 was a credit of £3.8m. The effect on the year ended 30 January 2005 was a charge to the profit and loss account of £1.7m. The adoption of FRS 20 has resulted in an increase in staff costs of £0.7m (2005: £0.4m).

The adoption of FRS 21 has resulted in an increase in shareholders funds of £82.0m at 30 January 2005 (2004: £71.6m) due to the write back of the dividend proposed as at 30 January 2005. The final proposed dividend for the current year will be recognised in 2007 as it has yet to be approved.

46 Called up share capital

	2006 £m	2005 £m
Authorised		
Equity share capital		
4,000,000,000 ordinary shares of 10p each		
(2005: 4,000,000,000)	**400.0**	400.0
Issued and fully paid		
Equity share capital		
2,673,290,458 ordinary shares of 10p each		
(2005: 2,658,291,079)	**267.3**	265.8

	2006 £m	2005 £m
Ordinary shares		
At start of period	**265.8**	157.4
Share options exercised	**1.5**	0.2
Acquisition of subsidiary (note 27(b))	**–**	107.9
Shares issued	**–**	0.3
At end of period	**267.3**	265.8

Details on new share capital subscribed are provided in note 22 above.

The authorised and issued Preference share capital of the Company is as follows:

	Shares	2006 £m	2005 £m
5¼% cumulative redeemable convertible preference shares of £1 each			
Authorised	50,000,000	50.0	50.0
Issued and fully paid	420,613	0.4	0.5

The 5¼% cumulative preference shares, which are classified as a current liability in 2006 in accordance with FRS 25 *Financial instruments*, do not carry any voting rights, and were issued in 1987 at £1 per share.

The preference shares can be converted at the option of the holder on the basis of 336 ordinary shares for every £100 in nominal amount of preference shares in the month of June in each year up to 2006. As over 75% of the preference shares originally issued have now been converted the remaining preference shares can be converted at the option of the Company on the same basis within three months of the end of each conversion period. The Company may redeem at par value preference shares at any time from 1 January 2007 and shall redeem at par value on 31 December 2009 the preference shares in issue on that date.

47 Other reserves

	Share premium account £m	Merger reserve £m
At 30 January 2005	20.1	2,578.3
Share options exercised	16.8	–
At 29 January 2006	**36.9**	**2,578.3**

Details on shares issued are provided in note 22 above.

48 Share-based payments

During the year the Company adopted FRS 20 *Share-based payment*. The requirements of FRS 20 have been applied to grants of equity instruments made since 7 November 2002 and to liabilities in respect of cash settled share based payment transactions outstanding at 1 January 2005.

The disclosure requirements of FRS 20 are identical to that of IFRS 2 *Share-based payment* and share-based payments included in the Company are the same as the Group. Full IFRS 2 disclosures are provided in note 23 above.

49 Capital commitments	2006 £m	2005 £m
Amounts contracted for	74.3	36.5

50 Operating lease commitments	2006 Land and buildings £m	2006 Plant, equipment & vehicles £m	2005 Land and buildings £m	2005 Plant, equipment & vehicles £m
Expiring within one year	0.3	0.7	–	0.8
Expiring within two to five years inclusive	0.6	1.5	–	1.0
Expiring over five years	2.4	–	1.8	–
	3.3	2.2	1.8	1.8

51 Contingent liabilities

The Company has given an unlimited guarantee in respect of the overdraft of all the subsidiary undertakings which at 29 January 2006 amounted to £12.6m including uncleared banking items (2005: £8.5m).

The Company has also provided a guarantee in respect of Sterling and Euro Bonds, amounting to £1,013.0m (2005: £1,004.5m) in respect of a subsidiary undertaking.

Seven year summary of results

52 weeks ended January

	IFRS GAAP 2006 £m	IFRS GAAP 2005[2,3] £m	UK GAAP 2005[2,3] £m	UK GAAP 2004 £m	UK GAAP 2003 £m	UK GAAP 2002 £m	UK GAAP 2001[1] £m	UK GAAP 2000 £m
Consolidated profit and loss account								
Group and share of joint venture	12,181.2	12,283.7	12,296.1	4,944.1	4,289.9	3,915.0	3,496.3	2,968.9
Less: share of joint venture	(66.4)	(180.0)	(180.0)	–	–	–	–	–
Group turnover	12,114.8	12,103.7	12,116.1	4,944.1	4,289.9	3,915.0	3,496.3	2,968.9
Other operating income	18.5	18.3	5.9	0.8	1.9	1.2	1.1	0.4
Raw materials and consumables	(9,155.5)	(9,110.3)	(9,110.3)	(3,681.7)	(3,185.4)	(2,944.5)	(2,637.5)	(2,221.4)
Gross profit	2,977.8	3,011.7	3,011.7	1,263.2	1,106.4	971.7	859.9	747.9
Staff costs	(1,630.8)	(1,536.9)	(1,533.2)	(570.7)	(498.1)	(444.6)	(391.1)	(339.5)
Depreciation	(256.9)	(259.2)	(264.9)	(120.4)	(111.2)	(98.6)	(89.4)	(76.5)
Other operating charges	(986.1)	(834.7)	(833.3)	(256.1)	(227.2)	(198.6)	(175.0)	(148.8)
Profit on sale of property, plant & equipment	7.5	14.5	17.9	0.8	1.2	0.3	5.3	–
Group operating profit before one off costs	111.5	395.4	398.2	316.8	271.1	230.2	209.7	183.1
One off costs	(374.4)	(139.2)	(99.2)	(10.9)	(3.5)	–	–	–
Group operating (loss)/profit	(262.9)	256.2	299.0	305.9	267.6	230.2	209.7	183.1
Share of joint venture operating profit	2.2	2.2	3.6	–	–	–	–	–
Total operating (loss)/profit	(260.7)	258.4	302.6	305.9	267.6	230.2	209.7	183.1
Amortisation of negative goodwill	–	–	58.2	–	–	–	–	–
Net interest	(52.2)	(65.4)	(59.2)	14.1	12.9	12.8	9.4	6.1
Other finance (costs)/income	–	–	(4.5)	(0.1)	2.0	–	–	–
(Loss)/profit before taxation	(312.9)	193.0	297.1	319.9	282.5	243.0	219.1	189.2
Taxation	62.6	(88.0)	(91.4)	(122.3)	(96.2)	(87.8)	(75.4)	(69.3)
(Loss)/profit after taxation	(250.3)	105.0	205.7	197.6	186.3	155.2	143.7	119.9
Minority interest – equity	–	–	–	–	(2.7)	(0.6)	(0.8)	(0.7)
(Loss)/profit for the period	(250.3)	105.0	205.7	197.6	183.6	154.6	142.9	119.2
Dividends[4]	(97.8)	(87.7)	(87.7)	(44.0)	(35.8)	(29.1)	(24.6)	(21.1)
(Loss)/profit retained	(348.1)	17.3	118.0	153.6	147.8	125.5	118.3	98.1
Basic earnings per share (p)	(9.46)	4.14	8.10	12.59	11.79	10.02	9.31	7.78
Diluted earnings per share (p)	(9.46)	4.12	8.07	12.48	11.61	9.79	9.05	7.57
Dividends per ordinary share (p)	3.70	3.70	3.70	3.25	2.70	2.20	1.80	1.50
Dividend cover	(2.56)	1.20	2.35	4.49[5]	5.12	5.31	5.81	5.65

1 53 weeks.

2 The results for 2005 include the acquired results of Safeway Limited.

3 Reclassification under UK GAAP to reallocate distribution costs.

4 Restated for FRS 25 *Financial instruments – disclosure and measurement* for preference share dividends and FRS 21 *Events after the balance sheet date* for dividends.

5 Excluding amounts payable on newly issued shares relating to the Safeway acquisition.

Seven year summary of results

52 weeks ended January

	IFRS GAAP 2006 £m	IFRS GAAP 2005[2,3] £m	UK GAAP 2005[2,3] £m	UK GAAP 2004 £m	UK GAAP 2003 £m	UK GAAP 2002 £m	UK GAAP 2001[1] £m	UK GAAP 2000 £m
Assets								
Goodwill and other intangibles	–	103.2	(262.9)	–	–	–	–	–
Property, plant and equipment	6,143.9	5,708.1	6,824.0	1,738.7	1,608.6	1,452.5	1,371.0	1,229.0
Lease prepayments	217.8	230.5	–	–	–	–	–	–
Investment property	225.3	218.5	–	–	–	–	–	–
Investment in Joint Venture	–	78.4	67.4	–	–	–	–	–
Financial assets	36.4	37.0	–	–	–	–	–	–
Non-current assets	6,623.4	6,375.7	6,628.5	1,738.7	1,608.6	1,452.5	1,371.0	1,229.0
Current assets	820.7	1,324.8	740.7	492.0	384.1	328.0	223.8	253.5
Liabilities								
Current liabilities	(1,806.8)	(1,712.4)	(1,732.1)	(742.7)	(655.6)	(586.3)	(525.1)	(538.0)
Other financial liabilities	(1,022.7)	(1,016.7)	(990.4)	(1.4)	(4.7)	(11.6)	(15.5)	(16.0)
Deferred tax liabilities	(422.6)	(501.6)	(206.3)	(38.9)	(36.8)	(39.8)	(42.0)	(39.0)
Pension liabilities	(416.2)	(408.1)	(263.5)	(47.5)	(20.1)	–	–	–
Provisions	(127.2)	(55.8)	(80.2)	(12.6)	(12.1)	(10.0)	(10.0)	(7.9)
Non-current liabilities	(1,988.7)	(1,982.2)	(1,540.4)	(100.4)	(73.7)	(61.4)	(67.5)	(62.9)
Net assets	3,648.6	4,005.9	4,096.7	1,387.6	1,263.4	1,132.8	1,002.2	881.6
Shareholders' equity								
Called up share capital	267.3	265.8	265.8	157.4	156.2	154.4	152.8	152.4
Share premium	36.9	20.1	20.1	15.9	12.8	7.7	4.4	2.9
Merger reserve	2,578.3	2,578.3	2,578.3	–	–	–	–	–
Retained earnings	766.1	1,141.7	1,232.5	1,214.3	1,094.4	970.7	845.0	726.3
Total equity	3,648.6	4,005.9	4,096.7	1,387.6	1,263.4	1,132.8	1,002.2	881.6

1 53 weeks.

2 The results for 2005 include the acquired results of Safeway Limited.

3 Restated for FRS 20 *Share-based payment* for share options, FRS 21 *Events after the balance sheet date* for dividends. and FRS 25 *Financial instruments: disclosure and measurement* for preference shares and minority interests.

Seven year summary of results

52 weeks ended January

	IFRS GAAP 2006	IFRS GAAP 2005[2,3]	UK GAAP 2005[2,3]	UK GAAP 2004	UK GAAP 2003	UK GAAP 2002	UK GAAP 2001[1]	UK GAAP 2000
Increase/decrease on previous year %								
Turnover	0.09	144.81	145.06	15.25	9.58	11.98	17.76	17.17
Group operating profit	(202.62)	(16.25)	(2.26)	14.31	16.25	9.78	14.53	10.57
Profit before taxation	(262.12)	(39.67)	(7.13)	13.24	16.26	10.91	15.80	11.03
Profit after taxation	(338.38)	(46.86)	4.10	6.07	20.04	8.00	19.84	16.18
Diluted earnings per share	(329.61)	(66.99)	(35.34)	7.49	18.59	8.18	19.55	15.57
Dividend per ordinary share	–	13.85	13.85	20.37	22.73	22.22	20.00	22.45
Shareholder funds	(8.92)	188.69	195.24	9.83	11.53	13.03	13.68	15.09
% of turnover								
Group operating profit	(2.17)	2.12	2.47	6.19	6.24	5.88	6.00	6.17
(Loss)/profit before taxation	(2.58)	1.59	2.45	6.47	6.59	6.21	6.27	6.37
(Loss)/profit after taxation	(2.07)	0.87	1.70	4.00	4.34	3.96	4.11	4.04
Retail portfolio								
Size 000's sq ft (net sales area)								
0 – 15	14	78	78	–	–	–	–	–
15 – 25	158	186	186	8	9	9	11	10
25 – 40	167	197	197	93	86	83	80	74
40+	39	37	37	24	24	21	19	17
Total	378	498	498	125	119	113	110	101
Petrol filling stations	275	283	283	112	98	89	82	73
Total sales area (000's sq ft)	10,633	12,468	12,468	4,526	4,241	4,039	3,907	3,572
Average store size	28.1	25.0	25.0	36.2	35.6	35.7	35.5	35.4
Average sales area (000's sq ft)	11,539	12,705	12,705	4,399	4,113	3,964	3,729	3,482
Total supermarket takings ex petrol (gross) £m	10,541	10,929	10,929	4,550	3,988	3,644	3,267	2,841
Average per sq ft per week (£)	17.69	16.80	16.80	19.94	18.65	17.68	16.53	15.69
Average per store per week (£000's)	477	400	400	716	666	629	584	556
Average number of customers per store per week	25,818	18,712	18,712	29,242	28,277	27,645	26,481	26,211
Average take per customer (£)	20.92	21.36	21.36	24.48	23.57	22.77	22.06	21.23
Employees								
Full time	57,501	56,005	56,005	23,296	21,136	18,931	16,530	14,899
Part time	76,836	84,896	84,896	29,088	25,642	24,028	21,370	19,662
Total	134,337	140,901	140,901	52,384	46,778	42,959	37,900	34,561
Full time equivalent	93,041	95,340	95,340	35,395	31,961	29,141	25,668	23,294
Average per employee								
Turnover (£000's)	130	127	127	140	134	134	136	127
Operating profit pre-exceptional costs (£)	1,198	4,147	4,177	8,950	8,482	7,899	8,170	7,860
Staff costs (£)	17,528	16,120	16,081	16,124	15,585	15,257	15,237	14,574
No. of participants in profit related pay scheme	81,819	45,583	45,583	30,943	28,570	26,399	24,329	22,067
Average profit related pay received (£)	409	432	432	517	498	472	450	447

1 53 weeks.

2 Includes Safeway Limited.

3 Reclassification under UK GAAP to reallocate distribution costs.

Investor relations and financial calendar

Annual General Meeting
The AGM will be held at 11.00 on Thursday 25 May 2006 at The Cedar Court Hotel, Mayo Avenue, Bradford, West Yorkshire.

Dividend Reinvestment Plan
The Company has a Dividend Reinvestment Plan which allows shareholders to reinvest their cash dividends in the Company's shares bought in the market through a specially arranged share dealing service. Full details of the plan and its charges, together with mandate forms, are available from the Registrars.

Corporate website
The Morrison website is available on the internet at www.morrisons.co.uk. In addition to our latest Annual report and financial statement for 2006, our website also contains information on Corporate Social Responsibility, company history, stores and services, latest offers, press information, as well as a local store finder.

Share price information is available on the corporate website, in the financial press and the Cityline service operated by the Financial Times (telephone 0906 843 3545).

Shareholder information online
Morrison shareholders have the option of viewing the Annual report through the internet. The information will be exactly the same as in the printed version, but using the internet has clear advantages such as lowering our costs and reducing environmental waste.

Financial calendar 2006/07

Financial events	
Financial year end	29/01/06
Prelim results announcement	23/03/06
Annual review posted	21/04/06
Annual general meeting	25/05/06
Half year end	23/07/06
Interim results announcement	21/09/06

Dividends	
Final dividend record date	28/04/06
Final dividend payment date	30/05/06
Interim dividend record date	13/10/06
Interim dividend payment date	13/11/06

Shareholder information

The number of shareholders at 29 January 2006 were 49,904 (2005: 51,986) and the number of shares in issue was 2,674,454,447 (2005: 2,658,291,079).

	Number of holders	%	Balance as at 29 Jan 2006	%
Analysis by type of shareholder				
Private shareholders	44,243	88.66	599,275,715	22.41
Deceased accounts	116	0.23	491,765	0.02
Insurance companies	5	0.01	24,748	0.00
Investment trusts	39	0.08	544,723	0.02
Pension funds	46	0.09	5,473,095	0.20
Nominee companies	5,042	10.10	2,092,412,443	78.24
Limited companies	299	0.60	7,989,055	0.30
Bank & bank nominees	14	0.03	4,404,824	0.16
Other institutions	100	0.20	3,838,079	0.14
Analysis by size of shareholding				
1 – 1,000	25,489	51.08	11,530,936	0.43
1,001 – 10,000	21,123	42.33	61,815,896	2.31
10,001 – 1,000,000	3,033	6.08	243,169,564	9.09
Above 1,000,001	259	0.52	2,357,938,051	88.17

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