Wm Morrison Supermarkets Plc – Preliminary Results, 13th March 2008

Slide 1 – Sir Ken Morrison, Chairman

Good morning ladies and gentlemen, and welcome to our preliminary results announcement for 2007/08.

Slide 2 - Agenda

This is our agenda for this morning.

Slide 3 – Overview 07/08

Good cash generation, solid sales growth and an increase in Operating Profits of 51% over last year demonstrate that our Optimisation Plan is very much on track and that the business is now well established for the future.

The Board is recommending a final dividend of 4.125p per share, to bring the total for the year up to 4.8p, an increase of 20%. On a normalised basis the dividend is covered 3 times by earnings and Richard will be giving you more details on this later.

I am very sorry to announce that David Hutchinson, our Manufacturing and Distribution Director who retired last June after 21 years with Morrisons, passed away last month after a cruelly short retirement. My thoughts, and those of everyone in the company, are with his widow Diane and the family.

This will be the last occasion on which I will introduce our results and I am therefore pleased to be passing on the baton at a time when the company is back in good health. Sir Ian Gibson, who is here today, will be succeeding me as Chairman tomorrow. With Ian's arrival to head the strong team I am leaving I am confident that the future of the business is assured. The long standing company principles of low cost operation, good quality and outstanding value for money for the consumer will undoubtedly stand us in good stead in the present economic climate.

Slide 4 – Overview 07/08

After two year's deliberations The Competition Commission Inquiry into the Grocery Sector will publish its final conclusions in April. As anticipated it has concluded that supermarket retailing in the UK is competitive! Equally as anticipated there is nothing in its provisional findings that suggests that we will need to change the way we do business.

I would like now to mention the OFT inquiry into the dairy industry in the early part of the millennium. This resulted in fines being levied on a number of retail companies including Safeway – albeit before we assumed ownership. Morrisons strongly denies it was also involved – we have therefore requested a judicial review.

As this is the last occasion on which I will stand in front of you in my present capacity, I would like to take this opportunity to thank you all for the kindness, courtesy and advice I have always received from you as a community. I am assuming the office of Honorary President of the Company and I will no doubt run a critical eye over the conduct of the business, just as you do. Many thanks to you all.

I'll now hand you over to Richard ….

Slide 5 – Richard Pennycook, Group Finance Director

Thanks Ken,

Good morning ladies and gentlemen. I propose to cover the financials using our normal format, and then at the end talk through the balance sheet strategy we have announced today.

Slide 6 – Financial summary

2007/8 was another good year for us – putting us solidly on track to deliver our Optimisation Plan promises. It was an important year, because it marked a change of emphasis. We moved from the cost reduction and margin recovery agenda of '05 and '06 to a balanced approach where activities to build top line growth had equal weight.

The trading backdrop of '07 was significantly tougher than in '06, particularly in the second half. We anticipated this, and were pleased that we more than held our own in a challenging market.

As usual, I will give you details on sales and operating profits later in the presentation, so on this slide I will just highlight three items:

Firstly, the property profits of £32m, a slight reduction on the previous year. Our portfolio is now in very clean shape – in the year we sold a surplus depot and a couple of stores, but nothing like the scale of earlier years. Indeed, the success of our smaller stores gave us the confidence to take 3 stores off the market and trade them as Morrisons after all. We do not expect much more property profit in the coming year.

Secondly, the net debt reduction to £543m. At the start of the year we anticipated an increase in net debt, rather than a decrease. The outcome reflects success in continuing to run a tight balance sheet, and a shift in the weight of our capital programme from '07 to '08. It also reflects an agreement reached with our pension trustees that a planned £200m injection into the schemes would be split over two years rather than a single payment in 2007 as originally planned.

Finally, on this slide, you will note that we have introduced the concept of "underlying earnings per share" this year.

Slide 7 – Underlying earnings

We have said previously that we will try to avoid showing exceptional items. But this year we are outlining a new dividend strategy linked to earnings per share, and additionally we are showing a low tax charge which needs to be normalised. Hence the underlying eps calculation, shown here. This backs out two things - non-trading property gains, and pension scheme funding, the volatility of which is outside our control.

The tax charge for the year was sub 10%, compared to a "normal" charge of 32%. This has been adjusted here, and a reconciliation of the tax charge is included at the back of your packs.

Slide 8 – Operating profit

Turning now to Operating Profit, the growth to 4.5% of turnover is pleasing and puts us well on track to hit our 2010 targets. However, I should caution that many of the big cost reduction and margin recovery initiatives have largely been delivered, and in some cases going forward we have activities planned that will add to cost in the short term. So the strong profit recovery seen in the past two years will inevitably now mature into a more normal profile of progressive profit growth linked to building the top line.

We were pleased to contain Administrative expenses to prior year levels. The increase in our marketing activities, which are recorded in this line, were offset by one-off income from indirect taxes and onerous leases. Additionally, we benefited from good cost control initiatives elsewhere, such as the further reduction in activity in our shared service centre in the North East, which we will close fully in twelve months time.

Slide 9 – Turnover bridge

Two years ago when I first showed this chart it was highly complex. Now it is very simple – a clear reflection of how the business is now in very clean shape.

Overall turnover growth was 4.1%, and with the 53rd week eliminated from the prior year, this rises to 6.0%. Encouragingly, this growth was broad based, with 2.6% coming from new customers, 2.0% from basket size and the remainder from new store space. Geographically, too, we saw growth in all areas, and we were particularly pleased to see solid like for like performances from Morrisons heartland stores in the second half.

Marc will talk further about our sales performance in his operating review, although just to remind you we will not be issuing any current year sales figures until our Quarter 1 IMS in early June.

Slide 10 – Profit bridge

This slide shows the key elements contributing to our profit improvement, from £331m pre property last year to £580m this time – an uplift of £249m or 75%. The contribution from sales growth, in new stores and through like for like performance, was £8m and £62m respectively. We made further progress on a number of our Optimisation Plan targets:

- store labour efficiency improved by 6% year on year – a financial benefit of £63m

- distribution efficiency improved by 9% year on year, to give a benefit of £38m.

- margin gains from our macro and micro space programmes totalled £44m.

On the cost lines, we absorbed £45m of pay inflation across the business, and invested a further £22m in marketing activity. Energy costs were favourable, both through improved efficiency and the benefit of a good contract concluded in 2006. Finally, as announced at the time of our Q3 update, we benefited from approximately £20m of one-off gains from VAT and onerous leases.

Slide 11 – Cash flow

Once again, we generated higher cash than profits in the year, reflecting the continued tight hold that has been placed on both working capital and capex. Cash from operations was £52m better than in the prior year – although with Operating Profits having increased by nearly £200m the rate of cash conversion has obviously declined. This is consistent with what we have said previously – that a number of one-time working capital gains were delivered in '06. I should also note that the growth in cash from operations was after allowing for the additional pension scheme contribution of £100m.

I previously talked about property gains, and you can see on this chart that they still gave us a meaningful cash inflow of £94m in the year. On the other side of the coin, capex rose to over £400m, with the opening of 8 new stores in the year. It will rise further to over £600m in the coming year as Optimisation Plan investments start to roll through.

Slide 12 – Outcome of the balance sheet review

As previously promised, we are today outlining our balance sheet strategy for the coming two years. Before announcing it, we considered there to be a number of prerequisites:

Firstly, it was important for us to articulate a clear business strategy and to begin to deliver it. Marc laid out our objective of being the food specialist for everyone this time last year, and we are well on our way with the programme. We understand what it will require in terms of capital investment.

Secondly, we said that we wish to operate with a solid investment grade balance sheet. We are confident that the recovery of the business in the past three years will lead to a strengthening of our credit rating, which is already investment grade, in the near future.

Thirdly, as we outlined last year, alongside our balance sheet strategy we were keen to eliminate our pension scheme deficit. I will update you on pensions in a moment.

Slide 13 – Solid progress over the past three years

I want to remind you of the progress we have made in the past three years, which sets the context for what we are announcing today.

The strong profit recovery seen in the past two years positions us well to lay out our balance sheet strategy now. At the financial year end, net debt to EBITDA was just 0.6 times, and the dividend was covered 3.0 times.

We have reduced debts by over £1bn from their peak.

We are also announcing today that we have agreed a package of measures with our pension scheme trustees that fix the brought forward deficits.

Slide 14 – Pensions

The Group has two defined benefit pension schemes, and whilst they have been closed to new members for a while they still represent very significant balance sheet components for us. The gross liabilities total approximately £2bn, matched by investments which mainly comprise equities and bonds. Two years ago, the schemes were in deficit by £400m, had too high a level of exposure to equities and relied on mortality assumptions that were under review by the actuarial profession. We have spent the past year in discussions with our pension trustees about a range of measures designed to strengthen the schemes, reduce their volatility, lower future costs, and eliminate the deficit.

I am pleased to confirm that these discussions have been successful. We have agreed a much more prudent funding strategy for the schemes, based on 50% equities, and a contribution of £200m from the Group to eliminate the deficit. In the interests of tax efficiency, we are making this contribution in two instalments of £100m, the first of which was paid before the year end and the second of which will come this month. Once that second payment has been made, the £68m deficit shown in our balance sheet for last year will have been eliminated.

I want to emphasise the strong assumptions we have made in fixing the deficit. Our new mortality assumptions, in line with those recommended last month by the Pensions Regulator, have added 3.6 years to assumptions that were regarded as prudent two years ago. For now, this will put us in the top 5% of FTSE companies for prudence – but I am sure others will be making significant moves in the year ahead.

Slide 15 – Recommendations right for Morrisons

We have stated previously, but it is important to reiterate, that our balance sheet management will be based on sound principles. We will never do anything to compromise operational control over our trading properties, we will always retain capacity to deal either with opportunities or with tough circumstances, and we are likely always to be at the "prudent" end of any sector league tables. That said, we have been able to maintain these sound principles whilst laying out a positive set of balance sheet actions for the coming two years.

Slide 16 – Summary of strategy

We were pleased to raise the dividend by 20% this year – and on our underlying eps calculation this still represents a dividend cover stronger than most in the retail sector. We intend to ease it over time to a level of cover closer to the sector average.

We have identified surplus capital of £1bn which we intend to return to shareholders during 2008 & 2009, with £500m of that delivered in the first 12 months of the programme. Our intention is to achieve this by way of a buyback programme which commences shortly, and we will review progress at the end of the first year of operation. The buyback will be funded from our internal cash resources and from the new revolving credit facility negotiated with our bank group last September. To remind you, this is a £1.1bn, five year facility, on attractive terms, and it is currently undrawn.

Finally, now is not the time to be realising shareholder value from properties. As we previously announced, the potential JV of our 26 investment related properties is on hold. We will keep this opportunity under review, but feel under no pressure to return value to shareholders through this route until commercial property and institutional credit markets have shown significant signs of recovery.

In summary, we are pleased to be returning value to shareholders, through both higher dividends and a share buyback. We are particularly pleased to be able to do this whilst retaining our position as one of the most prudent companies in our sector.

And now let me hand you over to Marc for the operational review.