

Interim Results Announcement

8 September 2011

Slide 2 – Dalton Philips, CEO

Good morning everyone and welcome to our interim results announcement for the six months ended 31 July 2011.

It will hardly come as a revelation when I tell you that the first half of 2011 has been yet another difficult period for the UK economy and for the consumer.

I'm therefore very pleased to be able to report that Morrisons unique focus on quality fresh food at outstanding value has again proved attractive to our customers, record numbers of whom have visited our stores.

Slide 3 - Overview

This has contributed to a good half year result with Turnover up 7%, Underlying Profits up by 8% and a 10% pro forma increase in the interim dividend.

It's been a busy time too as we pressed forward on all our strategic initiatives and I will be talking in more detail about these later.

As we entered 2011 we expected that the consumer would remain under pressure throughout the year, and planned our business accordingly. During the first half the trading environment has, as expected, been challenging and we anticipate it to continue to be so for some time to come. Despite this, our performance to date, our growing customer base and our ongoing focus on tight cost control throughout the business, give the Board confidence that we will deliver our expectations for the year.

I'll now hand over to Richard who will take you through the results and our thoughts on the market in more detail.

Slide 4 - Richard Pennycook, Group Finance Director

Thanks Dalton and good morning everyone.

2011 was always going to be a challenging year, given the fragile state of the economy and weak consumer confidence. So against this backdrop it is pleasing to be reporting a good first half, with sales again outperforming the market and solid earnings growth too.

I will take you through the financial results in the normal format, and then provide some commentary on what we see happening in the market, as background for Dalton's update.

Slide 5 - Financial Summary

Total turnover of £8.7bn was up 7% over last year and I'll break that down further in a moment. Statutory profit before tax increased by 9%, ahead of the turnover growth for a number of reasons, exhibiting the "self help" we've consistently talked about which will allow us to keep profit growth in line or ahead of sales growth despite the tough market backdrop.

Net debt rose as expected to just over £1.0bn, following a 60% increase in our investment activities and the commencement of our equity retirement programme.

The dividend reflects our full year commitment to a minimum of 10% growth, and also the previously announced rebalancing between interim and final dividends. I will cover the calculation of that later.

Slide 6 - Turnover – half on half

This is our usual chart which breaks out the key components of the 7% increase in turnover.

Growth from new stores contributed 1.9% to sales growth, reflecting the uplift from the 14 stores we opened last year and from the 16 ex-Netto stores that opened in Q2. Our remaining opening programme is heavily weighted to the fourth quarter of the year, and as a result we expect new space contribution to increase through H2.

Looking at like for like growth, we were pleased with a performance that we believe was the strongest of the big four players. Dalton will give some colour on how we caught the mood of the nation through the half, but I will just comment on some small effects that lie within the numbers. Firstly, as previously discussed, the large batch of stores acquired from Co-Op/Somerfield in 2009 appear in our like for likes for the first time, giving us a small positive “second full year effect”.

Secondly, in early May we extended and standardised the opening hours of most of our stores and although it is still relatively early days, we are pleased with the positive reaction we have had to this initiative from our customers. Finally, in the detail of the quarterly performance shown at the back of your packs, you will note the lower like for like in Q2 versus Q1 – you will recall that we said in our Q1 IMS that the “royal wedding” effect was undoubtedly a one-off boost for most retailers, which would not be indicative of the trend for the remainder of the year.

Turning to fuel, we have continued to lead the way at the forecourts. Our outstanding value again hit the spot with motorists, and we grew volumes by 4%. But of course it was again the rising cost of fuel that has had the most significant impact on overall sales. With average prices at the pump some 16% higher than the previous year, fuel inflation drove £240m of additional sales. And of course this is the second year of such pressure.

Slide 7 - Underlying earnings

This chart shows the calculation of underlying earnings and EPS, used to reflect a clean run rate of profits and to compute the dividend. The only point of note is the reduction in normalised tax rate from 30% to 29.3%. You will be aware that corporation tax this year is 26%, and we have previously talked about having a tax rate c.200 basis points above that. We estimate that the combined effect of the lower tax rate and the changes in capital allowances which accompanied the reduction in headline rate will increase the gap to 300 basis points – but still leave our overall tax rate 100 basis points better as a result of the changes.

Slide 8 - Operating profit

Operating profits grew by £31m with the margin constant at 5.2%. During the period we were successful in absorbing the cost of higher fuel prices incurred in the supply chain, the disproportionate increase in business rates following the 2010 rating revaluation and the new carbon reduction tax. Our various productivity and cost reduction programmes, including the new systems programme, indirect procurement initiative and in-store productivity drive all contributed, to ensure that such costs were not passed on to our customers. Dalton will give you more detail on these.

As we have discussed before, the impact of higher fuel prices and additional volumes results in a margin dilution effect, due to the very low profits achieved on fuel sales. In the half, we saw the proportion of fuel sales increase from 21% to 23% of total turnover and as a result our margin was 30 basis points lower than it would otherwise have been.

Slide 9 - Shareholder returns

Back in March I outlined our new dividend policy, which is to increase the dividend in line with underlying earnings, but with a minimum underpin of 10% annually for each of the next three years. We also explained that we would rebalance the interim payment to around 30% of the full year total. In line with this policy the Board is proposing an interim payment of 3.17p, technically an increase of 158% over last year but actually 10% on a pro forma basis.

Also in March we announced that we would be initiating a £1bn equity retirement programme over two years, and we have been active in that regard. By the close of business last night we had purchased and cancelled 82 million shares, at a total cost of £236 million and we are well on track to complete the first tranche of £500m by March next year.

Slide 10 – Market dynamics

That concludes the financial update, so now let me turn to the market dynamics that we see currently. These of course influence our thinking both in day to day trading and in our investment planning for the longer term.

Slide 11 – The Market Backdrop

I'm going to talk about two themes – the consumer and some general strengths exhibited by the supermarket sector.

Slide 12 – Consumers under pressure

We are all well aware of the very fragile consumer environment currently. An irony for the consumer is that whilst the economy was technically in recession in 2009, disposable incomes did rise a little bit, as the effect of tax rises had yet to be seen. In 2011, whilst technically we are out of recession, the consumer is seeing, and feeling, a sizeable reduction in their disposable income. Those who are most cash strapped are exhibiting very real behaviour changes to cope – and Dalton will talk more about this.

Slide 13 – Consumers under pressure (2)

In addition to having less to spend each week, consumers are finding that essentials are costing more to buy, driven by commodity price pressures and the devaluation of sterling over the past two years. So they are being doubly squeezed. The overall outcome will be the biggest rise in food and grocery spend as a proportion of GDP since World War 2.

Slide 14 – Sector response

Against this tough consumer backdrop, it should be no surprise that the supermarket sector appears to be faring better than most other areas of retail. Firstly, the competitive nature of the industry makes it a consumer champion. The charts on the top right show how effective we have been in ensuring that cost price pressures have not been fully passed on – whether in store or at the fuel pumps. And additionally as shown bottom right the industry response of promoting heavily in order to provide value to customers has been successful in sustaining volumes and footfall.

Now let me hand you over to Dalton for the business update.

Slide 15 – Dalton Philips, Trading and business review

Thank you Richard

I am now going to cover two things:

Firstly, I'll talk about how we traded through the environment Richard described and share our thinking on how this environment has affected our customers.

Secondly, I'll update you on the plan we outlined last September to make Morrisons different and better than ever.

Slide 16 – Sales Performance

Our trading performance was resilient in the face of the tough conditions Richard spoke about. Like for like sales grew 2.2% excluding fuel and 5.5% including fuel and like for like customer numbers grew 1.0%.

Overall our like for like sales per customer, at £22.33, were down slightly against last year's number as ex-Somerfield stores annualised and became part of the like for like comparison group. This is basically a mix issue as sales per customer for this year's enlarged group of like for like stores were up by over 1%. At £20.90, sales per sq. ft. were higher than the same period last year.

We are encouraged by these results and it's great to see more customers choosing to shop at Morrisons.

Slide 17 – Consumers under pressure

It is especially encouraging that we've delivered these results at a time when the economy is having such a pronounced impact on consumers. The last 3 years has seen the biggest drop in spending power since between 1980 and 1983. We're also hearing concern amongst our customers that there seems no end in sight. Consumer confidence is almost as low as it has ever been and under these conditions there is a real desire amongst customers to reassert control over their household budgets.

Slide 18 – Consumer behaviour shifting

We're seeing this in the resurgence of shopping and budgeting skills – it should not be overstated but it's clear that there is a growing professionalism in people's approach to shopping. Whereas the mantra used to be 'time is money' now it's 'time saves money'.

Customers are shopping more frequently to manage spend and half of our customers are now taking the time to check the price of every item in their trolley. People used to spend around a budget, now they spend to a budget. Cash and debit card spend has increased whilst spend on credit cards is down by about 8% as people seek greater control over their household spending. This is a social - not an individual –phenomenon.

The change in behaviour is also apparent in an almost insatiable search for bargains and customers are using social media to share great deals. We now see our promotions discussed on numerous forums, from small circulation blogs with 100's of views, to deal comparison sites with hundreds of thousands of members.

Slide 19 – Consumers choosing Morrisons

With Morrisons growing share faster than the other big four we believe this more professional approach to shopping plays to our strengths. Our value proposition stood up strongly under the increased scrutiny shoppers have been applying and we've reinforced our position by leveraging our vertical integration to help customers afford fresh food, such as our 49p produce deals and our two loaves of fresh bread for £1.00 promotion, and helping customers manage tight budgets through promotions that really resonate with the mood of the nation such as the end of month 'Pay Day Price Crunch' program or 'Fuel Britannia' which helps customers save on their petrol – so relevant today when they are experiencing such price increases at the pumps.

We're working harder than ever to help our customers.

Slide 20 – Consumers choosing Morrisons

As our customers become ever more professional in the way they shop, we're working harder than ever to remain at the top of our profession. At last year's interims, when I looked at what's working at Morrisons, you may remember these slides. It is these areas of strength, underpinned by our strong values, which we relentlessly exhibit day after day.

Customers expect fresh food, excellent availability, great value, new and exciting products, excellent store operational standards and friendly, knowledgeable customer service. That's the drum beat we are working to, driving it every hour, every day and every week within our business with an increasingly engaged and motivated colleague base.

And the results we're announcing today suggest customers appreciate it too.

Slide 21 – Recap: Our vision for the business

As I shared with you this time last year, our plan is to make Morrisons different and better than ever.

Different by reinforcing the differences that make us unique, and enable us to offer our customers great quality food at affordable prices: namely:

- Our focus on fresh food through the market street concept,
- Our unrivalled commitment to keeping the fresh craft skills in store,
- And, our vertical integration through our production capabilities

And better than ever by seizing our opportunities to improve efficiency, and by driving growth both in the core business and new channels.

Slide 22 – Three areas of focus

We have a programme of initiatives to deliver three areas of focus:

1. Driving topline
2. Increasing efficiency and,
3. Capturing growth

Today I'll update you on the strong progress we're making.

I've talked about twelve key initiatives in previous updates. Today I'm going to focus in detail on five of these but in the appendix to your packs we have also provided information about our other activities such as own brand, which we're excited to be launching in October, and vertical integration where we're making great progress on the integration of Flower World.

So, drawing inspiration from our price crunch this will be our biggest ever 'script crunch'.

Slide 23 – Three areas of focus

To our first area of focus, driving topline.

All five initiatives are on track.

Today I'll speak about moving further ahead on Fresh, optimising our space and how we're now trialling combinations of what we have learnt, bringing together:

- An enhanced fresh offer
- A rebalanced range including new categories and,
- A more relevant look and feel

Slide 24 – Moving further ahead on Fresh

Firstly, moving further ahead on fresh.

We're passionate about offering customers unbeatable fresh food at affordable prices.

In March, I shared with you the work underway at our Fresh Lab in Kirkstall. We said we would do 2 things:

- Remain unbeaten on affordable fresh foods and,
- Refine our lab to further drive sales

We have continued to test many new and extremely innovative ideas. For example we have developed a produce offering that reaffirms our fresh credentials, adding 336 new SKUs in total, a 35% increase. The range creates the experience customers associate with a real marketplace and we're able to offer this comprehensive range at really affordable prices.

Recent additions include:

- Orange vine tomatoes,
- Mini pineapples,
- And prickly pears

Customer reaction has been very positive and we've built on the 8% produce sales uplift we'd achieved by February - now we're up 13%.

Across the store we're giving our customers the full benefit of our craft skill expertise. Our fishmongers now prepare products like salmon enroute and haddock & parma ham swirls in-store. We've grown sales of 13% and in bakery our qualified bakers are now making 'clean breads' on site using the traditional 'polish' method. Bakery sales are up 15%.

Because our customers tell us great fresh food is even better when matched with great wine we trialled a new concept with more space, a new look and feel and merchandising by style rather than country. By doing a better job of helping customers find wines that bring the best out of their food, we've grown sales by 24%.

We've created a new look and feel for the store through improved signage, bulk heads and uniforms, and adding features such as a cookery demonstration pod, all creating a sense of fun and theatre. Customer numbers and basket size have both increased on a like for like store basis – a really positive indication that customers appreciate our new offer.

Slide 25 – Optimising our space

Through our Liberate project we said we would free up 750k sq. ft. of incremental space across the estate from the ambient centre of store without impacting sales, allowing us to do three things:

- Enable the rollout of the innovations we're developing in our fresh food business
- Make our offer more relevant to customers by rebalancing categories and introducing new ranges such as clothing
- Create a more pleasant shopping environment by giving space back to our customers in congested areas

In March I said we had initiated a trial at Shrewsbury, our Space Lab, and that we'd measure the customer response and continue to refine.

The results are very encouraging. Overall store sales are up 2.4% and EPOS margin is also up 2.4% compared to our control group. Furthermore, ambient sales have held up well. This is a very solid achievement because reducing ambient space isn't straightforward – it's both an art and a science.

The impact has been very encouraging. We freed up almost 1,000 sq. ft. of space for Kids' clothing; a new range to broaden our appeal to more shoppers, enabling busy parents to choose Morrisons and we've seen growth in existing categories where we increased space. For example, ready meals, where sales grew 9% and fruit juice, where sales are up 20%.

And there is opportunity to refine and do even better - some areas, such as cleaning products, were cut too aggressively. Other categories such as biscuits could have been rationalised further. Customers tell us they are really happy with the store and say they are more likely to recommend Morrisons.

Slide 26 – Combining Fresh and space

We're now bringing together the fresh innovations and improved look and feel from Kirkstall, and the rebalanced assortment and 'liberated' space from Shrewsbury. We will soon be testing the combined concepts in stores of different sizes and geographies to ensure we have a fully operational and commercially viable model before we embark on a wider rollout.

As a result we've now 'liberated' space at Kirkstall and started to introduce some of the successful elements of Fresh Lab to Shrewsbury.

We'll take the concept to St Albans, testing it in a new geography and trialling a few additional elements such as a sushi bar. We'll then implement it in Wrexham to see how the model works in a new build. Assuming the trials show the same success as the labs we will start rollout to the wider estate building towards:

- Liberating 750k sq. ft. of space to make way for this compelling fresh proposition and the most successful ranges from our space optimisation programme and
- Helping customers navigate our offer and showcase our range through a more relevant look and feel.

Slide 27 – Three areas of focus

Our second area of focus is ‘increasing our efficiency’

We’re making good progress against all four ‘self help’ opportunities and today I’ll update you on how we’re driving store efficiency, what we internally call Fresh Working.

Slide 28 – Driving store productivity

In March, I took you through some of the trials from our productivity lab in York and subsequent rollouts and said we would:

- Continue to trial and roll out further initiatives
- Save £20m this year across the estate and,
- Deliver £100m of savings by 2013/14.

Slide 29 – Driving store productivity

Since March we have completed the rollout of 10 initiatives across the network including changing counter opening times, which will not only save us £15m annually, but also showcases our craft skills to customers who tell us they appreciate seeing our butchers and fishmongers setting up for the day.

We currently have 11 initiatives in trial such as replacing our paper based order pad with an electronic system, as many retailers have done previously. This will not only remove the need to manually enter and tally hundreds of pages of written orders per store per day but will provide more information helping improve accuracy and drive greater availability for our customers.

There are a further 14 initiatives at the development stage and we continue to generate further ideas. We will continue to test initiatives in our York lab, incubate and then rollout the successful ideas to the rest of the estate. We are on track to meet our financial target this year and deliver £100m of savings by 2013/14.

Slide 30 – Three areas of focus

We are also on track with our ‘capturing growth’ initiatives.

Today I’ll share our progress on moving online and exploring convenience.

Slide 31 – Moving online

Firstly, moving online.

We see great potential online and have started the development of our Morrisons.com strategy. Under the Morrisons.com umbrella, we are exploring both non-food and food.

As part of our non-food drive, earlier this year we acquired kiddicare. This gave us a strong foothold in the baby category.

On the food side, we invested in Fresh Direct, a highly successful and profitable US online food retailer with a track record of terrific customer service.

We will support both businesses in sustaining their strong growth trajectories and learn as much as possible from these best-in-class operators as we explore this rapidly growing channel.

We announced our plan to launch a Morrisons online non-food proposition in 2012 and that we would follow this with the launch of online food in 2013/14 providing we have the right proposition and a profitable model.

Slide 32 – Moving online – non-food

Firstly, I'll share our progress on non food.

We have been working with Scott and Elaine Weavers-Wright, the team behind kiddicare's exceptional growth, to develop the business plan to drive the core kiddicare business. This week the business began to execute an international expansion plan conducting its first overseas transactions in Sweden. We've also done a great job integrating kiddicare into the Morrisons family including, beginning the rollout of kiddicare kiosks. We'll have them in 28 stores by the end of next month.

We've launched over 500 Morrisons-sourced products on the kiddicare site from baby food to cotton wool pads and baby wipes and we've deployed ranges from kiddicare in Morrisons stores for our recent baby event, such as car seats and changing mats and next week we'll roll out their 'Just for Bums' nappy range into a number of our stores.

The kiddicare business platform will enable us to roll out other non-food categories. These will sit next to kiddicare.com within the Morrisons.com stable. Over the coming months we will review the kiosk trial and assess opportunities for further rollout across the Morrisons estate and we'll continue preparations for the launch of our online business next year.

Slide 33 – Moving online – food

In terms of Fresh Direct and the development of an online food proposition we have established a team with some of our best people, drawn from multiple functions including production and logistics, to enable us to build an end-to-end understanding of Fresh Direct's unique operating model. The team is now hard at work in New York getting to understand how Fresh Direct operates.

Our focus over the next 6 to 12 months will be to gather the learning from Fresh Direct to help shape our thinking for a possible launch of a Morrisons online food proposition in 2013.

Slide 34 – Moving online – building our team

We're excited by the progress we're making on both our online initiatives and are delighted to announce two appointments that will drive this work forward.

Firstly, Scott Weavers Wright will be the MD for Morrisons.com Non-Food. Scott is recognised as a leading innovator in the industry and has an outstanding track record at kiddicare.

Secondly we've hired Simon Thompson to lead our online food business. Simon is one of the most respected online sales and marketing executives in Europe and joins us from Apple where he was:

- Worldwide strategy and customer experience director
- Prior to that, he was general manager of Apple's online store in Europe, Middle East, Africa and India and,
- Before that he was European Managing Director and Chief Marketing Officer for Lastminute.com

Both appointments are great news for Morrisons.com, and reaffirm our commitment to having the best talent in the key roles.

Slide 35 – Exploring convenience

Finally, exploring convenience.

The way customers shop is changing – more and more they are using smaller shops for top-up shopping given time pressures and to help with budgeting.

Convenience is a significant opportunity for Morrisons and it's growing fast. Between 2012 and 2016 it will grow at 5.5% per year. Furthermore, the big 4 control less than 5% of the 48,000 sites in the UK so there's a lot of opportunity for us to go after.

At the prelims, we confirmed our intention to open three neighbourhood convenience stores trading under the 'M local' fascia.

Slide 36 – Exploring convenience

We've opened our first two convenience stores; one in Ilkley, one in Wilmslow. We set out to create something that was different and truly Morrisons by:

- Placing great fresh food firmly at its heart
- Leveraging our store craft skills
- Ensuring exceptional shop-keeping standards and,
- All at really affordable pricing

Let me play you a short video to show you what we have achieved.

As you can see, this is not like a typical convenience store. You saw from the video that it encourages customers to interact with our great fresh food, whether by making their own salad, grinding coffee, squeezing orange juice or matching their meal to a great wine on the touch screen wine selector and it's locally relevant. We stock a wide range of great local products, including Ilkley ale, which you'll find in your goody bags.

It leverages fixed and variable costs in our business by linking the store to a hub store which is acting both as a production and cross dock facility and as you heard in the video, we're offering all our great fresh food at the same competitive prices we offer in our large stores making sure quality is convenient and affordable.

For example we're offering squeezed orange juice for just £1 compared with £2.20 elsewhere in Ilkley. This is still generating a commercial margin and the response has been fantastic. We sold 1,000 cups in just 10 days, showing that where you offer superior value you will win with customers.

I am really delighted with how these stores look, the offer we have created and how they are trading.

- Over the coming months we will:
- Measure the results and analyse customer feedback and continue to refine our offer...
- Open our third convenience store at Upton Rocks near Widnes and,
- It is also our intention to open a small number of additional trial stores, to test our offer in different types of convenience locations.

Slide 37 – In summary

So to summarise.

It's been another good half for Morrisons and we have delivered strong results:

- Underlying profits were up 8%
- The interim dividend was up 10%
- And the equity retirement is on track

We are performing well in the face of significant challenges. The core business is fundamentally strong, our value proposition resonates with the mood of the nation and stands up strongly under the increased scrutiny, which is characteristic of the greater professionalism we're seeing amongst shoppers.

We're making strong progress against our programme of initiatives to make Morrisons different and better than ever. Our team is engaged and we are focussed on sustaining our momentum and continuing to work harder than ever for our customers in these challenging economic conditions.

Thank you very much .