News Release

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PRELIMINARY RESULTS FOR THE YEAR ENDED 31 JANUARY 2010

Customer growth drives record performance for Morrisons

Financial summary

- Turnover up 6% to £15.4bn (2008/09: £14.5bn)
- Like-for-like sales (ex fuel, ex VAT) up 6.0% (2008/09: 8.2%)
- Profit before tax £858m (2008/09: £655m)
- Underlying profits[1] up 21% to £767m (2008/09: £636m)
- Net debt £924m (2008/09: £642m) after capital investment of £906m.
- Gearing of 19% (2008/09: 14%) and interest cover of 19 times.
- Basic earnings per share 22.8p (2008/09: 17.4p)
- Underlying earnings per share up 23% to 20.5p (2008/09: 16.7p)
- Total dividend for the year up 41% to 8.2p(2008/09: 5.7p) – with dividend cover of 2.5 times

Operating highlights

- Weekly average customer numbers up 7% [2]
- Optimisation Plan completed, with all key targets exceeded
- New regional distribution centre opened in the South East, ahead of schedule
- 43 new stores [3]
- Retailer of the Year for 2nd consecutive year [4]
- 10,000 new jobs created

Commenting on the results, Sir Ian Gibson, Non-Executive Chairman, said:

“Morrisons had another good year. Once again our focus on fresh food and great value appealed to shoppers everywhere, and we have successfully grown sales and profits to record levels. We completed delivery of the Optimisation Plan first launched four years ago, and we are well on the way to cementing our position as the Food Specialist for Everyone. The opening of 43 new stores in the year accelerated our journey from National to Nationwide.

We expect the economic environment to remain challenging, disposable incomes to be under pressure and value to remain a high priority for consumers. The Board believes that Morrisons unique offer of high quality, fresh food at great value prices will continue to attract customers from our competitors and drive market share growth in the year ahead. For the longer term, we will continue to utilise our balance sheet strength to invest for growth, with new space, new manufacturing capability and new systems priorities in the year ahead.

I am pleased that Dalton Philips will take up his role as our new CEO on March 29th and I welcome him to Morrisons."

[1] Excluding IAS19 pension interest, pensions credit and property disposals
[2] Represents average weekly till transactions in the year to January 2010 compared to the previous year
[3] 45 new stores were opened in the year, 2 of which were replacements for existing stores
[4] Awarded by Retail Week, the main industry periodical

-ENDS-

Chairman's statement

Results

Profit before tax was £858m compared with £655m last year. This included an exceptional credit of £91m arising from steps taken to strengthen our pension schemes. Underlying profit before tax was £767m, up 21% on last year. Underlying basic earnings per share (EPS) increased by 23% to 20.5p, whilst statutory basic EPS increased by 31%. The Board is recommending a final dividend of 7.1p per share, to bring the total for the year to 8.2p – an increase of 41%, which brings dividend cover in line with our policy of 2.5 times.

Cash generation was strong, with cash from operations of £1.0bn, up £40m on the previous year. Capital expenditure increased, as anticipated, to £906m (2008/09: £678m), following the development of a new South East regional distribution centre at Sittingbourne and an expanded store opening programme that saw 45 new stores open in the year, two of which were replacements. These investments in future growth resulted in an increase in net debt to £924m (2008/09: £642m). Gearing was 19%, a level well below average for the sector, and at the year end the Group had undrawn committed bank facilities of £650m. The Group's credit rating was upgraded by Moody's for the second consecutive year, to A3 – this is a strong investment grade rating which is held by only 2 other European retailers.

Board changes

We are pleased to welcome Dalton Philips as our new Chief Executive, following Marc Bolland's resignation in November 2009. Dalton joins from Loblaw, where he was Chief Operating Officer, having spent much of his career in grocery retail worldwide. He takes up his post with effect from 29 March 2010. We thank Marc for his contribution to the development of the business over the past three years.

As part of the Board's progressive succession strategy, Susan Murray retired as a Non-Executive on 31 December 2009. We are extremely appreciative of Susan's efforts and valued contribution throughout her four years on the Board and grateful to her for the support she gave to the Group through its business recovery and development.

We are pleased to welcome two new Non-Executive Directors. Penny Hughes, whose previous experience includes 10 years with Coca-Cola, ultimately as President of Coca-Cola GB and Ireland, joined us on 1 January 2010. Johanna Waterous joined the Board on 1 February 2010 and brings 22 years experience with McKinsey & Co, latterly as Co-Leader of the firm's Global Marketing and Sales Practice.

Industry recognition for colleagues

We are delighted that our commitment to providing our customers with the best value, quality and service has again been recognised in numerous industry awards, including Retailer of the Year from Retail Week for the second consecutive year, and top accolades at The Grocer Gold Awards 2009 including Customer Service Champion, best Product Availability and Store Manager of the Year.

These awards are a testament to the hard work and passion of all our 134,000 staff who day-to-day strive to make Morrisons the Food Specialist for Everyone. During the year we launched the Morrisons Academy, the next step in the training and development of our people, and already we have 20,000 colleagues working towards nationally recognised qualifications. I am delighted that our growth will provide a profit share pool of £42m, a 24% increase on the previous year, in recognition of their commitment to living our values. On behalf of the Board I want to express our continuing thanks for the commitment, dedication and professionalism shown by our staff every day.

Charitable donations

Throughout the business, our colleagues and customers have once again enthusiastically supported a variety of charitable activities, community initiatives and national events. These have included raising £220,000 for Children in Need and £600,000 for the Haiti Disaster Emergency Committee earthquake appeal.

For 2009/10, Morrisons employees voted Cancer Research UK as their charity of the year, and the fundraising campaign was the most successful charity partnership we have had. To date we have raised in excess of £1.8m through an array of fundraising activities such as coast-to-coast cycle rides, charity collection weeks and sales of special charity products.

Outlook

The completion of the Optimisation Plan means that the business is well positioned to meet its goal of being the Food Specialist for Everyone. The investments made in new store acquisitions and the early success of the smaller store format represent good progress on our journey from National to Nationwide and we see further opportunities to deliver further profitable growth.

We expect the economic environment to remain challenging, disposable incomes to be under pressure and value to be a high priority for consumers. The Board believes that Morrisons unique offer of high quality fresh food at great value prices will continue to attract customers from our competitors and drive market share growth in the year ahead. For the longer term, we will utilise our balance sheet strength to invest for growth, with new space, new manufacturing capability and new systems a priority in the year ahead.

Sir Ian Gibson, Chairman

Business review

We continued to broaden our customer appeal over the year by maintaining our focus on fresh food and value and providing great customer service through a wide range of stores from 10,000 to 40,000 square feet. With the building blocks now in place we have a strong platform to take Morrisons to a nationwide company.

Strategy

Morrisons has made considerable progress in its strategy to position the business as the UK's Food Specialist for Everyone:

'Food Specialist'	We really understand food… - we know where it comes from - we pack it and make it in our factories - we make it in our stores - we employ craft skills in every store
'For Everyone'	Great food which is also great value Great food which is for everyday, not just special days

As a food specialist we differentiate ourselves against our major competitors, all of whom have significant non-food offers. We are unique in having our own manufacturing and packing facilities, and being farmers ourselves. We also prepare more food and employ more specialist butchers, fishmongers and bakers in-store than our competitors. We can clearly demonstrate our deep understanding of food and ensure that everyone who shops with us receives outstanding value, freshness and service.

Our strategy will enable the business to continue sustainable, long term growth. It builds on our strengths, and is in tune with our customers' needs for excellent value and their increasing focus on the provenance, quality and freshness of the food they buy. In order to deliver our strategy, we have previously outlined the building blocks that need to be put in place, and our plans to do this were incorporated in the Optimisation Plan that has now completed. These include freshening our stores and the first phases of improving and developing the infrastructure of the business in relation to IT operating systems, manufacturing and distribution. Our progress towards these goals is set out in the operating review below.

We will continue to invest in our strategy of being the Food Specialist for Everyone. Colleagues in the business now have access to the Morrisons Academy, enabling them to be trained further in food related skills. We will invest in additional manufacturing capabilities in order to strengthen this point of difference with our competitors and we will continue to offer our customers new and innovative fresh food items of great quality produced in Market street, fresh on the day.

Store estate development

In 2007 we set out an objective to add an additional 1m square feet of new selling space to our estate over the three years to January 2010. We are pleased to have exceeded that target by 0.4m square feet, through a combination of store extensions and 57 net store openings including the 34 stores we acquired from the Co-operative Group in 2009.

As the fourth largest grocery retailer in the UK, we see significant opportunities to expand further our store estate. As the Food Specialist for Everyone, we offer a real difference in grocery retailing that is highly attractive to a wide range of consumers as evidenced by the increasing numbers of customers who are shopping in our stores and enjoying the Morrisons experience. However there are still many

parts of the country where we are under-represented. We estimate that there are some seven million households in the UK not located within a convenient 15 minutes drive time from a Morrisons store - a higher target customer base than any of our three larger competitors. A key part of our strategy, therefore, is to grow the number of Morrisons stores.

The early performance of the stores acquired from the Co-operative Group this year has confirmed that our offer works well in a wide range of store sizes, from 10,000 to 40,000 square feet, giving us increased flexibility when finding sites. We expect to add a further 1.5m square feet of selling space in the three years to January 2013.

We believe that the delivery of our strategy of space expansion and the optimisation of our business model has delivered strongly improved profit margins whilst also positioning the Group for long term growth.

Shareholder investment and returns

Delivery of our Optimisation Plan has ensured strong growth in sales, profits and dividends, whilst we have also invested to generate future growth. In line with the policy we announced in 2008, dividend per share has been increased by 41% to give a total for the full year of 8.2p. As a result, dividend cover has been reduced to 2.5 times, the average for the European retail sector.

In the four years since the launch of the Optimisation Plan, annual dividend growth has averaged 30% p.a. and total shareholder return 16% p.a. This compares with equivalent figures for the FTSE 100 and European Retail sector of 3% and 9% respectively.

The Group has a strong balance sheet and is securely financed, with competitive revolving credit facilities available until 2012 and a number of long dated bonds. £650m of the revolving credit facility remained undrawn at the end of the period.

We will continue to pursue a prudent approach to financial management which is based on four key principles:

- we will maintain a strong investment grade balance sheet
- operational control of our stores is fundamental to us
- we are a prudent organisation and we structure our finances accordingly, and
- our defined benefit pension schemes' assets and liabilities are effectively part of our balance sheet, and will be managed as such

Operating review of the year

2009/10 was another strong year for Morrisons. With the economic environment continuing to weigh heavily on consumers, our focus on value allowed our customers to stretch their household budgets further.

Turnover growth

Total turnover was £15.4bn, an increase of £0.9bn (6.0%) and we were pleased that our store sales (excluding fuel) again grew ahead of the market. Like-for-like sales (excluding fuel), which reflect performance in existing stores, increased by 6.0% with good growth in all regions. Total average basket size increased by 2.4% and customer numbers were up 6.7%. On average, 10.5m customers are now visiting our stores each week.

Based on market research data from Kantar (formerly Taylor Nelson Sofres), we believe our grocery market share grew from 12.3% to 12.6% in the year, building on similar growth the year before.

There is now much greater awareness of our brand throughout the country and as a result we grew sales well in all regions, particularly in the South and Scotland. Our market research showed that we continued to attract new customers from competitors, including both the premium grocery segment and the discounters.

The easing of the worldwide spike in oil prices in 2008 resulted in a welcome reduction in fuel prices at the pumps, although prices again began to rise during the second half. Fuel sales were down by 6% in line with the average reduction in pump prices seen through the year.

	Like for like stores	**Other**	**2009/10 Total**	**2008/09 Total**
Sales of goods (£m)	12,029	394	12,423	11,378
Fuel (£m)	2,844	49	2,893	3,069
Other sales (£m)	94	-	94	81
Turnover exc VAT (£m)	14,967	443	15,410	14,528
Sales per square foot (£)	21.03	16.07	20.82	19.94
Customer numbers (m)	520	25	545	511
Customer spend (£)	23.08	16.13	22.76	22.23

New retail space

The Group has made good progress in its plans to move from being a national presence to a truly nationwide retailer. During the year we opened 43 new stores and now have a total of 425 trading. 34 of these were acquired from the Co-operative Group and we also opened 11 other stores. Of these, two were replacements of existing stores. All our new stores are listed on our web site. With a total of 667,000 square feet of new store space and a further 69,000 square feet from the 13 extensions completed during the year, we now operate 11.9m square feet of selling space, an increase of 7%.

In November 2008, we announced the acquisition of 38 stores from the Co-Operative Group and we opened 34 of these during the year. In the original package were four further stores which do not naturally fit the Morrisons operating model. As planned, they will remain closed until we are in a position to evaluate the results of other stores. Excluding these, the acquisition has enabled us to add 480,000 square feet of net new store space with final acquisition and development costs of £325m as projected. In addition we incurred £32m of one-off costs relating to pre-opening activities which has been included within Operating Profit. This was below our initial projection of £40m due to tight cost control and the timely manner in which the OFT approvals were granted.

Although early days, we are pleased with the customer response to the new stores, many of which were community stores operating with a limited range and high prices under the Somerfield fascia. As Morrisons, these stores offer a full weekly shop, with a strong fresh offer, at the normal nationwide prices charged throughout our estate. Whilst these stores are smaller than our average, being below 20,000 square feet, we are confident that we can operate this size of store very successfully. There are now 96 such stores in our estate, and we expect that smaller store formats will form an important element of our ongoing new space acquisition strategy.

The combination of our organic store opening programme and the Co-Operative/Somerfield acquisition has given us a great next step in our move from National to Nationwide.

Trading

Whilst we have continued to maintain focus on the quality and provenance of our food, we have responded to the challenges our customers face through the provision of consistently innovative value. In all we initiated over 30,000 price cuts through the year and delivered a promotional programme that enabled our customers to save money whilst eating good fresh food. Our 'Big Price Crunch' weeks and 'Essentials For Less' were popular with customers. Treats too were in evidence, and after months of belt-tightening we saw customers trading up to enjoy Christmas. Our party food ranges and champagnes on offer at less than half price sold extremely well. Building on its success last year we relaunched and expanded our 'Collector Card' scheme over the Christmas period, rewarding our loyal customers with a £25 shopping voucher.

Market Street performed particularly well, not only because of our very sharp everyday pricing but because we are able to offer deeper, more attractive promotions on fresh products, supported by our own preparation facilities, than others who do not have this capability. We continue to lead the market, not just on fresh value, but also on quality and provenance, and we remain the only major British retailer to offer 100% British fresh pork, beef, lamb and poultry. Our customers strongly endorse this policy, which supports British farming, reduces food miles and means that we sell only fresh meat raised to British standards of animal welfare.

Sales of our own-label 'Value' range grew by 34% as consumers tightened their belts in a challenging economic environment. Many of these products were relaunched in the year, and they are routinely blind-tasted to ensure their quality is as good as the best in the market, whilst being significantly better value. Sales of organic and fair-trade products continued to decline, with consumers unable or unwilling to bear the premium prices that these products command. We did however see a resurgence in sales of the healthy eating 'Eat Smart' range following a relaunch, up 7% reflecting consumers' continuing demand for a healthier diet and their concern over the nutritional value of the food they eat.

We are unique amongst major UK food retailers in owning our own factories and fruit and vegetable packhouses and in the proportion of fresh food preparation that takes place in our stores every day. We also employ more qualified bakers, butchers and fishmongers than any other supermarket. All these factors mean that we can talk with authority to our customers about the provenance and freshness of our food offer, a quality which is becoming more important in a more health conscious environment.

Our broadening appeal and involvement in the community is reflected in the expansion of our award winning 'Lets Grow' initiative in which we provide free gardening equipment and materials to schools to teach children how to grow food. The scheme has been a huge success with over 22,500 schools throughout the country, including 60% of UK primary schools registering to take part. During the year we dispatched thousands of pieces of free gardening equipment to participating schools, ranging from watering cans to wormeries, wellington boots to weather stations and packets of seeds to bags of compost. This initiative was a gold and grand prix winner at the IPA Effectiveness Awards 2009.

Our like-for-like sales momentum, which has been industry leading for a sustained period, has allowed us to invest strongly in the value that our customers seek, ensuring that we maintain a very competitive position in the market. We continue to target annual sales growth ahead of market growth. Over and above our investment in customer value, our volume growth delivered supply chain benefits which allowed us to continue the process of recovering our margins which began with the launch of the Optimisation Plan in 2006.

The UK grocery retail market

The consumer continued to face a difficult economic environment last year. Unemployment and the fear of unemployment, limited credit availability, the impact of tax increases and, with an election due in 2010, uncertainty about future government tax and fiscal policy, all affected consumer confidence and behaviour. Although commodity prices continued to ease, the cost of an average shopping basket rose year-on-year, partly due to the weakness of Sterling. Kantar reported that in the year to January 2010 grocery market growth was 4.7%.

The grocery sector continues to be under a close focus from the Office of Fair Trading (OFT), despite the findings of the Competition Commission that the sector is highly competitive. We always cooperate fully with such inquiries. In the case of the OFT investigation into milk, which began in 2004, we continue to believe strongly that Morrisons has no case to answer and have made representations in detail to this effect. Our view is unchanged by the Supplementary Statement of Objections issued by the OFT in July 2009. In the case of the tobacco inquiry which started in early 2003, there is a complex legal question as to whether well established industry practices represented a breach of competition law. It is likely that this can only be settled clearly through a formal judicial process, although the OFT have indicated an intention to reach their own conclusion in the first quarter of 2010.

Operating results

Summary income statement	2010 £m	2009 £m	Change %
Turnover	15,410	14,528	6
Gross profit	1,062	913	16
Other operating income	65	37	76
Administrative expenses[5]	(315)	(281)	(12)
Underlying Operating profit	812	669	21
Pensions credit	91	-	-
Property transactions	4	2	100
Operating profit	907	671	35
Net finance charges	(49)	(16)	(206)
Taxation	(260)	(195)	(33)
Profit for the period	598	460	30

Total turnover grew by 6% in the year with in-store sales increasing by 9%, reflecting strong like- for-like growth and the benefit of our investment in new space. Oil prices were lower than in the previous year and we maintained our competitive position. As oil prices began to fall so too did prices at the pump and this was reflected in a fall of 6% in fuel sales.

Our gross profit grew ahead of turnover growth, in part reflecting a reduction of low margin fuel sales in the mix. The gross profit margin of 6.9% increased by 60 bps which we estimate was 30 bps higher than it would have been had the proportion of fuel sales in the mix remained at the same level as the previous year.

We have continued to make good progress in delivering further supply chain benefits as our business expands as well as driving further outperformance from our gross margin Optimisation Plan initiatives.

After cost of goods sold, the Group's two biggest costs are store wages and distribution costs. The significant increase in new store space opened during the year and the higher proportion of smaller stores in that mix, impacted our store labour costs performance. However we continued to deliver further in-store labour efficiencies through Optimisation Plan initiatives, such as self scan checkouts

and queue management and these helped to deliver an overall year on year improvement in store labour costs relative to sales. Our distribution costs, measured on a cost per case basis, fell by 2% as we benefited from our investment in improved systems such as voice picking in our warehouses and from a network rebalance following the opening of our new South East Regional Distribution Centre.

Other Operating income increased by 76% reflecting improved income from our investment properties and miscellaneous sales.

Our administration expenses[5] were up 12% well below the level of profit growth in the year. This was in part due to increased investment in marketing in support of our significant sales growth albeit that we were able to take advantage of lower advertising rates available. We also incurred additional costs as the Group's Long Term Incentive Plan programme was extended for a third year.

Optimisation Plan

Our Optimisation Plan, first launched in 2006, concluded in January 2010, with all major milestones achieved or exceeded. In total, sustainable annual EBITDA[6] improvements of £526m have been delivered through the various initiatives contained in the Plan.

During the year, our continuing work on store ranging and segmentation delivered good benefits, with all our major categories showing solid growth. We believe our management of the economics of promotions to be industry leading. As part of our commitment to continuous quality improvement and innovation we introduced some 3,000 new fresh and core grocery products.
Additionally, our in-store efficiency benefited from the industry leading queue management self-scan checkout systems which we began rolling out in 2008.

The Optimisation Plan included significant investment in infrastructure, and a key milestone was the opening, three months early, of our new Regional Distribution Centre (RDC) at Sittingbourne in Kent. The 900,000 square foot site will service 65 stores in the South East, will ease capacity issues created by our rapid growth in recent years and will reduce the distance travelled in servicing these stores by around 22 million kilometres annually. We have now submitted a planning application for a new RDC in the South West, at Bridgwater, which will provide further capacity when needed in 2011/12 to support our National to Nationwide expansion.

The roll-out of voice picking technology across all our grocery warehouses has been completed and has proved particularly successful in increasing depot productivity and pick accuracy, and hence improving in-store availability.

Replacement of our systems

The Optimisation Plan included the first phase (£110m) of a major programme of systems renewal, which will continue for a number of years. The programme will see the replacement of all the Group's core systems, including store based point of sale, warehousing, manufacturing, supply chain, product management, HR, payroll and financial systems. The primary technology is provided by Oracle, the store based systems by Retailix and systems integration is being undertaken by Wipro.

Much of the work in 2009 related to systems design and development activity, but we also began implementation in a number of areas. We successfully delivered the first phase of our new financial systems, continued the roll-out of new HR and payroll processes (now covering 82% of our staff) and implemented voice picking into our distribution centres as mentioned above. This is already having a positive impact on the efficiency of our order fulfillment process. We have also installed self-scan checkout units in around 75% of our estate, implemented sophisticated queue management software into the majority of our stores and begun a pilot of our new EPOS system in store, which will provide a common platform replacing the five separate systems we currently operate.

The programme will continue at high levels of activity until 2013. In the year ahead, we plan to roll-out the new EPOS system to all stores, to implement new manufacturing systems into our packing houses and to begin the roll-out of the warehouse management system. Additionally, we will begin to populate the new product master file which will, in due course, replace our legacy system.

The next phase of the programme is expected to involve further investment of £200m over the three years to 2013. The Board recognises the strategic importance of this activity, and has established a separate committee to provide appropriate oversight. Additionally, independent programme assurance is provided by KPMG.

Corporate Social Responsibility

We continued to work hard on our CSR programme which is a key focus of our management agenda. We have made great progress in meeting the challenging targets we set out when the programme was launched three years ago. Carbon emissions have been cumulatively reduced by more than 830,000 tonnes since 2006, 56% better than we planned. We have also reduced the amount of waste sent to landfill by 34% over the period. Over 17,000 tonnes of packaging has been saved.

Our commitment to helping cut food waste saw the launch during the year of a major new initiative called ‘Great Taste, Less Waste’, which gives practical tips on how to store food more effectively. Key elements of the programme include ‘Best Kept’ stickers on packs giving storage advice and recipe ideas on how to make the most of leftovers.

During the year, we again issued free reusable bags to our customers, and as a result of this and other initiatives we reduced carrier bag consumption by 126 million bags. We also completed the conversion of our filling station pumps to highly efficient vapour recovery pumps which emit much reduced levels of fuel vapour into the atmosphere, a £16m investment in improved environmental performance.

As the Food Specialist for Everyone, Morrisons understands where food comes from. To build further on our food specialist credentials, we have launched a ground-breaking joint venture to farm 700 acres on the Dumfries House Estate in East Ayrshire. The Morrisons Farm aims to become a leading centre of excellence for farming research, working in a new partnership with the Scottish Agricultural College to drive research into sustainable and commercial farming models and share best practice throughout the industry.

[5] Administrative expenses excluding pensions credit
[6] EBITDA is earnings before interest, tax, depreciation and amortisation

Financial review

Introduction

Morrisons financial performance for 2009/10 was strong once again despite the current challenging economic environment.

Investment in new and acquired stores and infrastructure stepped up in the year, funded by strong cash flows, secure financing and a robust balance sheet.

Financial strategy

The Group's financial strategy is to deliver strongly improved profit margins, whilst positioning the Group for long term growth.

The underlying principles behind this strategy are:

- Sales growth that exceeds the market
- Earnings that meet the expectations of shareholders
- Maintaining a strong balance sheet whilst retaining prudent principles

We are achieving these principles by:

- Increasing our customer appeal and growing sales organically
- Converting sales growth into profitable growth
- Retaining our prudent principles and targeting investments to yield an appropriate rate of return

How we are doing?:

Increasing our customer appeal and growing sales organically:

	2007	2008	2009	2010
Like-for-like sales growth in excess of the market (source: Nielsen)	+1.2%	+1.1%	+2.3%	+2.3%

Converting sales growth into profitable growth:

	2007	2008	2009	2010
Underlying basic earnings per share (pence)	8.3	14.4	16.7	20.5

Retaining our prudent principles:
Assumptions and judgements used in the valuation of the Group's balance build on our strong financial position:

- 89% of our estate is freehold
- We use prudent assumptions to value our defined benefit pension schemes
- Our long term financing facilities will adequately cover our planned investments

Turnover and operating profit

Turnover for 2009/10 was £15,410m (2008/09: £14,528m) and operating profit was £907m, an increase of £236m from last year.

The Operating review of the year as shown above contains further information on our turnover increase and includes an analysis of like-for-like and new store turnover, sales densities and customer numbers. Operating margins and operating profit are also discussed. Operating profit includes £32m one-off costs related to the acquisition of 38 stores from the Co-operative group.

Underlying earnings

	2009/10	2008/09
Operating profit	£907m	£671m
Underlying earnings before tax	£767m	£636m

The Group uses Underlying earnings as its measure to assess normal underlying business performance and trends. Earnings are adjusted to remove volatile or one-off costs and credits. A reconciliation of Underlying earnings is provided in note 1 of the Group financial information.

Our underlying earnings have, in previous years, adjusted Operating profit for net pension interest and profits arising on the sale of properties. This year we have further adjusted for a one-off pensions credit of £91m. This is discussed in the pension section below.

The increase in underlying earnings is discussed above in the Operating review of the year.

Earnings per share

Basic earnings per share increased from 17.4p to 22.8p.

Underlying earnings per share provides a more consistent measure of EPS as earnings are adjusted to remove volatile and one-off costs. Underlying earning per share increased to 20.5p from 16.7p last year. The growth in underlying EPS is primarily from the increase in underlying profit as described above as there were no significant changes in the number of issued shares or tax rate effects.

Summary cash flow

	2010 £m	2009 £m
Cash generated from operations	1,004	964
Interest and tax	(261)	(145)
Capital expenditure	(906)	(678)
Proceeds from sale of property, plant & equipment	7	22
Dividends paid	(159)	(131)
Financing activities	199	246
Share issues and buyback	34	(143)
Long term cash on deposit movement	-	74
Net cash (outflow)/inflow	(82)	209
Net debt	924	642

Cash generated from operations
Cash from operating activities increased by £40m reflecting the overall growth in profits offset by increases in working capital. Stocks increased in the year by £83m as a result of the high number of store openings and the stocking of the new regional distribution centre at Sittingbourne. Working capital management remains strong with yearly average stock turnover at 22 times (2008/09: 24 times).

Interest & tax

Interest
Net interest paid increased by £11m year-on-year. Low interest rates throughout the year on borrowings reduced our interest paid, but this was offset by the reduction in interest received. In addition, interest received reduced further due to a lower than average cash on deposit balance through the year. With no movement on the total bonds, the amount of bond interest paid of £45m is the same as the prior year. The repayment of a Euro bond due in April 2010 will see a reduction in bond interest payable of £9m in 2010/11.

Tax
Corporation tax paid in the year was £209m (2008/09: £104m). This cash outflow represented 50% of the total tax bill for the year to 1 February 2009, and 50% of the expected tax charge for the year to 31 January 2010, as well as repayments received for prior years.

The effective tax rate for the year was 30% which is 2% above the prevailing corporation tax rate of 28%. The higher rate is primarily as a result of non-qualifying depreciation, and expenses for which the Group is unable to obtain a tax deduction. The principal objective of the in-house tax department continues to be to pay the appropriate level of tax at the right time.

We actively engage with the UK tax authorities and aim to be transparent in all our activities. The Group is predominantly UK-based, operates a simple business model, and does not engage in sophisticated tax planning structures.

Capital expenditure
Cash outflows from capital expenditure increased by £228m to £906m. As expected, expenditure on stores increased significantly with the purchase of the Co-op/Somerfield stores at the beginning of the year. The total investment in these stores was £325m, with an initial capital purchase of £223m and £102m of refurbishment and fit out costs. In addition we opened 11 new stores and extended a further 13. We also invested £100m in IT infrastructure of which £57m related to our systems renewals programme. £48m was spent completing our new regional distribution centre at Sittingbourne.

Financing
The Group is securely financed with a £1.1bn revolving credit facility (RCF) and £759m of long term bonds. At the year end £450m of RCF was utilised allowing significant headroom for investments and the forthcoming bonds repayment. The facility is not due to mature until September 2012. €250m bonds are due to mature in April 2010 and will be repaid using the existing credit facility.

Interest cover
As anticipated, interest cover fell as a result of the increase in average net debt and the very low levels of interest received on money on deposit. In addition, the net pension interest income reduced by £21m all of which resulted in interest cover reducing to 19 times from 42 times in 2008/09.

Pension

Pension deficit bridge	£m
Net pension deficit at 1 February 2009	(49)
Actual vs expected return on scheme assets	245
Actuarial loss due to changes in financial assumptions	(316)
Pensions credit	91
Funding above annual service cost	16
Other	(4)
Net pension deficit at 31 January 2010	(17)

We continue to calculate the Group's defined benefit pension obligations on a prudent basis, consistent with prior years, and update assumptions for market fluctuations.

The net pension deficit has decreased by £32m as outlined in the table above. The improving stability in the markets in recent months has provided a better than expected return on assets and required us to slightly reduce the discount factor applied to the liabilities.

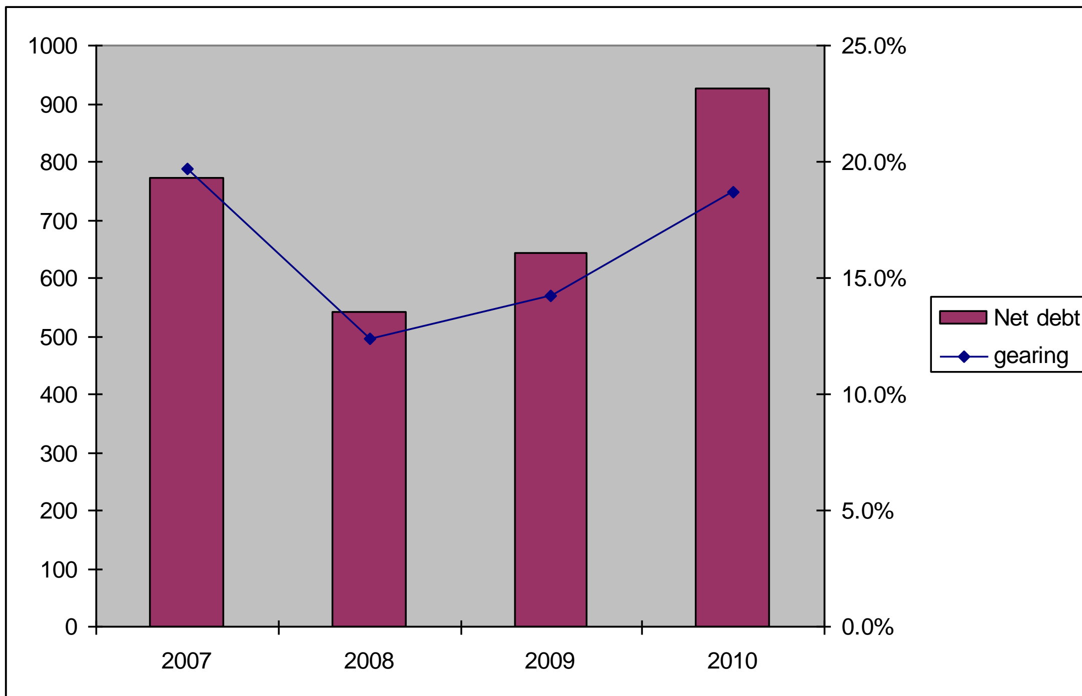
Following consultation with members of the schemes and approval by the Board and Trustees, the Group became committed to the final proposals from the Pension Review on 2 July 2009. The move from a final salary basis to career average earnings (CARE) represents an accounting curtailment of certain pension liabilities. In accordance with IAS 19 Employee Benefits, the defined pension schemes' obligations were revalued by the schemes' actuaries immediately prior to the change and assumptions reviewed at that date. The change resulted in a pensions credit of £91m which is presented separately in the Consolidated statement of comprehensive income.

The 2010 triennial valuation is underway and will be completed later in the year. The reassessment of the liabilities and assumptions will be incorporated in the financial statements from our year ended January 2011 onwards.

Net debt
Net debt increased by £282m in the year to £924m from £642m in 2008/09. The anticipated increase was primarily from capital expenditure on the Optimisation Plan which has increased significantly from previous years reflecting the costs of purchasing and refitting the Co-op stores.

Gearing
Our gearing ratio is well below the sector average at 19% (2009:14%) demonstrating the strength in our balance sheet and cash efficiency given the increased level of operating and investing activity throughout the year.

Our credit rating has been upgraded by Moody's for the second successive year to A3. We are one of only three retailers in Europe to have this rating.



Returns to shareholders

Progressive dividend growth

The final dividend proposed is 7.1 pence per share, an increase of 2.1 pence from last year. This brings the total dividend for the year to 8.2 pence per share, making dividend cover 2.5 times.

Since 2008 our policy has been to grow the dividend over and above underlying earnings growth to bring dividend cover in line with the sector average, which is around 2.5 times. Payment of the final dividend will bring us in line with this policy.

Total shareholder return & share price

The company's share price has risen to 289.1p on 31 January 2010, an increase of 7% from the start of the year.

Since 30 January 2006, the Company's share price has risen 53% compared with a fall of 10% in the FTSE 100 index.

Optimisation Plan

The Optimisation Plan that was established in 2006 concluded successfully. The plan contained a series of programmes designed to bring profit back in line with sector standards following the integration of Safeway and to make investments to shape the business for growth.

	Savings	Total planned £m	Total completed £m	**Investment**	Total planned £m	Total completed £m
Gross margin	Better buying, sales mix and wastage control	210	240	-	-	-
In-store	Realising efficiencies	140	149	Store refresh programme	180	188
Manufacturing	Managing capacity	15	15	New abattoir/packhouse	70	45
Distribution	Rationalisation	55	79	New capacity in the South	90	111
Centre/IT	Elimination of dual running costs	40	43	New systems across the business	110	91*
	Total savings	**460**	**526**		**450**	**435**

* Capital expenditure on new IT systems has reached £91m of the expected £110m with the balance of £19m due to be completed in the first half of 2010/11. In addition, we anticipate an investment of £200m over the next 3 years. This will bring the total value of IT expenditure on enterprise systems to £310m over 6 years from inception in 2007, close to an average annual expenditure on IT for a group of Morrisons size and complexity.

Key judgements & assumptions

Judgements and assumptions made in the financial statements are continually reviewed. Whilst some outcomes have been affected by the volatility in the financial markets, all judgements and assumptions in the accounting policies remain consistent with previous years. Consideration of impairment to the carrying values of assets has been made and we concluded that the individual carrying values of stores and other operating assets are supportable either by value in use or market values. The impact of the current economic conditions on the assessment of going concern has been considered in the general information section of the Directors' report.

Provisions

Property provisions decreased by £12m from £112m last year (note 22 of the Group financial information). The decrease is primarily a release in the onerous lease provision. The release was for a store we have re-opened as it fits well with our new smaller stores format and for a number of tenants' lease breakpoints being passed resulting in a continuing commitment from the tenant to continue the leases. A small charge has been made in the year as a result of the difficult conditions in the property market.

Consolidated statement of comprehensive income

52 weeks ended 31 January 2010

	Note	**2010 £m**	2009 £m
Turnover	2	**15,410**	14,528
Cost of sales		**(14,348)**	(13,615)
Gross profit		**1,062**	913
Other operating income		**65**	37
Administrative expenses		**(224)**	(281)
Profits arising on property transactions		**4**	2
Operating profit	4	**907**	671
Analysed as:			
Operating profit before pensions credit		**816**	671
Pensions credit within administrative expenses	21	**91**	-
Operating profit		**907**	671
Finance costs	5	**(60)**	(60)
Finance income	5	**11**	44
Profit before taxation		**858**	655
Taxation	6	**(260)**	(195)
Profit for the period attributable to the owners of the Company		**598**	460
Other comprehensive (expense)/income:			
Actuarial loss arising in the pension scheme	21	**(71)**	(101)
Foreign exchange movements		**(1)**	6
Cash flow hedging movement		**(11)**	6
Tax in relation to components of other comprehensive income	6	**22**	31
Other comprehensive expense for the period, net of tax		**(61)**	(58)
Total comprehensive income for the period attributable to the owners of the Company		**537**	402
Earnings per share (pence)			
- basic	8	**22.80**	17.39
- diluted	8	**22.37**	17.16

Consolidated balance sheet

31 January 2010

	Note	**2010 £m**	2009 £m
Assets			
Non-current assets			
Property, plant and equipment	9	**7,180**	6,587
Lease prepayments	10	**257**	250
Investment property	11	**229**	242
Other financial assets	13	**-**	81
		7,666	7,160
Current assets			
Stocks	14	**577**	494
Debtors	15	**201**	245
Other financial assets	13	**71**	-
Cash and cash equivalents	16	**245**	327
		1,094	1,066
Liabilities			
Current liabilities			
Creditors	17	**(1,845)**	(1,915)
Other financial liabilities	18	**(213)**	(1)
Current tax liabilities		**(94)**	(108)
		(2,152)	(2,024)
Non-current liabilities			
Other financial liabilities	18	**(1,027)**	(1,049)
Deferred tax liabilities	20	**(515)**	(472)
Net pension liabilities	21	**(17)**	(49)
Provisions	22	**(100)**	(112)
		(1,659)	(1,682)
Net assets		**4,949**	4,520
Shareholders' equity			
Called-up share capital	23	**265**	263
Share premium	23	**92**	60
Capital redemption reserve	24	**6**	6
Merger reserve	24	**2,578**	2,578
Retained earnings and hedging reserves	24	**2,008**	1,613
Total equity attributable to equity holders of the parent		**4,949**	4,520

Consolidated cash flow statement

52 weeks ended 31 January 2010

	Note	**2010** **£m**	2009 £m
Cash flows from operating activities			
Cash generated from operations	25	**1,004**	964
Interest paid		**(60)**	(70)
Taxation paid		**(209)**	(104)
Net cash inflow from operating activities		**735**	790
Cash flows from investing activities			
Interest received		**8**	29
Proceeds from sale of property, plant and equipment		**7**	22
Purchase of property, plant and equipment and investment property		**(906)**	(678)
Net cash outflow from investing activities		**(891)**	(627)
Cash flows from financing activities			
Proceeds from issue of ordinary shares		**34**	3
Shares repurchased for cancellation		**-**	(146)
Finance lease principal payments		**-**	(2)
New borrowings		**200**	250
Repayment of borrowings		**(1)**	(2)
Decrease in long term cash on deposit		**-**	74
Dividends paid to equity shareholders		**(159)**	(131)
Net cash inflow from financing activities		**74**	46
Net (decrease)/increase in cash and cash equivalents		**(82)**	209
Cash and cash equivalents at start of period		**327**	118
Cash and cash equivalents at end of period	16	**245**	327

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

	Note	**2010** **£m**	2009 £m
Net (decrease)/increase in cash and cash equivalents		**(82)**	209
Cash outflow from decrease in debt and lease financing		**2**	4
Cash inflow from increase in loans		**(200)**	(250)
Long term cash on deposit		**-**	(74)
Other non cash movements		**(2)**	12
Opening net debt		**(642)**	(543)
Closing net debt	26	**(924)**	(642)

Consolidated statement of changes in equity

	Note	Attributable to the owners of the Company						
		Share capital	**Share premium**	**Capital redemption reserve**	**Merger reserve**	**Hedging reserve**	**Retained earnings**	**Total equity**
		£m	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Current year								
At 1 February 2009		**263**	**60**	**6**	**2,578**	**12**	**1,601**	**4,520**
Profit for the period		**-**	**-**	**-**	**-**	**-**	**598**	**598**
Other comprehensive income								
Actuarial loss arising in the pension scheme	21	**-**	**-**	**-**	**-**	**-**	**(71)**	**(71)**
Foreign exchange movements		**-**	**-**	**-**	**-**	**-**	**(1)**	**(1)**
Cash flow hedging movement		**-**	**-**	**-**	**-**	**(11)**	**-**	**(11)**
Tax in relation to components of other comprehensive income	6	**-**	**-**	**-**	**-**	**2**	**20**	**22**
Total comprehensive income for the period		**-**	**-**	**-**	**-**	**(9)**	**546**	**537**
Employees share options schemes:								
Share-based payments	27	**-**	**-**	**-**	**-**	**-**	**17**	**17**
Share options exercised		**2**	**32**	**-**	**-**	**-**	**-**	**34**
Dividends	7	**-**	**-**	**-**	**-**	**-**	**(159)**	**(159)**
Total transactions with owners		**2**	**32**	**-**	**-**	**-**	**(142)**	**(108)**
At 31 January 2010		**265**	**92**	**6**	**2,578**	**3**	**2,005**	**4,949**

	Note	Attributable to the owners of the Company						
		Share capital	Share premium	Capital redemption reserve	Merger reserve	Hedging reserve	Retained earnings	Total equity
		£m	£m	£m	£m	£m	£m	£m
Prior year								
At 3 February 2008		269	57	-	2,578	6	1,468	4,378
Profit for the period		-	-	-	-	-	460	460
Other comprehensive income								
Actuarial loss arising in the pension scheme	21	-	-	-	-	-	(101)	(101)
Foreign exchange movements		-	-	-	-	-	6	6
Cash flow hedging movement		-	-	-	-	6	-	6
Tax in relation to components of other comprehensive income	6	-	-	-	-	-	31	31
Total comprehensive income for the period		-	-	-	-	6	396	402
Employees share options schemes:								
Share-based payments	27	-	-	-	-	-	14	14
Share options exercised		-	3	-	-	-	-	3
Shares purchased for cancellation		(6)	-	6	-	-	(146)	(146)
Dividends	7	-	-	-	-	-	(131)	(131)
Total transactions with owners		(6)	3	6	-	-	(263)	(260)
At 1 February 2009		263	60	6	2,578	12	1,601	4,520

General information
Wm Morrison Supermarkets PLC is a public limited company incorporated in the United Kingdom under the Companies Act 2006 (Registration number 358949). The Company is domiciled in the United Kingdom and its registered address is Hilmore House, Gain Lane, Bradford, BD3 7DL, United Kingdom.

Basis of preparation
The financial information set out herein does not constitute the Company's statutory accounts for the periods ended 31 January 2010 or 1 February 2009 but is derived from those accounts. Statutory accounts for 2009 have been delivered to the registrar of companies, and those for 2010 will be delivered in due course. The auditors have reported on those accounts; their report was (i) unqualified, (ii) did not include references to any matters to which the auditors drew attention by way of emphasis without qualifying their report, and (iii) did not contain statements under sections 237(2) or (3) of the Companies Act 1985 in respect of the accounts for 2009 nor a statement under sections 498(2) or 498(3) of the Companies Act 2006 in respect of the accounts for 2010.

The Group’s accounting policies are set out below and have, unless otherwise stated, been applied consistently to all periods presented in these consolidated financial statements.

Presentation of financial statements

IAS 1 (revised) *Presentation of financial statements* is mandatory for the first time for this financial year. The standard provides that all owner changes in equity may be presented in the consolidated statement of changes in equity and non-owner changes in equity in the consolidated statement of comprehensive income. The Group adopts this policy and there is no impact to the financial statements other than presentation. The Group has elected to present one statement of comprehensive income.

Comparative information has been represented so that it is also in conformity with the revised standard.

Segmental reporting

From 2 February 2009 the Group has adopted IFRS 8 *Operating segments* which requires the Group to determine and present its operating segments based on information which is provided internally to the chief operating decision-maker (CODM). The CODM has been identified as the Executive Board as it is this Board that make the key operating decisions of the Group.

The Director’s consider there to be one reporting segment, that of grocery retailing. The CODM’s focus is on the performance and growth of this activity. In making operational decisions the CODM considers internal reports presented regularly to it, primarily the Board Management Accounts, in order to assess the Group’s performance. These internal reports focus on the operation of the Group as a whole and it is these reports that the CODM use to make resourcing and operational decisions. Therefore adoption of this standard has not led to any changes in the operating segments previously reported.

Customer loyalty schemes

IFRC 13 requires customer loyalty credits to be accounted for as a separate component of the sales transaction in which they are granted. A portion of the fair value of the consideration received is allocated to the award credits and deferred. This is then recognised as revenue over the period that the award credits are redeemed. This interpretation has not had a material impact on the Group as it is consistent with the accounting policy already applied by the Group.

There have been no further alterations made to the accounting policies as a result of considering all amendments to IFRS and IFRIC interpretations that became effective during the financial period as these were considered to be immaterial to the Group’s operations or were not relevant.

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

Revenue recognition
Revenue is recognised when significant risks and rewards of ownership have been transferred to the buyer, there is reasonable certainty of recovery of the consideration and the amount of revenue, associated costs and possible return of goods can be estimated reliably.

a) Sale of goods in-store and fuel
Sale of goods in-store is recorded net of value added tax, staff discounts, coupons, vouchers and the free element of multi-save transactions. Sale of fuel is recognised net of value added tax and Morrisons Miles award points. Revenue is recognised when transactions are completed in-store.

b) Other sales
Other revenue primarily comprises income from concessions and commissions based on the terms of the contract and manufacturing sales made direct to third party customers recognised on despatch of goods. Revenue collected on behalf of others is not recognised as turnover, other than the related commission. Sales are recorded net of value added tax and intra-group transactions.

Other operating income
Other operating income primarily consists of income not directly related to the operating of supermarkets and mainly comprises rental income from investment properties and income generated from recycling of packaging. Rental income arising from operating leases on investment properties is accounted for on a straight-line basis over the lease term. Details of rental income from Investment Property are provided in note 11.

Cost of sales
Cost of sales consists of all costs to the point of sale including manufacturing, warehouse and transportation costs. Store depreciation, store overheads and store based employee costs are also allocated to cost of sales.

Supplier income
Supplier incentives, rebates and discounts are collectively referred to as supplier income in the retail industry. Supplier income is recognised as a deduction from cost of sales on an accruals basis based on the expected entitlement which has been earned up to the balance sheet date for each relevant supplier contract. The accrued incentives, rebates and discounts receivable at year end are included within prepayments and accrued income. Where amounts received are in the expectation of future business, these are recognised in line with that future business.

Property transactions
Property includes the balance sheet headings of property, plant and equipment, investment property, lease prepayments and non-current assets classified as held for sale. The results of transactions relating to disposal of property are reported in the income statement under 'Profit arising on property transactions'. Depreciation and any impairment charges or reversals are recognised in cost of sales or administrative expenses, as appropriate.

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

Deferred and current tax

Current tax payable is based on the taxable profit for the period, using tax rates enacted at the balance sheet date and any adjustments to tax payable in respect of previous periods. Taxable profit differs from the profit as reported in the income statement as it is adjusted both for items that will never be taxable or deductible and temporary differences. Current tax is charged in the income statement, except when it relates to items charged or credited directly in equity in which case the current tax is reflected in equity.

Deferred tax is recognised using the balance sheet method. Provision is made for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. No deferred tax is recognised for temporary differences that arise on the initial recognition of goodwill or the initial recognition of assets and liabilities that is not a business combination and that affects neither accounting nor taxable profits. Deferred tax is calculated based on tax law that is enacted or substantively enacted at the reporting date and provided at rates expected to apply when the temporary differences reverse. Deferred tax is charged or credited in the income statement except when it relates to items charged or credited directly to equity in which case the deferred tax is reflected in equity.

Deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which the asset can be utilised. Deferred tax assets recognised are reviewed at each reporting date as judgement is required to estimate the availability of future taxable income. Deferred tax assets and liabilities are not discounted and are offset where amounts will be settled on a net basis as there is a legally enforceable right to offset.

Accruals for tax contingencies require management to make judgements and estimates of ultimate exposures in relation to tax compliance issues. All accruals are included in current liabilities.

Business combinations and goodwill
All business combinations are accounted for by applying the purchase method.

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.

Property, plant and equipment
a) Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. 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 on a straight line basis are:

Freehold land	0%
Freehold buildings	2.5%
Leasehold buildings	Over the shorter of lease period and 2.5%
Plant, equipment, fixtures and vehicles	14-33%
Assets held under a finance lease	Shorter of life of lease or asset
Assets under construction	0%

Investment property
Property held to earn rental income is classified as Investment property. Investment property is recorded at cost less accumulated depreciation and any recognised impairment loss. The depreciation policy is consistent with those described for property, plant and equipment.

Income from investment properties is disclosed in ‘Other operating income’ and details are shown in note 11 ‘Investment property’. The related operating costs are immaterial and are included within Administrative expenses.

Impairment of non-financial assets
Property, plant and equipment and investment property are annually reviewed for indications of impairment, or when events or changes in circumstances indicate that the carrying amount may not be recoverable. This is performed for each cash generating unit, which in the case of a supermarket is an individual retail outlet. If there are indications of possible impairment then a test is performed on the asset affected to assess its recoverable amount against carrying value. An asset impaired is written down to its recoverable amount which is the higher of value in use or its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If there is indication of an increase in fair value of an asset that had been previously impaired, then this is recognised by reversing the impairment, but only to the extent that the recoverable amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognised for the asset.

Stocks
Stocks are measured at the lower of cost and net realisable value. Cost is calculated on a weighted average basis and comprises purchase price, import duties and other non-recoverable taxes less rebates. Stocks represent goods for resale.

Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs necessary to make the sale.

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. The Group does not lease any assets on a finance lease basis either as lessor or lessee.

Lessor accounting – Operating leases
Assets acquired and made available to third parties under operating leases are recorded as property, plant and equipment and are depreciated on a straight line basis to their estimated residual values over their estimated useful lives. Operating lease income is charged on a straight line basis to the date of the next rent review.

Lessee accounting – Operating leases
Rental payments are taken to the income statement 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.

Provisions
Provisions are created where the Group has a present obligation as a result of a past event, where it is probable that it will result in an outflow of economic benefits to settle the obligation from the Group, and where it can be reliably measured.

Provisions are 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 likely committed outflow to the Group. Where material, these estimated outflows are discounted to net present value.

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 a formula using either the employee's compensation package or career average earnings.

The Group operates two defined benefit retirement schemes which are funded by contributions from the Group and members. The defined benefit schemes are not 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 on a discounted present value basis using assumptions as shown in note 21. The operating and financing costs of the scheme are recognised separately in the income statement 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 other comprehensive income.

The Group has a right to recognise an asset, should one arise, in respect of the Group's net obligations to the pension schemes. Therefore either an asset or a liability is recognised in the balance sheet, calculated separately for each scheme.

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 settled share-based payments to certain employees in exchange for services rendered by them. The fair value of the share-based award is calculated at the date of grant and is expensed on a straight line basis over the vesting period with a corresponding increase in equity. This is based on the Group's estimate of share options that will eventually vest. This takes into account movement of non-market conditions, being service conditions and financial performance, if relevant.

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 Group has applied fair values to all grants of equity instruments after 7 November 2002 which were unvested as of 1 January 2005 at each balance sheet date.

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.

a) Financial assets
i) Trade and other debtors
Trade and other debtors are carried at the lower of their original invoiced value and recoverable amount. Provision is made when there is objective evidence that the Group will not be able to recover balances in full, with the charge being recognised in administrative expenses in the income statement. Balances are written off when the probability of recovery is assessed as being remote.

ii) 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.

b) Financial liabilities

i) Trade and other creditors

Trade and other creditors are stated at cost.

ii) Borrowings

Interest-bearing bank loans and overdrafts are initially recorded at fair value, net of attributable transaction costs. Subsequent to initial recognition, any difference between the redemption value and the initial carrying amount is recognised in the income statement over the period of the borrowings on an effective interest rate basis.

c) Derivative financial instruments and hedge accounting

Derivative financial instruments are initially measured at fair value, which normally equates to cost, and are remeasured at fair value through profit or loss.

Cash flow hedges

Derivative financial instruments are classified as cash flow hedges when they hedge the Group's exposure to variability in cash flows that are either attributable to a particular risk associated with a recognised asset or liability, or a highly probable forecast transaction.

The Group has a cross-currency swap which has been designated as a cash flow hedge. This derivative financial instrument is used to match or minimise risk from potential movements in foreign exchange rates inherent in the cash flows of certain financial liabilities. To minimise the risk from potential movements in energy prices, the Group has energy price contracts which are also designated as cash flow hedges.

Derivatives are reviewed quarterly for effectiveness. Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or highly probable forecast transaction, the effective part of any gain or loss on the movement in fair value of the derivative financial instrument is recognised in other comprehensive income and presented in the hedging reserve in equity.

The gain or loss on any ineffective part of the hedge is immediately recognised in the income statement within finance income/costs in relation to the cross-currency swap and within cost of sales in relation to the energy price contracts. If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or liability, the associated cumulative gains or losses that were recognised directly in equity are reclassified into the income statement when the transaction occurs.

Net debt

Net debt is cash and cash equivalents, long term cash on deposit, bank and other current loans, bonds and derivative financial instruments (stated at current fair value).

Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.
Where any Group company purchases the Company's equity share capital, the consideration paid, including directly attributable incremental costs, is deducted from retained earnings until the shares are cancelled. On cancellation, the nominal value of the shares is deducted from share capital and the amount is transferred to the capital redemption reserve.

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 shares are deducted 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) Provisions
Provisions have been made for onerous leases, dilapidations and decommissioning costs. These provisions are estimates based on the condition of each property and market conditions for the relevant location. The actual costs and timing of future cash flows are dependent on future events. Any difference between expectations and the actual future liability will be accounted for in the period when such determination is made.

b) Pension scheme assumptions and mortality table
The carrying value of defined benefit pension schemes is valued using actuarial valuations. These valuations are based on assumptions including the selection of mortality tables for the profile of members in each scheme. All these are estimates of future events. The mortality experience study conducted as part of the Safeway scheme triennial valuation is statistically significant and the longevity assumption is adjusted to reflect its results. As both of the Group's schemes have a similar composition and type of members, this adjustment is also made to the Morrisons scheme. The mortality assumptions, financial assumptions and mortality experience study are based on advice received from the schemes' actuaries. Where appropriate these are corroborated from time-to-time with benchmark surveys and ad-hoc analysis.

c) Determination of useful lives, residual values and carrying values of property, plant and equipment, investment property and long leasehold land prepayments
Depreciation is provided so as to write down the assets to their residual values over their estimated useful lives as set out in the accounting policies for property, plant and equipment, investment property and long leasehold land prepayments. The selection of these residual values and estimated lives, particularly in respect of plant and equipment, requires the exercise of judgement.

The Group is required to assess whether there is indication of impairment to the carrying values of assets. In making that assessment, judgements are made in estimating value in use. The Directors consider that the individual carrying values of stores and other operating assets are supportable either by value in use or market values.

Notes to the financial information

52 weeks ended 31 January 2010

1 Underlying earnings

The Directors consider that underlying earnings per share measures referred to in the Chairman's statement, Business review and Financial review provide additional useful information for shareholders on underlying trends and performance. The adjustments are made to reported profit to (a) remove the impact of pension interest income volatility on the comprehensive income statement; (b) remove the one-off pensions credit as a result of the move from final salary to career average revalued earnings (CARE) (note 21); (c) remove profits arising on property transactions since these profits do not form part of the Group's principal activities; and (d) apply an effective tax rate of 30%, being an estimated normalised tax rate.

In the prior period, we have used the actual tax charge as the difference between the actual tax charge and normalised charge is not significant.

	2010	2009
	£m	£m
Profit after tax	**598**	460
Add back: tax charge for the period	**260**	195
Profit before tax	**858**	655
Adjustments for:		
Net pension interest cost/(income) (note 5)[1]	**4**	(17)
Pensions credit[1]	**(91)**	-
Profits arising on property transactions[1]	**(4)**	(2)
Underlying earnings before tax	**767**	636
Taxation[1]	**(230)**	(195)
Underlying earnings after tax charge	**537**	441

Underlying earnings per share (pence)		
- basic (refer note 8(b))	**20.47**	16.67
- diluted (refer note 8(b))	**20.08**	16.45

[1] adjustments marked 1 equal £61m (2009: £19m) as shown in the reconciliation of earnings disclosed in note 8(b)

2 Turnover (excluding VAT)

	2010	2009
	£m	£m
Sale of goods in-stores	**12,423**	11,378
Fuel	**2,893**	3,069
Total store based sales	**15,316**	14,447
Other sales	**94**	81
Total turnover	**15,410**	14,528

3 Employees and Directors

	2010 £m	2009 £m
Employee benefit expense for the Group during the period		
Wages and salaries	**1,638**	1,453
Social security costs	**113**	105
Share-based payments (note 27)	**17**	14
Pension costs	**29**	42
Pension credit	**(91)**	-
Other staff costs	**1**	3
	1,707	1,617

	2010 No.	2009 No.
Average monthly number of people employed by business group		
Stores	**120,135**	111,462
Manufacturing	**4,810**	5,042
Distribution	**5,890**	4,886
Centre [2]	**2,908**	3,140
	133,743	124,530

[2] Centre includes employees on maternity leave and long-term sick leave.

Key management comprises Executive and Non-Executive Directors as they have the responsibility of planning and controlling the operations of the business as a whole. The aggregate remuneration paid to or accrued for the Directors for services in all capacities during the period is as follows:

	2010 £m	2009 £m
Directors		
Short term employee benefits	**4.7**	5.8
Pension costs	**0.4**	0.4
Share-based payments	**1.9**	3.9
	7.0	10.1

There are three Executive Directors (2009: three) who have retirement benefits accruing under the Group's defined benefit pension scheme.

4 Operating profit

	2010 £m	2009 £m
The following items have been included in arriving at operating profit:		
Depreciation:		
- Property, plant and equipment – owned assets	**298**	284
- Investment property	**6**	6
Charge in the income statement	**304**	290
Operating lease rentals:		
- minimum lease payments	**40**	35
- sublease receipts	**(6)**	(5)
Value of stock expensed	**11,548**	11,016

Services provided by the Group's auditor

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

	2010 £m	2009 £m
Audit services		
- statutory Group and Company audit	**0.4**	0.4
- statutory audit of subsidiaries	**0.2**	0.2
- audit related regulatory reporting	**0.1**	0.1
Tax services		
- compliance services	**-**	0.1
- advisory services	**0.1**	0.2
Other		
- independent project assurance	**0.9**	0.5
	1.7	1.5

5 Finance costs and income

	2010 **£m**	2009 £m
Interest payable on short term loans and bank overdrafts	**(5)**	(3)
Interest payable on bonds	**(45)**	(45)
Interest capitalised	**5**	4
Total interest payable	**(45)**	(44)
Fair value movement of derivative instruments	**(8)**	(8)
Other finance costs	**(7)**	(8)
Finance costs	**(60)**	(60)
Bank interest received	**4**	17
Amortisation of bonds	**8**	8
Other finance income	**3**	2
Pension liability interest cost	**(109)**	(113)
Expected return on pension assets	**105**	130
Net pension interest (expense)/income	**(4)**	17
Finance income	**11**	44
Net finance cost	**(49)**	(16)

Interest is capitalised at the effective interest rate incurred on borrowings 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.

6 Taxation

a) Analysis of charge in the period	2010 £m	2009 £m
Corporation tax		
- current period	**205**	145
- adjustment in respect of prior period	**(27)**	(10)
	178	135
Deferred tax		
- current period	**54**	69
- adjustment in respect of prior period	**28**	(9)
	82	60
Tax charge for the period	**260**	195

b) Tax on items (credited)/charged in other comprehensive income	2010 £m	2009 £m
Actuarial loss arising in the pension scheme	**(20)**	(29)
Cash flow hedges	**(2)**	(2)
Total tax on items included in other comprehensive income	**(22)**	(31)

Analysis of items (credited)/charged to other comprehensive income		
Current tax	**17**	(19)
Deferred tax (note 20)	**(39)**	(12)

The tax for both periods is different to the standard rate of corporation tax in the UK of 28% (2009: 28%). The differences are explained below:

c) Tax reconciliation	2010 £m	2009 £m
Profit before tax	**858**	655
Profit before tax at 28% (2009: 28%)	**240**	183
Effects of:		
Expenses not deductible for tax purposes	**4**	8
Non-qualifying depreciation	**24**	31
Deferred tax on Safeway acquisition assets	**(8)**	(7)
Divestment profits not taxable	**1**	(2)
Other	**(2)**	1
Prior period adjustments	**1**	(19)
Tax charge for the period	**260**	195

7 Dividends

	2010 £m	2009 £m
Amounts recognised as distributed to equity holders in the year:		
Interim dividend for the year ended 31 January 2010 of 1.08p (2009: 0.8p)	**28**	21
Final dividend for the year ended 1 February 2009 of 5.0p (2008: 4.125p)	**131**	110
	159	131

The Directors are proposing a final dividend in respect of the financial period ending 31 January 2010 of 7.12p per share which will absorb an estimated £189m of Shareholders' funds. Subject to approval at the AGM, it will be paid on 9 June 2010 to shareholders who are on the register of members on 7 May 2010.

A dividend reinvestment plan is available in respect of the final dividend.

8 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.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares. The Company has two (2009: two) classes of financial instruments that are potentially dilutive: 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 and contingently issuable shares under the Group's long term incentive plan.

a) Basic and diluted earnings per share (unadjusted)

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

	2010			2009		
	Earnings £m	**Weighted average number of shares millions**	**EPS pence**	Earnings £m	Weighted average number of shares millions	EPS pence
Unadjusted EPS						
Basic EPS						
Earnings attributable to ordinary shareholders	**598**	**2,623.3**	**22.80**	460	2,644.9	17.39
Effect of dilutive instruments						
Share options and LTIPs	**-**	**50.5**	**(0.43)**	-	36.5	(0.23)
Diluted EPS	**598**	**2,673.8**	**22.37**	460	2,681.4	17.16

b) Underlying earnings per share

Given below is the reconciliation of the earnings used in the calculations of underlying earnings per share:

	2010			2009		
	Earnings £m	**Weighted average number of shares millions**	**EPS pence**	Earnings £m	Weighted average number of shares millions	EPS pence
Underlying EPS						
Basic EPS						
Earnings attributable to ordinary shareholders	**598**	**2,623.3**	**22.80**	460	2,644.9	17.39
Adjustments to determine underlying profit (see note 1)	**(61)**	**-**	**(2.33)**	(19)	-	(0.72)
	537	**2,623.3**	**20.47**	441	2,644.9	16.67
Effect of dilutive instruments						
Share options and LTIPs	**-**	**50.5**	**(0.39)**	-	36.5	(0.22)
Diluted EPS	**537**	**2,673.8**	**20.08**	441	2,681.4	16.45

c) Adjusted earnings per share

The following earnings per share calculations are for the purposes of the LTIP performance conditions:

	2010			2009		
	Earnings £m	**Weighted average number of shares millions**	**EPS pence**	Earnings £m	Weighted average number of shares millions	EPS pence
Adjusted EPS						
Basic EPS						
Earnings attributable to ordinary shareholders	**598**	**2,623.3**	**22.80**	460	2,644.9	17.39
Profits arising on property transactions [1]	**(3)**	**-**	**(0.12)**	(1)	-	(0.04)
Pensions credit [1]	**(66)**	**-**	**(2.51)**	-	-	-
	529	**2,623.3**	**20.17**	459	2,644.9	17.35

[1] Profits arising on property transactions and pension credit as shown in the income statement after adjusting for tax charges.

9 Property, plant and equipment

	Land and buildings		Plant, equipment, fixtures & vehicles	Total
	Freehold	Leasehold		
	£m	£m	£m	£m
Current year				
Cost				
At 1 February 2009	6,519	375	1,449	8,343
Additions at cost	346	186	337	869
Interest capitalised	5	-	-	5
Transfer from investment properties	28	2	-	30
Disposals	(4)	-	(9)	(13)
At 31 January 2010	**6,894**	**563**	**1,777**	**9,234**
Accumulated depreciation and impairment				
At 1 February 2009	681	77	998	1,756
Charge for the period	107	18	173	298
Transfer from investment properties	10	-	-	10
Disposals	(1)	-	(9)	(10)
At 31 January 2010	**797**	**95**	**1,162**	**2,054**
Net book amount at 31 January 2010	**6,097**	**468**	**615**	**7,180**
Assets under construction included above	**32**	**2**	**158**	**192**

The acquisition of 38 stores from the Co-operative Group (note 12) has been treated as an asset purchase. No infrastructure was purchased with the stores, and therefore this has not been treated as a business acquisition.

Since 3 February 1985, the cost of financing property developments prior to their opening date has been included in the cost of the project. The cumulative amount of interest capitalised in the total cost above amounts to £245m (2009: £240m).

	Land and buildings		Plant, equipment, fixtures & vehicles	
	Freehold	Leasehold		Total
	£m	£m	£m	£m
Prior year				
Cost				
At 3 February 2008	6,142	372	1,165	7,679
Additions at cost	380	18	286	684
Interest capitalised	4	-	-	4
Transfer from assets held for sale	9	-	-	9
Transfer to investment properties	(6)	-	-	(6)
Disposals	(10)	(15)	(2)	(27)
At 1 February 2009	**6,519**	**375**	**1,449**	**8,343**

Accumulated depreciation and impairment				
At 3 February 2008	566	69	839	1,474
Charge for the period	110	13	161	284
Transfer from assets held for sale	5	-	-	5
Disposals	-	(5)	(2)	(7)
At 1 February 2009	**681**	**77**	**998**	**1,756**
Net book amount at 1 February 2009	**5,838**	**298**	**451**	**6,587**
Assets under construction included above	**129**	**26**	**73**	**228**

10 Lease prepayments

	2010 £m	2009 £m
Long lease land premiums	**257**	250

The current element of long lease land premiums is included within debtors (note 15). During the period, new long lease land premiums amounting to £10m were paid (2009: £13m).

11 Investment property

	2010 £m	2009 £m
Cost		
At start of period	**294**	285
Additions	**13**	3
Transfer (to)/from property, plant and equipment	**(30)**	6
At end of period	**277**	294
Accumulated depreciation		
At start of period	**52**	46
Charge for the period	**6**	6
Transfer to property, plant and equipment	**(10)**	-
At end of period	**48**	52
Net book amount at end of period	**229**	242

Included in other operating income is £21m (2009: £19m) of rental income generated from investment properties.

The fair value of investment properties at the end of the period was £281m (2009: £259m). The Directors' do not believe that there has been a material change in yield since last year and that the increase in value has been generated by a growth in the rental income stream.

12 Capital commitments

	2010 £m	2009 £m
Contracts placed for future capital expenditure not provided in the financial statements	**95**	321

Included above are capital commitments of £47m (2009: £46m) for future capital expenditure on the new IT systems.

During the prior period, Morrisons entered into an agreement with the Co-operative Group to acquire over half a million square feet of additional selling space through the purchase of a number of Co-operative Group and former Somerfield stores, at a cost of £223m. A deposit of £22m was paid during the prior period and was classified within debtors. The transaction has been completed during the current financial period.

13 Other financial assets

	2010 £m	2009 £m
Non-current asset:		
Cross-currency swaps maturing 2010	**-**	81
Current asset:		
Cross-currency swaps maturing 2010	**71**	-

The cross-currency swaps cover the Group from currency exposure arising from payments of interest and repayment of the principal in relation to Euro bonds.

The notional principal amount of the outstanding cross-currency swaps at 31 January 2010 was €250m (2009: €250m).

14 Stocks

	2010 £m	2009 £m
Goods for resale	**577**	494

15 Debtors

	2010 £m	2009 £m
Trade debtors	**148**	105
Less: Provision for impairment of trade debtors	**(3)**	(3)
	145	102
Lease prepayment – long lease land premiums	**2**	1
Other debtors	**11**	78
Prepayments and accrued income	**43**	64
	201	245

The ageing analysis of trade debtors is as follows:

	2010 £m	2009 £m
Neither past due nor impaired	**137**	79
Past due but not impaired:		
Not more than 3 months	**6**	23
Greater than 3 months	**2**	-
Impaired debt	**3**	3
	148	105

As at 31 January 2010, trade debtors that were neither past due nor impaired related to a number of independent customers for whom there is no recent history of default.

The other classes of debtors do not contain impaired assets.

16 Cash and cash equivalents

	2010	2009
	£m	£m
Cash and cash equivalents	**245**	327

17 Creditors - current

	2010	2009
	£m	£m
Trade creditors	**1,350**	1,443
Other taxes and social security payable	**32**	28
Other creditors	**134**	160
Accruals and deferred income	**318**	273
Interest accrual	**11**	11
	1,845	1,915

18 Other financial liabilities

The Group had the following current and non-current borrowings and other financial liabilities:

	2010	2009
	£m	£m
Current		
Bank loans and overdrafts due within one year or on demand:		
€250m Euro bonds 6.50% April 2010	**198**	-
	198	-
Energy price contracts	**14**	-
Forward foreign exchange contract	**1**	-
Finance lease obligations	**-**	1
	213	1

	2010	2009
	£m	£m
Non-current		
£150m Sterling bonds 6.50% August 2014	**154**	155
£200m Sterling bonds 6.00% January 2017	**202**	202
£200m Sterling bonds 6.12% December 2018	**205**	205
€250m Euro bonds 6.50% April 2010	**-**	222
Total non-current Sterling and Euro bonds	**561**	784
Floating credit facility – 0.81% (2009: 2.08%)	**450**	250
Other loans – 9.38%	**11**	15
Energy price contracts	**5**	-
	1,027	1,049

Borrowing facilities
Borrowings are denominated in Sterling and Euros and bear fixed interest rates, with the exception of the floating credit facility which bears floating interest rates. All borrowings are unsecured.

The expiry date for the floating credit facility is consistent with the undrawn element of the facility disclosed below.

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

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

	2010	2009
	£m	£m
Undrawn facilities expiring:		
Between 2 and 3 years	**650**	-
Between 3 and 4 years	**-**	850

19 Financial instruments

a) Financial risk management
The Group's treasury operations are controlled centrally by the Treasury Committee in accordance with clearly defined policies and procedures that have been authorised by the Board. There is an amount of delegated authority to the Treasury Committee, but all activities are summarised in half yearly treasury reports which are presented to the Audit Committee.

The Group's principal financial liabilities, other than derivatives, comprise bank loans and overdrafts, bonds, other borrowings, finance leases and trade and other creditors. The main purpose of these financial liabilities is to raise finance for the Group's operations. The Group has various financial assets such as trade debtors and cash and short term deposits which arise directly from its operations.

The Group enters into derivative transactions, in the form of forward currency contracts, cross-currency swaps and energy price contracts. The purpose of these derivative instruments is to manage risks arising from the Group's operations and its sources of finance. As part of our normal banking arrangements, we utilise letters of credit in order to facilitate contracts with third parties. The financial derivatives relating to commitments entered into during the year are to manage the risks arising from its usage of energy and foreign currency. It remains the Group's policy not to engage in speculative trading of financial instruments.

The objectives, policies and processes for managing these risks, which remain unchanged from the prior year are stated below:

i) Foreign currency risk
The Group makes the majority of its purchases in Sterling however it incurs currency exposure in respect of overseas trade purchases made in currencies other than Sterling, primarily being Euro and US Dollar. The Group's objective is to reduce risk to short term profits from exchange rate fluctuations. It is Group policy that any transactional currency exposures recognised to have a material impact on short term profits will be hedged through the use of derivative financial instruments. As at the balance sheet date, the Group had entered into forward foreign exchange contracts to mitigate foreign currency exposure on up to 50% (2009: 50%) of its forecasted purchases within the next six months. Exposure on debt denominated in a foreign currency is fully hedged using cross-currency swaps.

The sensitivity to a reasonably possible change (+/- 20%) in the US dollar /Euro exchange rate has been determined as being immaterial.

ii) Liquidity risk

The Group policy is to maintain a balance of funding with a range of maturities and a sufficient level of undrawn committed borrowing facilities to meet any unforeseen obligations and opportunities. Short term cash balances, together with undrawn committed facilities, enable the Group to manage its liquidity risk. The Group finances its operations with a combination of bank credit facilities and bonds.

The Treasury Committee monitors rolling forecasts of the Group's liquidity reserve on a quarterly basis, which comprises committed and uncommitted borrowing facilities on the basis of expected cash flow. At the year end, the Group had undrawn committed facilities of £650m (note 18); these facilities remain available to the Group.

The table below summarises the maturity profile of the Group's other financial liabilities based on contractual undiscounted payments, which includes interest payments. Creditors and current tax liabilities have been excluded from this analysis as these balances are due within 12 months and their contractual undiscounted payments equal their carrying balances as the impact of discounting is not significant.

As the amounts included in the table are the contractual undiscounted cash flows, these amounts do not agree to the amounts disclosed on the balance sheet for borrowings. Where borrowings are subject to a floating rate, an estimate for interest has been made.

	2010 **£m**	2009 £m
Less than one year	**270**	52
One to two years	**39**	281
Two to three years	**487**	40
Three to four years	**35**	288
Four to five years	**185**	35
More than five years	**493**	677

The table below analyses the Group's derivative financial instruments into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

At 31 January 2010	**< 1 year**	**1 – 2 years**	**2 – 3 years**	**3 – 4 years**
Derivatives settled on a gross basis				
Cross-currency swap – cash flow hedges				
-Outflow	(160)	-	-	-
-Inflow	231	-	-	-
Forward contracts				
-Outflow	(51)	-	-	-
-Inflow	50	-	-	-
Derivatives settled on a net basis				
Energy price contracts – cash flow hedges				
-Outflow	(14)	(4)	(2)	-

At 1 February 2009	**< 1 year**	**1 – 2 years**	**2 – 3 years**	**3 – 4 years**
Derivatives settled on a gross basis				
Cross-currency swap – cash flow hedges				
-Outflow	(11)	(156)	-	-
-Inflow	14	235	-	-
Forward contracts				
-Outflow	(53)	-	-	-
-Inflow	56	-	-	-
Derivatives settled on a net basis				

Energy price contracts – cash flow hedges				
-Outflow	(2)	-	-	-

iii) Credit risk
Credit risk is managed on a Group basis. Credit risk arises from cash and cash equivalents, deposits with banking groups as well as credit exposures from other sources of income such as supplier income and tenants of investment properties.

The Group maintains deposits with banks and financial institutions with an acceptable credit rating for a period not exceeding six months. Further, the Group has specified limits that can be deposited with any banking group or financial institution at any point. The maximum exposure on cash and cash equivalents and deposits is equal to the carrying amount of these instruments. The Group does not expect any significant performance losses from counterparties.

The Group trades only with recognised, creditworthy third parties. It is the Group's policy that tenants of investment properties who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant. The maximum exposure is the carrying amount as disclosed in note 15. There are no significant concentrations of credit risk within the Group.

iv) Other risk
Pricing risk: The Group manages the risks associated with the purchase of electricity, gas and diesel consumed by its activities. This does not include fuel purchased for resale to customers. The Treasury Committee reviews the Group's market price exposure to these commodities on a quarterly basis and determines a strategy for utilising derivative financial products in order to mitigate the volatility of the energy prices.

The Group intends to hold derivatives to maintain cover of its energy purchases of up to 75% over an appropriate timescale.

Cash flow interest rate risk: The Group's long term policy is to protect itself against adverse movements in interest rates by maintaining up to 60% of its consolidated total net debt in fixed rate borrowings over a four year horizon. As at the balance sheet date 61% (2009: 74%) of the Group's borrowings are at fixed rate, thereby substantially reducing the Group's exposure to adverse movements in interest rate.

Cash and cash equivalents is a significant interest-bearing asset held by the Group. At the year end, a 1% movement in interest rates would have had a £2m (2009: £2m) impact on the Group's annual finance income/(expense). There are no other significant interest-bearing assets held by the Group.

b) Capital management
The Group's objectives are to safeguard its ability to continue as a going concern providing returns to shareholders, through the optimisation of the debt and equity balance, and to maintain a strong credit rating and headroom. The Group manages its capital structure and makes appropriate decisions in light of the current economic conditions and strategic objectives of the Group.

A key objective of the Group's capital management is to maintain compliance with the covenants set out in the revolving credit facility.

The Group's policy is to maintain both a gearing ratio and interest cover, which represents headroom of at least 10% over and above the requirements laid down in the revolving credit facility. Throughout the year, the Group has comfortably complied with this policy.

There has been no change in the objectives, policies or processes with regards to capital management during the years ended 31 January 2010 and 1 February 2009.

c) Fair values
i) Financial assets
All financial derivatives are held at fair value which has been determined by reference to prices available from the markets on which the instruments are traded.

Cash and cash equivalents and Debtors are held at book value which equals the fair value. The values of the financial assets are disclosed within note 13.

ii) Financial liabilities
All financial liabilities are carried at amortised cost. The Euro bonds are retranslated at balance sheet date spot rates. The fair value of the Sterling and Euro Bonds are measured using closing market prices. These compare to carrying values as follows:

	2010 Amortised cost £m	**2010 Fair value £m**	2009 Amortised cost £m	2009 Fair value £m
Total bonds - current	**198**	**220**	-	-
Total bonds - non-current	**561**	**598**	784	781
	759	**818**	784	781

The fair value of other items within current and non-current borrowing equals their carrying amount, as the impact of discounting is not significant.

d) Hedging activities
i) Cash flow hedge
At 31 January 2010, the company held a cross-currency swap which has been designated as a cash flow hedge. This derivative financial instrument is used to minimise risk from potential movements in foreign exchange rates inherent in cash flow of certain liabilities. To minimise the risk from potential movements in energy prices, the Group has energy price contracts which are also designated as cash flow hedges.

The hedged forecast transactions denominated in foreign currency are expected to occur in the next year (2009: two years). Gains and losses recognised in the hedging reserve in equity (note 24) on cross-currency swaps as at 31 January 2010 are recognised in the income statement in the period or periods during which the hedged forecast transaction affects the income statement, which is in the next year (2009: two years).

ii) Forward contracts
The Group uses forward foreign exchange contracts to hedge the cost of future purchases of goods for resale, where those purchases are denominated in a currency other than the functional currency of the purchasing company. The hedging instruments are primarily used to hedge purchases in Euro and US dollar. The cash flows hedged will occur within one year of the balance sheet date.

At 31 January 2010, the total notional amount of outstanding forward foreign exchange contracts to which the Group has committed was £51m (2009: £53m). The fair value of these outstanding forward exchange contracts at the balance sheet date was a liability £1m (2009: £nil).

e) Fair value hierarchy

IFRS 7 requires an analysis of financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices)
- Level 3: inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs)

All financial instruments carried at fair value within the Group at 31 January 2010 and 1 February 2009 are financial derivatives and all are categorised as Level 2 instruments.

20 Deferred tax

	2010 £m	2009 £m
Deferred tax liability	**(563)**	(546)
Deferred tax asset	**48**	74
Net deferred tax liability	**(515)**	(472)

IAS 12 Income Taxes permits the offsetting of balances within the same tax jurisdiction. All of the deferred tax assets were available for offset against deferred tax liabilities.

The movements in deferred tax assets/(liabilities) during the period are shown below.

	Property, plant and equipment £m	**Pensions £m**	**Share based payments £m**	**Other short term temporary differences £m**	**Total £m**
Current year					
At 1 February 2009	(546)	14	6	54	(472)
Charged to income statement	(17)	(29)	(3)	(33)	(82)
Credited to other comprehensive income	-	20	-	19	39
At 31 January 2010	**(563)**	**5**	**3**	**40**	**(515)**
Prior year					
At 3 February 2008	(554)	19	5	106	(424)
Credited/(charged) to income statement	8	(34)	1	(35)	(60)
Credited/(charged) to other comprehensive income	-	29	-	(17)	12
At 1 February 2009	**(546)**	**14**	**6**	**54**	**(472)**

The deferred income tax credited/(charged) through other comprehensive income during the period was as follows:

	2010 £m	2009 £m
Actuarial losses	**20**	29
Short-term temporary differences	**19**	(17)

21 Pensions

a) Defined benefit pension schemes

The Group operates two pension schemes, the 'Morrison' and 'Safeway' schemes, providing benefits based on pensionable pay of the final years of membership. The assets of the schemes are held in separate trustee administered funds; no part of the schemes is wholly unfunded. The latest full actuarial valuations, which were carried out at 6 April 2007 and 1 April 2007 for the Morrison and Safeway schemes respectively, were updated for IAS 19 purposes for the periods to 31 January 2010, 1 February 2009, 3 February 2008, and 4 February 2007 by a qualified independent actuary.

Following consultation with members and approval by the Board of Trustees, the Group became committed to the final proposals from the Pension Review on 2 July 2009.

The move from a final salary basis to career average revalued earnings (CARE) represents an accounting curtailment of certain pension liabilities. In accordance with IAS 19 *Employee Benefits*, the defined pension schemes' obligations were revalued by the schemes' actuaries immediately prior to the change and assumptions reviewed at that date. As a result a pensions credit of £91m has been recognised in comprehensive income during the year.

The Deed and Rules of the Morrison Pension Scheme gives the Trustees power to set the level of contributions. In the Safeway Scheme this power is given to the Group, subject to regulatory override.

The current best estimate of employer contributions to be paid for the year commencing 1 February 2010 is £42m (2009: £44m).

b) Assumptions

The major assumptions used in this valuation to determine the present value of the schemes' defined benefit obligation are shown below. The assumptions used at the valuation date of 2 July 2009 used in calculating the pensions credit of £91m remained the same as the prior year end (1 February 2009) apart from the discount rate, which reduced from 6.25% to 6.0%.

i) Financial

	2010	2009	2008
Rate of increases in salaries	**4.85-5.85%**	4.75-5.75%	5.00 – 6.00%
Rate of increase in pensions in payment and deferred pensions	**3.60%**	3.50%	3.75%
Discount rate applied to scheme liabilities	**5.65%**	6.25%	5.75%
Inflation assumption	**3.60%**	3.50%	3.75%

ii) Longevity

The average life expectancy in years of a member who reaches normal retirement age of 65 and is currently aged 45 is as follows:

	2010	2009	2008
Male	**23.5**	23.5	23.5
Female	**25.8**	25.8	25.8

The average life expectancy in years of a member retiring at the age of 65 at balance sheet date is as follows:

	2010	2009	2008
Male	**22.2**	22.2	22.2
Female	**24.7**	24.7	24.7

Assumptions regarding future mortality experience are set based on actuarial advice and in accordance with published statistics. The longevity assumption considers how long a member will live when they reach the age of retirement. Amongst the UK population there is a continuing trend for a generation to live longer than the preceding generation, and this has been reflected in the longevity assumption. This means that a 45 year old today is assumed to live on average longer than a 65

year old today. This particular adjustment, described in the mortality tables below, is known as 'Long Cohort' and is in-line with the latest advice from the Pension Regulator.

In calculating the present value of the liabilities the actuary selects the appropriate mortality table that reflects the longevity assumption. The most up to date tables are used in each period. The current mortality table used is PNX00 YOB LC (2009 and 2008: PNX00 YOB LC). As disclosed in the Critical accounting assumptions, the results of the experience study conducted for the Safeway scheme have been used to adjust the longevity assumption for both schemes.

iii) Expected return on assets

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

	2010	2009	2008
Long term rate of return on:			
Equities	**7.25%**	7.00%	7.00%
Corporate bonds	**5.65%**	6.00%	6.00%
Gilts	**4.35%**	4.25 – 4.50%	4.25 – 4.50%
Property related funds	**5.65%**	6.00%	6.00%
Cash	**1.50%**	2.50%	5.50%

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.

c) Valuations

Assets of the schemes are held in order to generate cash to be used to satisfy the schemes' obligations, and are not necessarily intended to be realised in the short-term. The allocation of assets between categories is governed by the Investment Principles of each scheme and is the responsibility of the trustees of each respective scheme. The trustees should take due consideration of the Group's views and a representative of the Group attends Trustee Investment Committees. The fair value of the schemes' assets, which 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, are as follows:

	2010	2009	2008
	£m	£m	£m
Equities	**798**	592	1,040
Corporate bonds	**636**	547	237
Gilts	**609**	545	531
Property and property related funds	**54**	71	104
Cash	**14**	3	27
Total fair value of schemes' assets	**2,111**	1,758	1,939
Present value of defined benefit funded obligation	**(2,128)**	(1,807)	(2,007)
Net pension liability recognised in the balance sheet	**(17)**	(49)	(68)
Related deferred tax asset (note 20)	**5**	14	19
Net deficit	**(12)**	(35)	(49)

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

	2010	2009	2008
		£m	£m
Fair value of scheme assets at start of period	**1,758**	1,939	1,774
Expected return on scheme assets	**105**	130	116
Actuarial gain/(loss) recognised in other comprehensive income	**245**	(425)	(113)
Employer contributions	**42**	141	193
Employee contributions	**10**	10	10
Benefits paid	**(49)**	(37)	(41)
Fair value of scheme assets at end of period	**2,111**	1,758	1,939

The above pension scheme assets do not include any investments in the Parent Company's own shares or property occupied by any member of the Group.

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

	2010	2009	2008
	£m	£m	£m
Defined benefit obligation at start of period	**(1,807)**	(2,007)	(1,972)
Current service cost	**(26)**	(38)	(44)
Employee contributions	**(10)**	(10)	(10)
Interest on defined benefit obligation	**(109)**	(113)	(99)
Actuarial (loss)/gain recognised in other comprehensive income	**(316)**	324	77
Benefits paid	**49**	37	41
Pensions credit	**91**	-	-
Defined benefit obligation at end of period	**(2,128)**	(1,807)	(2,007)

d) Sensitivities

Below is listed the impact on the liabilities at 31 January 2010 of changing key assumptions whilst holding other assumptions constant:

Discount factor	+/- 0.1%	£50m
Longevity	+/- 1 year	£61m

e) Income statement

The following amounts have been (charged)/credited in employee benefits in arriving at operating profit:

	2010	2009	2008
	£m	£m	£m
Current service cost	**(26)**	(38)	(44)
Pensions credit	**91**	-	-
	65	(38)	(44)

The amounts for current service cost and pensions credit have been (charged)/credited in the following income statement lines:

	2010	2009	2008
	£m	£m	£m
Cost of sales	**(21)**	(30)	(35)
Administrative expenses	**86**	(8)	(9)
	65	(38)	(44)

The following amounts have been included in finance income:

	2010	2009	2008
	£m	£m	£m
Expected return on pension scheme assets	**105**	130	116
Interest on pension scheme liabilities	**(109)**	(113)	(99)
	(4)	17	17

f) Actuarial gains and losses recognised in other comprehensive income
The amounts included in the other comprehensive income were:

	2010	2009	2008
	£m	£m	£m
Actual return less expected return on scheme assets	**245**	(425)	(113)
Experience gains and losses arising on scheme obligation	**-**	(4)	83
Changes in financial assumptions underlying the present value of scheme obligations	**(316)**	328	(6)
Actuarial movement recognised in other comprehensive income	**(71)**	(101)	(36)
Taxation on actuarial movement in other comprehensive income	**20**	29	10
Net actuarial movement recognised in other comprehensive income	**(51)**	(72)	(26)

	2010	2009	2008
	£m	£m	£m
Cumulative gross actuarial movement recognised in other comprehensive income	**(159)**	(88)	13
Taxation on cumulative actuarial movement recognised in other comprehensive income	**44**	24	(5)
Cumulative net actuarial movement recognised in other comprehensive income	**(115)**	(64)	8

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

	2010	2009	2008
	£m	£m	£m
Expected return on schemes' assets	**105**	130	116
Actuarial movement recognised in other comprehensive income reflecting the difference between expected and actual return on assets	**245**	(425)	(113)
Actual return on schemes' assets	**350**	(295)	3

The expected return on schemes' 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.

g) History of experience gains and losses

	2010 £m	2009 £m	2008 £m	2007 £m	2006 £m
Difference between the expected and actual return on scheme assets:					
- Amount	**245**	(425)	(113)	78	165
- Percentage of scheme assets	**11.6%**	(24.2%)	(5.8%)	4.4%	10.8%
Experience gains and losses arising on scheme liabilities:					
- Amount	**-**	(4)	83	37	14
- Percentage of present value of scheme obligation	**-**	(0.2%)	4.1%	1.9%	0.7%
Effects to changes in the demographic and financial assumptions underlying the present value of the scheme liabilities:					
- Amount	**(316)**	328	(6)	55	(219)
- Percentage of present value of scheme obligation	**(14.8%)**	18.2%	(0.3%)	2.8%	(11.2%)
Total amount recognised in other comprehensive income:					
- Amount	**(71)**	(101)	(36)	170	(40)
- Percentage of present value of scheme obligation	**(3.3%)**	(5.6%)	(1.8%)	8.6%	(2.1%)
Total value of schemes' assets	**2,111**	1,758	1,939	1,774	1,536
Present value of defined benefit obligation	**(2,128)**	(1,807)	(2,007)	(1,972)	(1,952)
Net pension liability recognised in the balance sheet	**(17)**	(49)	(68)	(198)	(416)

h) 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:

	2010 £m	2009 £m	2008 £m
Stakeholder pension scheme	**(3)**	(3)	(3)
Life assurance scheme	**(2)**	(1)	(1)
Total costs	**(5)**	(4)	(4)

22 Provisions

	Property provisions £m
At 1 February 2009	112
Charged to the income statement	3
Unused amounts reversed during the period	(15)
Utilised in period	(6)
Unwinding of discount	6
At 31 January 2010	**100**

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

Onerous leases relate to sublet and vacant properties. Where the rent receivable on the properties 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 62 years. Market conditions have a significant impact and hence the assumptions on future cash flows are reviewed regularly and revisions to the provision made where necessary. As noted in the financial review, the amount reversed in the period primarily relates to a store that has been reopened as it fits well with our new

smaller stores format and a number of tenants' lease breakpoints being passed resulting in a continuing commitment from the tenant to continue the lease.

Other property provisions comprise petrol filling station decommissioning reserve and dilapidations cost. Provision is made for decommissioning costs for when the petrol filling station tanks reach the end of their useful life or when they become redundant and is based on the present value of costs to be incurred to decommission the petrol tanks. Dilapidation costs are incurred to bring a leased building back to the condition in which it was originally leased. Provision is made for these costs, which are incurred on termination of the lease.

23 Called-up share capital

	Number of shares Millions	**Share capital £m**	**Share premium £m**	**Total £m**
Current year				
At 1 February 2009	2,630	263	60	323
Share options exercised	21	2	32	34
At 31 January 2010	**2,651**	**265**	**92**	**357**
Prior year				
At 3 February 2008	2,686	269	57	326
Shares purchased for cancellation	(58)	(6)	-	(6)
Share options exercised	2	-	3	3
At 1 February 2009	**2,630**	**263**	**60**	**323**

The total authorised number of ordinary shares is 4,000m shares (2009: 4,000m shares) with a par value of 10p per share (2009: 10p per share). All issued shares are fully paid.

The holders of ordinary shares are entitled to receive dividends as declared from time-to-time and are entitled to one vote per share at the meetings of the Company.

Preference shares

The Group had in issue 282,666 5¼% cumulative preference shares with nominal amount of £1, amounting to £0.3m classified as a current financial liability in accordance with IFRS 7 *Financial instruments: Disclosure*. They did not carry any voting rights. These preference shares were redeemed at par on 30 October 2009.

24 Reserves

	2010 £m	2009 £m
Capital redemption reserve	**6**	6
Merger reserve	**2,578**	2,578
Hedging reserve	**3**	12
Retained earnings	**2,005**	1,601
Total	**4,592**	4,197

Included in retained earnings is a deduction of £44m (2009: £44m) in respect of treasury shares held at balance sheet date. This represents the cost of 16,985,266 (2009: 17,641,448) of the Company's ordinary shares (nominal value of £1.7m (2009: £1.8m). 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 market value of the shares at 31 January 2010 was £49m (2009: £48m). The trust has waived its rights to dividends. These shares are not treasury shares as defined by the London Stock Exchange.

a) Capital redemption reserve
The Company purchased 57,788,600 of its own shares in the open market for cancellation between 31 March 2008 and 21 November 2008 at a cost of £146m. The shares repurchased represented 2.15% of the ordinary share capital at 3 February 2008. There has not been any movement in this reserve in the current period.

b) Merger reserve
The merger reserve represents the reserve in the Company's balance sheet arising on the acquisition in 2004 of Safeway Limited. In the opinion of the Directors, this reserve is not distributable and accordingly it will be carried forward as a capital reserve.

c) Hedging reserve
This represents the gains and losses arising on the cash flow hedges from the Group's cross-currency swaps and energy price contracts, see note 19.

25 Cash flows from operating activities

	2010	2009
	£m	£m
Profit for the period	**598**	460
Adjustments for:		
Taxation	**260**	195
Depreciation	**304**	290
Profit on disposal of property, plant and equipment	**(5)**	(2)
Net finance cost (note 5)	**49**	16
Other non-cash changes[1]	**(81)**	17
Excess of contributions over pension service cost	**(16)**	(103)
Increase in stocks	**(83)**	(52)
Decrease/(increase) in debtors	**36**	(44)
(Decrease)/increase in creditors	**(46)**	214
Decrease in provisions	**(12)**	(27)
Cash generated from operations	**1,004**	964

[1] Other non-cash changes includes the impact of the pension credit arising on moving from a final salary basis to career average revalued earning within the defined benefit pension schemes (note 21).

26 Analysis of net debt

	2010	2009
	£m	£m
Cash and cash equivalents per cash flow	**245**	327
Cross-currency swaps	**71**	81
Other financial assets (note 13)	**71**	81
Bonds	**(198)**	-
Energy price contracts	**(14)**	-
Forward foreign exchange contracts	**(1)**	-
Finance lease obligations	**-**	(1)
Current financial liabilities (note 18)	**(213)**	(1)
Bonds	**(561)**	(784)
Floating credit facility	**(450)**	(250)
Other unsecured loans	**(11)**	(15)
Energy price contracts	**(5)**	-
Non-current financial liabilities (note 18)	**(1,027)**	(1,049)
Net debt	**(924)**	(642)

27 Share-based payments

The Group operates a number of share-based payments schemes; (i) the Executive share option scheme, (ii) the Sharesave scheme and (iii) an equity-settled Long Term Incentive Plan ('LTIP'). In line with IFRS 2 *Share-based payment*, the Group has fair valued all grants of equity instruments issued 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 £17m (2009: £14m), all of which related to equity-settled share-based payment transactions. After corporation and deferred tax, the total charge in the income statement was £16m (2009: £11m).

a) Share option schemes

i) Executive share option scheme

In May 1995, the Group adopted the 1995 Senior Executive Share Option Scheme which was made available to Directors and other senior employees. The scheme was terminated on 25 May 2005. The scheme offered 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 a binomial stochastic option pricing model. The fair value per option granted and the assumptions were as follows:

Grant date	12 Nov 2004	02 Apr 2003
Share price at grant date	£2.33	£1.81
Fair value of options granted	£1.4m	£1.9m
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 on weekly share prices over the last six years prior to the date of grant.

	2010		2009	
	Weighted average exercise price in £ per share	**Options thousands**	Weighted average exercise price in £ per share	Options thousands
Movement in outstanding options				
Outstanding at start of period	**1.84**	**1,814**	1.90	3,223
Exercised	**1.80**	**(755)**	1.98	(1,409)
Outstanding at end of period	**1.88**	**1,059**	1.84	1,814
Exercisable at end of period	**1.88**	**1,059**	1.84	1,814

	2010		2009	
	Weighted average share price at date of exercise	**Number of shares**	Weighted average share price at date of exercise	Number of shares
Share options exercised in the financial period	**£2.91**	**755,000**	£2.84	1,409,000

	2010	2009
Share options outstanding at the end of the period		
Range of exercise prices	**£1.75 - £2.22**	£1.75 - £2.22
Weighted average remaining contractual life	**3.0 years**	3.8 years

ii) Sharesave scheme
The Sharesave scheme has been in operation since 18 May 2000 and all employees (including Executive Directors) are eligible once the necessary service requirements have been met. The scheme allows participants to save up to a maximum of £250 each month for a fixed period of three years. 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 six months commencing after the end of the fixed period of the contract. The exercise of options under this scheme is only subject to service conditions and is equity-settled.

Options granted before 7 November 2002
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.

	2010		2009	
	Weighted average exercise price in £ per share	**Options thousands**	Weighted average exercise price in £ per share	Options thousands
Movement in outstanding options				
Outstanding at start of period	-	-	1.79	179
Exercised	-	-	1.76	(40)
Expired	-	-	1.79	(139)
Outstanding at end of period	-	-	-	-
Exercisable at end of period	-	-	-	-

	2010		2009	
	Weighted average share price at date of exercise	**Number of shares**	Weighted average share price at date of exercise	Number of shares
Share options exercised in the financial period	-	-	£2.89	40,000

Options granted after 7 November 2002
Those options which have been granted after 7 November 2002 to those eligible employees, including Directors, who chose to participate in the scheme have been fair valued using a binomial stochastic option pricing model. The fair value per option granted and the assumptions were as follows:

Grant date	14 May 2009	18 May 2007	24 Apr 2006
Share price at grant date	£2.43	£3.26	£1.94
Fair value of options granted	£17.4m	£12.3m	£16.2m
Exercise price	£1.98	£2.47	£1.58
Dividend yield	2.38%	1.23%	1.91%
Annual risk free interest rate	2.1%	5.58%	4.57%
Expected volatility*	28.0%	23.5%	25.6%

*The volatility measured at the standard deviation of expected share price returns is based on statistical analysis on weekly share prices over the past 3.25 years prior to the date of grant.

The requirement that the employee has to save in order to purchase shares under the Sharesave plan is a non-vesting condition. This feature has been incorporated into the fair value at grant date by applying a discount to the valuation obtained from the Binomial stochastic option pricing model using the assumptions disclosed above. The discount has been determined by estimating the probability that the employee will stop saving based on expected future trends in the share price and employee behaviour.

	2010		2009	
	Weighted average exercise price in £ per share	**Options thousands**	Weighted average exercise price in £ per share	Options thousands
Movement in outstanding options				
Outstanding at start of period	**1.83**	**29,073**	1.84	32,335
Granted	**1.98**	**27,650**	-	-
Exercised	**1.58**	**(20,532)**	1.61	(82)
Forfeited	**2.16**	**(3,973)**	2.01	(3,180)
Outstanding at end of period	**2.07**	**32,218**	1.83	29,073
Exercisable at end of period	**1.58**	**29**	-	-

	2010		2009	
	Weighted average share price at date of exercise	**Number of shares**	Weighted average share price at date of exercise	Number of shares
Share options exercised in the financial period	**£2.48**	**20,532,110**	£2.69	82,000

	2010	2009
Share options outstanding at the end of the period		
Range of exercise prices	**£1.58 - £2.47**	£1.58 - £2.47
Weighted average remaining contractual file	**2.5 years**	1.2 years

b) Long Term Incentive Plans

i) Equity based Long Term Incentive Plan ('LTIP')

In May 2007, a discretionary Long Term Incentive Plan for the benefit of certain employees as approved by the Remuneration Committee was introduced. The awards are free share-based awards, with non-market vesting conditions attached, that accrue the value of dividends over the vesting period.

The maximum total market value of shares over which awards may be granted to any employee during any financial year of the company is 300% of salary. Awards normally vest three years after the original grant date providing the relevant performance criteria have been met.

The fair value at the date of grant, which is being charged to the income statement over the three year vesting period, has been calculated based on the following assumptions:

Grant date	29 Jan 2010	20 Oct 2009	9 April 2009	14 Oct 2008	14 Apr 2008	24 Oct 2007	6 Jun 2007	24 May 2007
Share price at grant date	£2.93	£2,71	£2.50	£2.42	£2.77	£2.88	£3.13	£3.23
Assumed leavers	-	5%	5%	5%	5%	4%	3%	3%
Performance criteria achieved	90%	90%	90%	90%	90%	90%	90%	90%
Exercise price	£nil	£nil	£nil	£nil	£nil	£nil	£nil	£nil
Fair value of share awards granted	£1.1m	£1.0m	£18.8m	£0.6m	£12.5m	£0.4m	£0.1m	£10.5m

	2010		2009	
	Weighted average exercise price in £ per share	**Share awards thousands**	Weighted average exercise price in £ per share	Share awards thousands
Movement in outstanding share awards				
Outstanding at start of period	**-**	**10,598**	-	4,470
Granted	**-**	**8,055**	-	6,128
Forfeited	**-**	**(677)**	-	-
Outstanding at end of period	**-**	**17,976**	-	10,598

Exercisable at end of period	-	-	-	-

	2010	2009
Share awards outstanding at the end of the period		
Range of exercise prices	-	-
Weighted average remaining contractual file	**1.5 years**	1.8 years

28 Operating lease arrangements

a) Lessee arrangements

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

	2010		2009	
	Property £m	**Vehicles, plant and equipment £m**	Property £m	Vehicles, plant and equipment £m
Within one year	**35**	**7**	33	8
More than one year and less than five years	**134**	**14**	125	19
After five years	**427**	**-**	422	-
	596	**21**	580	27

The Group leases various offices, stores and warehouses under non-cancellable operating lease agreements. The leases have various terms ranging from 4 to 11 years for vehicles, plant and equipment and 25 to over 100 years for property (including land), with varying escalation clauses and renewal rights. Generally all property leases are reviewed every five years to align them with market rentals.

b) Lessor arrangements

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

	2010 £m	2009 £m
Within one year	**26**	28
More than one year and less than five years	**88**	94
After five years	**148**	159
	262	281

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

29 Contingent liabilities

In September 2007 the Office of Fair Trading (OFT) issued a Statement of Objections to a number of grocery retailers and milk producers, alleging collusion in the setting of prices for certain dairy products in 2002 and 2003. The Board strongly believes that Morrisons has no case to answer and have made representations in detail to this effect. Our view is unchanged by the Supplementary Statement of Objections issued by the OFT in July 2009. The Board does not consider it probable that the Company will ultimately incur a fine and, accordingly, has made no provision.

The OFT also continues to investigate the market for the sale of tobacco, and in this case, there is a complex legal question as to whether well established industry practices represented a breach of competition law. It is likely that this can only be settled through a formal judicial process. The Board has not made a provision for such a liability

30 Principal subsidiaries

Wholly-owned subsidiaries of Wm Morrison Supermarkets PLC	Principal activity
Bos Brothers Fruit and Vegetables BV	Produce wholesaler
Farmers Boy Limited	Manufacturer and distributor of fresh food products
Farock Insurance Company Limited	Captive insurer
Neerock Limited	Fresh meat processor
Wm Morrison Produce Limited	Produce packer
Safeway Limited	Holding company
Rathbone Kear Limited	Baker
Optimisation Developments Limited	Property development
Wholly-owned subsidiaries of Safeway Limited	
Safeway Overseas Limited	Grocery retailer
Safeway Stores Limited	Grocery retailer

All of 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.

During the year the Company has also entered into a Joint Venture, The Morrisons Farm at Dumfries House Limited, whose principal activity is to farm 700 acres of agricultural land located on the Dumfries House Estate near Cumnock in Ayrshire, Scotland. This has been accounted for as a Joint Venture in accordance with IFRS, however as the results are not material to the Group no further disclosure has been made of these accounting policies within the consolidated financial statements.

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.