Sir Kenneth Morrison, Chairman's Script

Slide 1

Good morning ladies and gentlemen and welcome to our interim results announcement for the 25 weeks to 23rd July 2006.

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This is our agenda for today. I am delighted to welcome our new CEO, Marc Bolland, and he will be making a brief introduction.
Richard will take you through the financial results and tell you about the real progress that we have made during the first half.

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Our first half trading performance has been solid with more customers visiting our stores and, more importantly, liking what they found, resulting in our improved sales productivity. Like for like sales increased by 6.6% including fuel, and by 4.6% excluding fuel.

When we presented the preliminary results for 2005/06 we said that the Safeway integration and conversion programme was at last behind us and that we had stabilised the business.

We also outlined our optimisation plan, a three-year tactical recovery programme, and I am pleased to report that we have made good progress and are on track to deliver the benefits we identified.

Richard will talk about this in more detail later.

Total PBET of £134.2m was slightly ahead of expectations and was a significant improvement over last year, albeit that this was hardly a challenging comparative.

The Board is recommending maintaining the interim dividend of 0.625p per share.

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There have been some key changes to our Board in the first half of this year.

Firstly David Jones retired as Deputy Chairman in June, and I am pleased to confirm that the recruitment process for his successor is proceeding well.

Marc Bolland joined us as CEO at the beginning of this month from Heineken and we are delighted to have him on board. He will bring first-class leadership skills to Morrisons and I am already enjoying working with him.

Marc replaces Bob Stott who retires from the Board on September 30th. I am pleased to say that we will not be losing Bob's expertise and experience entirely, because he is going to be leading the dedicated team that we have assigned to representing us during the Competition Commission enquiry into food retail. As I said at the prelims presentation in March, we welcome the enquiry and hope that measures will be taken to clean up the competitive landscape – it is however an incredibly intensive process and Bob's involvement with the project will allow other members of our management team to focus on their day jobs.

And now I'll hand over to Marc.

Marc Bolland, CEO Script

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- Thank you Ken and good morning everyon**e.**
- As Ken indicated I am now into my third week with Morrisons.
- It's an excellent opportunity to say a personal hallo to you.
- I am delighted to have joined one of the UK's leading retail companies at a particularly interesting time.
- As we all know the past two years have been difficult and a huge challenge for Morrisons.
- However, as Ken has just said, good progress is being made.
- The business has now been stabilised, revenue growth is back on track and the optimisation plan is delivering the benefits indicated.
- There is of course much more to do.
- Our task now is to develop a sustainable business model which delivers growth and returns to our shareholders over the long term.
- This is my first priority.
- In the coming months I will be reviewing the business, its people and its operations, as well as the competitive landscape.

- From this review we will develop a strategic next step for Morrisons.
- For that reason I won't be seen much in the city until I am in a position to share with you an informed view.
- As we say in Yorkshire – "if thars nought to say – say nought!"
- Given the wide range of the review, I plan to updating you again in Q1 next year.
- Thank you and now I'll hand over to Richard

<u>Richard Pennycook, FD Script</u>

Thanks Marc.

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We are pleased with progress in the first half, and right across the business we can see the benefits of colleagues concentrating again on the day job after the distractions of the conversion programme.

We also feel that the market has given us something of a tailwind in this first phase of our Optimisation Programme.

Turnover was level with the prior year, reflecting the drag effect of store disposals in 2005/06 – a feature that will continue in the second half.

Operating profit recovered strongly from the previous year's low level, and I am pleased that we are not reporting any exceptional items this time. This emphasises that the business has come out of the conversion programme in pretty clean shape.

Our operating cash flow was particularly strong, at £419m. With no exceptionals and a pause for breath on capital expenditure, we saw net debt come down substantially to £881m.

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This chart shows the normal breakdown of operating profits, and it highlights particular progress on margin performance and staff costs, as indicated in our optimisation plan targets.

On the face of it, margin at 25.6% is already ahead of our three year target, but in the second half we will experience the normal highly promotional run-up to Christmas, so we are not altering our overall guidance for the year.

As you can see, overheads were up year on year, despite progress on cost saving targets – these were more than outweighed by the effects of heat, light and fuel cost rises as well as increased marketing activity.

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As usual I will bridge sales and profits for you, and this chart shows the sales effects. I've done this at total turnover level, as I think it is useful to highlight the big movements relating to fuel in our overall sales line.

Looking at the major effects, you can see that disposals continue to play a big part in the picture, being a drag of £430m in the period. Much of the gap was filled by good non fuel growth of £207m in the like for like estate and a contribution of £75m from the 8 stores not included in the like for like total.

Looking at fuel sales in the continuing estate, £92m of growth was due to oil price inflation and, pleasingly, we also grew volume by £59m.

I will come on shortly to look at like for like and market share performances.

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This chart bridges profit, and again helps to isolate disposal effects. Running left to right, you can see that disposals, whilst accounting for over £400m of sales, only represented lost contribution of £5m. This is due to the low profitability and high rents of the stores sold. The profit contribution from new stores and from like for like sales growth was £3m and £31m respectively.

As with most businesses, we saw a significant further cost impact from higher energy prices, accounting for £16m in the half, and additionally we continued to accelerate the elimination of our pensions deficit with a further £16m additional charge.

Thus, all things being equal, operating profits would have been £48m – the growth from here to the delivered profit reflects progress on our various optimisation programmes.

Our margin performance was particularly strong, although it must be borne in mind that some of this is driven by our own manufacturing. Here we incur staff costs and overheads that are included in the statutory headings for those costs rather than shown in margin.

Hence I have illustrated the net position here, a gain of £61m. Included in the margin uplift are improvements in buying terms, own brand participation (including the manufacturing benefit) and wastage – all areas targeted by the optimisation programme.

Distribution savings reflect the closure of three surplus depots at the start of the year. The central cost savings reflect efficiency gains from eliminating multiple head offices during the period. Store wages savings reflect progress on our targets for productivity in the newly converted estate.

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Cash flow from operations of £419m was strengthened by a very good working capital performance, but part of this was the timing effect of the period end – our big payment runs take place at the end of each month, but the period end this time was 23 July.

This situation will reverse at the year end, as we have a 53 week year this time and a year end date of 4 February 2007.

Proceeds from disposals of £51m do not include the transaction announced just before the period end, where we are selling 6 stores and a depot to Waitrose.

This transaction will complete in October.

Capital expenditure was contained at £103.8m, lower than depreciation in the half. This reflected a quiet investment period where only one new store was opened, along with the new head office.

We expect capex to rise to match depreciation by the year end, and to rise further next year as we establish a more normal programme of new store openings and complete our distribution infrastructure.

Net debt was £881m at the half year, and we anticipate that it will remain well below £1bn at the year end.

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Let me now turn to a review of our operations in the period, the first period of the optimisation phase of our new business.

I have previously described this as a tactical phase, very much concentrated on re-establishing the Morrisons operational disciplines across the new business and driving out the associated profit benefits.

Alongside this activity, we have also to hone our skills in smaller stores and in parts of the country where our customers do not know us well. Progress, at this early stage, has been satisfactory.

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This chart gives a sense of the developing sales picture, and we are encouraged by it. To remind you, we started the year with strong like for like growth in the converted estate, but with negative like for likes in the original Morrisons estate.

We indicated that we did not expect original Morrisons to turn positive until mid year, and this has proved to be the case. You can impute from this that the converted stores continue to build sales strongly, and we have been particularly pleased that stores in their second year post conversion have shown no signs of slowing momentum.

We have previously said that we are keen to build sales in the converted stores by attracting new customers, learning what Morrisons is all about. We are pleased to see this happening, and with the conversion programme now complete we have increased our weight of marketing activity to bring the message to potential new customers.

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Scotland was the first region to see a completed conversion programme, and the like for like sales in the second half of 2005/06 gave us encouragement that customers were responding positively. We did not, however, want to make too much of this as the sales were coming off a weak base. Progress this year has continued to be very encouraging, particularly with the majority of these stores now in their second year post conversion.

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The conversion programme concluded in the South, and so evidence of its acceptance by customers is only just emerging. Again, the picture is encouraging. Many of these stores fall within our smaller stores initiative, and we are seeing a good response from customers as the work of tailoring ranges to suit both the demographics of the catchment area and the available space begins to take effect.

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This chart is designed to track the progress of the converted stores in comparison to the way in which completely new Morrisons stores build in their early years.

We have previously made the point that growing footfall, as new customers find us, has been key to our success, and as we showed in a previous slide this is indeed what we are seeing in the converted stores.

To date, the profile is building in a similar way to new Morrisons, albeit at the lower level one would expect given that these were stores with an established level of trade under Safeway.

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When we announced the Optimisation Plan we acknowledged that one of our challenges was successfully to apply the Morrisons model to stores below 25,000 square feet, many of them in the South of the country.

Our work in these stores is at an early stage, but already we are seeing the benefits of specific focus.

Numerous trials have been conducted. Just to give you a few examples:

We have tailored the participation of own brand products, with more weight given to “Best” products and less to “Bettabuy”, with consequent benefit to margin.

We have deepened the shelves in some departments, allowing us to ensure even better availability through the supply chain.

Finally we have successfully improved productivity in Market Street, for example combining the butchery and fishmongery departments in certain stores.

As this chart shows, the focus on these stores has resulted in favourable performance since we launched this initiative – with most financial kpi's outperforming their larger store counterparts. It should be noted, as we said in March, that these stores start from a position of much lower profitability than their large counterparts. Therefore we need to see a sustained period of outperformance before the gap is closed.

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As we have seen, Morrisons continues this year to battle against the headwind of store disposals last year, but most measures of market share showed the picture stabilising in the early part of this year.

More recently, as this chart shows, we have been growing slightly ahead of the market. It is particularly helpful in our dealings with suppliers that they can again see their accounts with Morrisons growing.

These charts are based on Neilsen data, which we use internally alongside TNS. Each has their own merits, but for this purpose the fact that Neilsen is based on epos data polled from 15,000 stores reassures us that the measurement is very robust.

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For most of the last two years, our buyers have been fully occupied with the challenges of combining the Morrisons and Safeway catalogues. They have been seeking to maintain or improve terms, despite the volume losses associated with the disposals programme.

There is much now to do in terms of range development. Our in-house labels of Best, Eat Smart, Free From and Organics give us a repertoire of umbrella brands able to provide the customer premium quality, healthy product of impeccable provenance.

These ranges, however, are underdeveloped in comparison to our competitors, and this is an area of focus for us.

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Morrisons invests more in service in store than our main competitors, with a heavier management presence and genuine craft skills in bakery, butchery and fishmongery. It is clearly important that the investment in service is recognised by customers. We are therefore pleased to have retained the Grocer Award for Service this year and particularly pleased to have received the same award from Checkout and GapBuster just a couple of weeks ago.

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This slide summarises progress against our optimisation plan targets for this year.

We talked at the time of the trading update about accelerated progress in gross margin delivery. Whilst we anticipate the second half being a little tougher than the first, due to the highly promotional Christmas period, we are now confident that the vast majority of the gross margin target will be delivered this year.

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With kids back at school, and holidays over, we are now in a period where our sales comparatives gradually start to get tougher. However, in the first 8 weeks of the half you can see here that the prior year figures were 2.6 % like for like, and against that this year’s 5.9% remains a strong performance.

Fuel prices are now down year on year – this week we are at 86.9p for unleaded, where a year ago it was 91.5p.

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Ladies and gentlemen, I want to stress again that this morning's results announcement represents an early staging post in the Group's profit recovery. We are pleased to be operating a stable business where clear plans are in place and being well executed, but we are under no illusions that there remains much to do. Next time we talk to you – in March – Marc will be in a position to lay out his plans for the long term prosperity of Morrisons, and we look forward to seeing you then.

Questions….