MORRISONS

Interim Results 9 September 2010

Script

Slide 1 Sir Ian Gibson, Chairman

Good morning Ladies and Gentlemen and welcome to Morrisons Interim Results for the 26 weeks to 1st August 2010 and a particular welcome to Dalton Philips our new CEO who makes his city debut this morning.

Slide 2 Overview

I'm pleased to be announcing another solid set of results, building on the foundation of the last four years successful growth. With Turnover up 9.1% to £8.1bn, Underlying Profit up 14% to £410m and EPS up by 14% too, it's been a pleasing performance.

Today's presentation will follow our usual format: Firstly Richard will run through the financials and give you some thoughts on our view of the market and then Dalton will set out his views on the business after nearly six months at the helm and tell you about our exciting plans for the future.

At the end we'll be pleased to take Q&A.

So now let me hand over to Richard.

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Slide 3 Richard Pennycook, Group Finance Director

Thanks Ian, and good morning everyone.

In looking at 2010, one has to start by thinking about the conditions we came out of in 2009. The grocery sector had been cushioned somewhat by weak sterling, which had prevented the deflation that had been seen in other parts of the world. And in Morrisons, we had been delivering the last components of our Optimisation Plan, which continued to drive market beating earnings growth. So 2010 was always going to be a tough year for the sector and a tougher challenge for Morrisons.

The year so far is playing out very much as anticipated. We have seen the virtual elimination of inflation, and a very tight market. Promotional activity has risen to record levels, and space expansion across the sector has ticked up. At the same time, Morrisons has been cycling two years of industry leading like for like sales.

Against this backdrop, our interim performance is pleasing. We have continued our market-beating sales growth and delivered our expectations of profitable growth.

I will talk you through the financial results in the normal format, and then at the end of my section I will give you our view on the market for the coming years.

Slide 4 Financial summary

Our turnover at £8.1bn was up 9% year on year, and I will break that down for you as usual in a moment. Statutory profit before tax was £412m – worth remembering that this result was higher for the six months than our total annual profit only 4 years ago. The headline figure appears to be down year on year, but to remind you that is because of a large pensions exceptional credit last year, as you can see on the slide. Excluding that, statutory profit before tax was up 15%.

Net debt was down, with strong cash generation coming through again, and our dividend is up 14%, consistent with our published policy of growing in line with underlying earnings.

Slide 5 Underlying earnings

This next chart does the maths for you on underlying earnings – very little of note this time, but it does allow you to see clearly the year on year underlying increase of 14%, and the follow-through into the dividend.

Slide 6 Turnover Bridge

Looking in a little more detail at turnover, this chart shows the key components. Its shape, in terms of store sales, is very much as anticipated. Growth from new stores was 4.9% excluding fuel, reflecting the uplift from the 43 stores opened in the previous year, including 34 acquired from the Co-Operative group. More than half of these stores had annualised by the interim date, and the rest will have done so by the end of Q3, so you should expect this component of our growth to ease as we go through the second half, and you will see that come through in the Kantar figures.

Slide 7 Like for Like Sales

When we announce our Q3 and Q4 figures, bear in mind the way we account for like for like, which is illustrated on this chart. New stores only go into like for like at the beginning of the financial year following the one where they annualise. So, for example, Kingsbridge and Shefford, the first two Co-operative stores we converted back in June 2009 have already annualised, but do not go into our like for like numbers until 1 February next year. I know the lack of an industry standard on like for like is a frustration to many of you – all I can say is that the Morrisons definition is we think, the most prudent practical way of measuring like for like. As a result, though, do not expect to see a like for like "bump" in H2 courtesy of last year's new stores annualising.

Slide 8 Turnover Bridge

I'll pick up our like for like performance in a moment, but just to finish this chart on fuel, you can see here the effect of the upward movement in pump prices in the period. We grew volumes as we always do when price is in focus, this time by 4%, but this was secondary to the price effect, with unleaded pump prices on average £1.15 in the period, a rise of 14% on the prior year. As I've said before, another way to look at this is that overall fuel price inflation took some £240m out of our customers' pockets. If that had been spent in store, it would have added another 4% to our like for like – and whilst that is simplistic, it does help to emphasise the pressure the consumer is under.

Slide 9 Sales Performance

Let me now give you a little more detail on the like for like performance. Our sales were up 0.9%, with Q2 very slightly stronger than Q1. On a two year basis, building on the 7.8% growth last year, the like for like was 8.7%. Based on published total market growth we believe our LFL performance this time was, perhaps, 50bps better than the market average.

We continue to grow customers, up 1.1% whilst the elimination of inflationary effects this year led to a decline in spend of -0.2%. We have always said that our priority is to continue to grow loyal customers, and we are pleased to be doing so. If we include the new customers acquired through opening stores as well as like for like, we served on average 800,000 more customers each week this year. We are not surprised to be seeing spending levels a shade lower– the consumer is under pressure and remains very cautious in nearly all areas of the country, and the one area which is seeing a stronger recovery – Greater London – is the area where we remain under-represented.

Slide 10 Operating profit

Operating profits grew by £45m, representing a further improvement in margin, up 10bps year on year to 5.2%.

The performance improvement of 10 basis points was a true underlying performance, containing a number of small effects. We saw the benefits coming through of the new RDC at Sittingborne, offset somewhat by higher fuel prices in distribution. We were also successful in offsetting the drag effect on margins of all the new space opened last year, through productivity improvements such as the continuing roll out of self scan checkout. Our administrative expenses increase of 6% reflects marketing costs growing in line with sales and the admin costs of supporting the new space.

Slide 11 Operating Profit notes

There are two key elements to adjust in looking at the operating margin, which happen to offset one another. The first is the effect of higher petrol prices, which increased fuel sales from 19% to 21% of turnover, and in the process diluted margin by 30 basis points. The other was the unwinding of the dilutive impact, last year, of one-off costs associated with the Co-Op / Somerfield acquisitions. This had the effect this year of boosting margins by 30 basis points. So these two impacts were offsetting, and are highlighted on the chart for completeness.

Slide 12 Cash Flow

Our cash flow was strong in the period, with cash from operations up 9% to £580m. Working capital was neutral, and capital expenditure was well down on the previous year when we had acquired the stores from the Co-Op and were building the Sittingborne RDC. Capex of £236m in the first half is well below the projected run-rate for the year, as our opening programme is back-end loaded in H2. As a result, we are guiding to a full year capex of c£800m.

Our closing net debt was £849m, down £75m on the year end and £36m on the previous half year, to give gearing of 17%. We retain headroom from committed facilities of £650m. Our guidance for full year net debt is c£900m. We have previously confirmed that we will update our balance sheet principles relating to gearing and dividends at the final results stage next March.

Slide 13 Outlook

I said at the beginning of this section that 2010 is shaping up very much as anticipated, and for that reason there is no change at all in our expectations for the full year. As autumn progresses we expect the media to be awash with public sector cuts stories, so confidence will remain very weak. There may be a small boost on the run-in to Q4 because we all know that in hard times the British are more than ever determined to have a good Christmas – and the looming VAT rise will provide an added incentive.

In Dalton's section you will hear much about our future plans. There are no changes to our financial outlook for this year as a result of these.

We have put our business in shape to operate satisfactorily in this market, and our strength allows us to look further forward, through the recession, to consider our longer term growth opportunities.

Slide 14 Market backdrop

Let me turn now to a brief overview of the longer term dynamics for the market as we see it. Following completion of the Optimisation Plan and Dalton's arrival, we have of course been considering our strategy, and we have to make an assessment of the market outlook in order to do that.

Our core strategy, through the Optimisation Plan years, was to recover the profitability of the business by concentrating hard on our key point of difference – our fresh food preparation – and to drive cost and margin improvements by sticking to our core operating model. We also began to expand space again, recognising that large parts of the country were still not served by a convenient Morrisons store. This strategy has worked extremely well for us, and Dalton will describe how we intend to continue emphasising what makes Morrisons different, and how we will continue to make the core business better than ever.

Slide 15 The Market

This chart shows our 3 year market share performance – a period when some would have argued that a "food focused" strategy in stores from 10 – 40,000 square feet was too narrow.

Our view is that core, big box, grocery remains a solid platform for growth, as we look through the recession. Our optimism is founded on three fundamentals:

Slide 16 Macro Trends - Population Growth

Population growth is accelerating in the UK, particularly in heartland areas for Morrisons.

Slide 17 Macro Trends - Food Prices Continue to Firm

Global food prices will continue to firm as the emerging market economies accelerate their growth. The UK, whilst growing more slowly economically, cannot be immune from these forces, with the result that food expenditure as a proportion of GDP will continue to rise gradually, compared to the inexorable 50 year decline seen up to 2007.

Slide 18 Macro trends - Provenance, Health and Enjoyment Are Key

The pre-recession focus on provenance, health and quality of food has been pretty resilient in the downturn and will be an important factor as the recovery takes hold.

Slide 19 The Changing Shape of UK Grocery

So each of these macro trends will continue to favour a food focused, value oriented grocer. We retain our ambition to grow ahead of the market, and market growth itself will be solid in the medium to long term.

Our customers really appreciate our points of difference, and we will not simply follow the herd in any future expansion. That said, with our core business in great shape we cannot ignore some of the other trends in our market. It seems highly likely that the disproportionate growth being seen in the convenience sector and in the internet grocery market will continue, as shown on the chart. Dalton will address our first thoughts on how we intend to explore these markets a little.

And now let me hand you over to Dalton.

Slide 20 Dalton Philips, CEO

Thank you Richard and good morning ladies and gentlemen.

Let me start by saying that I have joined a business in great shape. This has become crystal clear over the course of my induction when I have had the chance to really get to know and understand Morrisons and what makes it different.

I spent three months on a very solid induction program, got right across the country in and every region, met all of our store managers, many of our colleagues, I have been in our depots, been in our manufacturing facilities, been in our farm, which is in the middle of nowhere. And I've net loss of customers.

This has left me with three thoughts that form the backdrop to what I will share with you today.

First and foremost – and I say this as a retailer who has spent the last 20 years working across countries and formats – Morrisons is a world class operator anchored by a world class team of operators who know how to deliver
Second, Morrisons is different: different from other retailers in its product; the craft-based skills of its people; and in its ability to take products from the farm (literally) through its production facilities and onto its shelves
Third, there is still a lot of opportunity that is ours to seize

These thoughts leave me excited about the business and what can be done.

Slide 21 Set Out Operational Levers

Today, I would like to take these thoughts and share with you:

what's working – the strengths of our business
what I see as opportunities
and what we are going to do

Slide 22 Discuss Strategic Options

Now, I understand that analysts are always after numbers for their models, but you need to understand that at this point, it's still early days. It's important that we take some time to properly understand the initiatives we're announcing today. So there will be very few numbers in today's presentation. In March, I'll update you on the progress we've made on the initiatives and also go into more depth on some of the strategic options we are considering. And when we have some numbers to share, we will of course be delighted to share them with you!

Slide 23 What's Working

So, let's get started with what I've seen in my first few months and kick off with what's working.

Slide 24 Fresh Food Is At The Heart Of What We Do

For many years, Morrisons has taken its Fresh offer very seriously; whilst others have been focusing elsewhere, reducing the space and attention given to fresh food, we have continued to invest – and successfully.

Don't forget we have 28,000 people in food production, including over 4,000 qualified butchers, bakers and fishmongers, and a great apprenticeship program.

You know the retailer to go to if you want your fish filleted; you want your beef cut in a certain way; you want bread made from water, salt, yeast; that's what they're doing in Morrisons and that is very unique and we want to build upon that. It matters for our customers, it matters for our colleagues.

Slide 25 We Have A Unique Food Production Capability

Another aspect of our business that I find truly distinctive is our production capability.

Over 50% of fresh food sales come through our 15 production sites. A very different way of doing fresh, it gives us unrivalled control over quality and provenance, and ultimately leads to a cost advantage that we are able to use to give our customers the very best value for money.

Slide 26 We're Quick To Get New Products To The Market

Of course, quality is only one aspect of our products; I also recognise we are an innovative organisation and, critically, we're able to get those products to market rapidly. For example, you can see on the slide here "Dinner Made Easy" which is a new concept for a fresh, exciting and affordable meal kit that customers could prepare at home – it's a great idea and we took it to market in just 12 weeks.

Alongside it, you can see one of my favourites… our home baked cup cakes – again a 'kit' concept where customers can create the product at home and customise it as they see fit. It's a great seller and one where we have an exclusive deal with the supplier for the topper kits and wraps.

Now those are just a couple of examples, but in total we've taken over 1,000 new products to market in the first half of the year.

Slide 27 With Excellent Availability

Of course, all that would be worth nothing if we couldn't get the product in front of our customers, and again I feel this is an area where we can be proud:

And remember I've worked in some very good retail businesses around the world and know we have a very responsive supply chain; 70% of our ambient volume is delivered to store in 16 hours or less from our stores' ordering, and in keeping with our Fresh credentials 90% of our Fresh volume is delivered within 12 hours.

And the availability of our top 150 products is over 99%.

These are good numbers; you can build off a business like that.

Slide 28 And A Strong Value Focussed Programme

Supporting all of this, we've got a really strong value programme out there. Sir Ken Morrison started it and it still lives today. I've got a few examples on the slide here. We have:

Very keen regular shelf pricing (for example on Heinz Tomato Ketchup, the SKU up there is the 342g where our average price over the past 26 weeks has been below that of our three main competitors.

So you got shelf pricing, we back it up with very strong promotional items. Milk here, the best price in July, 50p; that price hasn't been seen in United Kingdom for a number of years; 50p for 4 pints.

And then you have it communicated in-store with strong programs. We just launched this week our Nation's Favourite programme, so the best items, biggest brands in the country on promotion and then you back it all up with really good media, on the bottom right some of you may have seen our new advertising, which is really getting a good cut through.

Slide 29 We Have Outstanding Store Operators

One thing I've learnt over the 20 years that I have been in retail is that quality store managers make the difference between a good store and a great store. They really do make the difference and we've got great store managers. Really great store managers; there is a heritage in this business of building strong store managers.

Let me give you a couple of examples – up here you can see:

Stephen Gale from Newquay has been with us for over 21 years, has worked in 6 stores and I'm delighted to say, was promoted to Area Manager last year.

Meanwhile, Lucy Denton from Kidderminster won Store Manager of the Year at the Retail Industry Awards in Oct 2009.

And Jackie Mills - at this stage, just remember her face as I'll come back to her in a few minutes – she's the manager of our Penrith store.

Slide 30 And A Uniquely Skilled Workforce

Of course it's not just the store managers; we've got back up with great people in the stores. And that's another area that Morrisons has really focused on. We've got a world class training program. We call it the Morrisons Academy. I've seen a lot of these programs around the world and this one is really good, this is a really first class academy. It's got 24,000 graduates this year and 100,000 will have gone through it by next year. You've got to train the frontline, you've got to give them the skills to do the job.

Slide 31 And Behind It All, We've Got Our Values

And as you can see, underpinning everything we do are our values – not just words on a page, but ideas that we truly believe in and guide what we do day to day.

And these are not just my values. They were already in place when I arrived – and I think they are great.

One up there that I particularly like is the "Can Do" mentality; it's something that I've seen throughout the business in my first few months – and something that I'm really excited about.

Slide 32 Where Are The Opportunities?

Now of course, notwithstanding the enormous progress the Company has made over the past 3-4 years, not everything is perfect.

As I've toured the business, I've certainly seen areas of opportunity. I want to share these with you because opportunities are good, we can build on them.

Slide 33 Simplifying Our Range

For example, I've seen an opportunity to focus and simplify our range because it's too complex.

One of my favourite examples of this is balsamic vinegar. As you can see in the picture, when I started with the business we had 16 varieties of balsamic vinegar.

And not only that, even our smaller stores carried over 6.

It’s clearly too much and represents a real opportunity for us to offer our customers a simpler shopping experience and by simplifying our product set, we can also continue to give them the very best value for money.

Slide 34 Creating True Own Label Differentiation

We got a very strong owned label brand, in fact, at the Grocer awards this year, we won five awards. But how can we differentiate it further to be a meaningful point of difference. Remember, this is a business that sells £6 billion a year of product with the Morrisons name on it. So it’s the biggest brand in the store and how do we differentiate that. And we index at around 45% in this business; some of the other leading retailers are indexing higher. So what is the opportunity there?

Slide 35 Eliminating Duplication On Deal

And on deal, this is a promotionally driven market that we are in. We can have 6 teas on promotion at any one time, six teas! And at one stage here we had nine. I am talking just general teas and again that adds complexity to the supply chain, it adds cost and of course, it's difficult for the consumer.

Slide 36 Improving The Flow Of Goods

I talked about very responsive supply chain and it is. But improving the flow of goods can go further, and with the systems that are now coming online, we can make it easier. You can pull a palette of the back of a truck in one of our stores, and be very responsive but you can have 40 different commodity groups on the palette. Imagine working in a store when you pull a palette off and you have got baby care and pet care on it that are on two sides of the store. So it can be difficult, we can make it easier.

Slide 37 Strengthening Our Service Culture

As you know, we have deliberately pursued a high service model:

Our staff are uniquely qualified – nobody in the industry has so many colleagues trained to the levels that we have – be that butchers, bakers or fishmongers.

We have also made the choice to have more colleagues in store than our competitors.

I’m happy with that – retailing is a contact sport; this is a key part of what makes shopping at Morrisons feel different.

However, I want to make sure that we get the benefit of this extra focus; we have to ensure that our people really give our customers a unique experience when they visit a Morrisons; we still need to strengthen our service culture.

Slide 38 Ensuring Our Systems Support Our People

And I've talked a lot about people and people are important, but you've got to make tasks easier for people to get jobs done. And I'll give you an example; our systems in stores. Although we've got a bigger systems program in place that we're working through, a six-year program, it can currently be difficult for colleagues to do certain tasks. Price changes, if you are in a big store, 45,000 square foot store, or a small store, 7,500 square foot, you get the same price changes going down, even though your assortment is different and you have to wade through them. We got to make it easier for our colleagues to do tasks that are more about selling and working with the customer.

Slide 39 Moving At Pace

However we look at our strengths and the opportunities out there, the fact remains, we're the number 4 player in an immensely competitive market – that's a challenge.

As we're not the biggest, we have to be the quickest. We need to react first, and establish positions before our larger competitors have had a chance to move in.

This mindset needs to be reflected throughout our business - in our structures, our decision making, and our culture.

And we know we can do it.

I've already referred to Jackie Mills and her team in Penrith. As you can see from the pictures, their store was destroyed by a huge fire in the lead up to Christmas.

But just 9 days after construction started, they were trading in a freshly erected temporary structure in what used to be their car park – where else would you see something like that?

Now we need to make that attitude the norm within our business...

Slide 40 What Are We Going To Do?

So what are we going to do about some of these observations? Across the business, I've seen what's working, I've seen opportunities. And there are two fundamental thoughts that come to mind and that's the basis of the planning I'm going to talk to you about now.

Slide 41 My Vision For The Business

The first is, we are different. And different is good because it gives you a strategic advantage. We are different because we do fresh differently, because we do so much more production in store. We're different because we've got trained colleagues in the store, and we are different because we've got our own production capabilities. And that's the point of
difference that I want to push on. I want to reinforce that difference. The second thought that was come through is that there is a lot of opportunity in this business. And I want to seize that opportunity. So how do we bring it together? We bring it together by being different and better than ever and that's what I want to talk to you about this morning. Now, we can talk about this chart but the words means nothing unless you can execute on them. I'm an operator and it means nothing until you do it. So, let me talk to you about what we're going to do about it. And I'll remind you that I'm not going to give you numbers on this. I'm talking about initiatives what we're going to start with and then in March I will be able to give you a further update.

Slide 42 Three Areas Of Focus

Three areas.

One, driving top line growth. It's a business that survives on driving the top line, we're in retail.

But you've got to be efficient as well. If driving top line growth is the fuel, efficiency is the oil, and it's making it more efficient so you can invest back into price into service or in margin.

And the third is capturing growth, capturing growth to continue growing this business not because I want to be a different business, but I want to be a good for customers, I want to be good for colleagues and need to be good for shareholders. So whatever we do has got to be right, for customers, colleagues, and our shareholders.

Slide 43 Driving Top line

To drive the top line we will focus on 5 initiatives:

Moving further ahead on Fresh
Enhancing our service culture
Strengthening our brand
Optimising our space
and Completing our National to Nationwide rollout.

Slide 44 Fresh Credentials: Already Leading

Our customers already recognise our fresh credentials – we're ahead of the competition.

This chart shows how shoppers rate us in terms of fresh.

On the left-hand side, you will see that customers gave us a lot of credit in terms of preparing fresh food in store.

On the right-hand side, you will see that we also hold a clear lead on our commitment to fresh food, we need to build on that.

Slide 45 Fresh Credentials: Moving Further Ahead

To go after this opportunity, we have launched a number of Fresh trials – we currently have eight active in the business.

These trials range from our “Classic Kitchen” – where delicious ‘homemade’ meals are prepared in store for customers to take home and cook through, “Fresh to Go” counters which prepare pizzas, baguettes and rolls to order, all the way to the Fresh Fruit Bar, pictured here in our Victoria store.

Beyond these ongoing trials, we’re going to go even further and launch what I’m calling a “Fresh Lab”

“Lab stores” are central to my way of operating; I am not by nature a big risk taker, but I am passionate about experimentation to ensure the concepts work for our customers but also deliver both top and bottom line growth for our shareholders.

Testing new concepts which are high impact and are scalable over the rest of the network. So we are going to launch a Fresh Lab where we are going to really push the boundaries of what can be done, and this image isn't a Morrison store. This is a picture from another retailer. But it's the opportunity of how you take fresh further.

And then the third area of fresh I want to focus on is what we call the Revitalise Lab. As with all retailers part of our estate is ageing. But as we modernise stores through the normal remodel program we’ll test how we put a decor package in place in an environment that is contemporary in fitting with the customer needs of today. That's what we're going to work on. So Fresh Lab is a high impact, scalable initiative, rolling out into the network as a very comfortable environment to shop in.

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Slide 46 Enhancing Our Service Culture

The second is reinforcing our service culture and there are some numbers there. On the chart you can see 131,000 colleagues in this business, 100,000 people going through our training academy by the end of next year - 100,000 people, that's the largest training program anywhere in this country in retail. 1 million training days invested, really giving our people unique craft skills. But what I want to focus on is this; if we've got the people in the store and they know more than anybody else, because they are so well trained, because we've got the butchers and the bakers and the fishmongers, - how can we sell more? How can we interact and help the customer more? And that's the opportunity.

Slide 47 Strengthening Our Brand

The third area I want to talk about in driving top line sales ,is strengthening our brand. I talked about this earlier, £6 billion of sales a year on our Morrison's brand. Now there are number of retailers and I have seen some of them and I have been fortunate to work in Canada, where retailers have got very strong private brands and Loblaw arguably has the Gold Standard, President's Choice. Their tagline is "worth switching supermarkets for".

If you're going to have a brand selling £6 billion, it better be different otherwise what you want be in it for. And that's going to be a big focus, we're going to work on differentiating that. What we've got for back-to-school at the moment, and my kids have just gone back, we've got a new chocolate biscuit range. Compared to the leader it's half the price, has 20% more chocolate and delivers more margin. And it's that sort of differentiation we need to get more often.

And remember private brand has a higher margin potential. Okay so what's the gap, if you can close a gap with the supermarket with the highest index in this market, its £12 million more sales every week. I am not saying we're going to go there, but that's what we've got to look at. And to do that you got put a leadership structure in place, you've got to have somebody accountable for it. And I'll be doing that.

Slide 48 Optimising Our Space Project Liberate

The fourth area of developing the top-line is optimising our space. And we're launching what I call a Macro Space Lab, and we call this Project Liberate - liberating space.

Today, with our systems we have the opportunity to swap our space more effectively and so in this one lab we'll be targeting somewhere between 5% and 15% reduction in SKUs, 5% and 15% reduction in space to free up that space, which we can then use in what I call a space race. And internally we're looking at how we maximize the space. You can give it back to the customer or make more room to shop in. We can try and drive sales through new categories or by developing existing categories further, a real opportunity for us to develop our offer further. And remember the most profitable source of sales is driving more sales in existing assets. And that's what we can do and that's what we'll be doing in one lab.

Slide 49 Completing National To Nationwide

And finally in terms of driving top line this is the National to Nationwide expansion plan. You've heard a lot about it, 7 million customers don't have easy access to Morrisons. We're focused on our commitment which is to add 1.5 million of additional net selling space over the three years to 2012/13. We're on track with that and we're on track to open 400,000 square feet this year. And to support that for the South because it is so important, we opened earlier this year near Heathrow, our southern property office, our first experience of taking our property portfolio resources out of Bradford. So, driving top line is key.

Slide 50 Three Areas of Focus

Second is increasing efficiency because efficiency as I said earlier can go back into value. It can go back into service or it can go back into margin expansion.

Slide51 Increasing Efficiency

Four big areas for increasing efficiency; driving productivity in stores, re-ramping our systems, going further in indirect procurement, and finally increasing the efficiency and effectiveness of our network.

Slide 52 Driving Store Productivity

So, driving store productivity. At over £1 billion pounds spend a year, it's the largest cost item on the P&L, after cost of goods sold.

Every hour costs us. If you can take an hour out of the business and invest it elsewhere;, it's worth just over a million pounds. So what are we doing?. We're launching a Productivity Lab. One store looking at the processes of how we're working as to how we can make it more efficient. And so the first phase of this is looking at one-dimensional activities. This picture of bread: in the store we are stacking bread from the baskets it comes in on from the truck straight on to the shelf. That is an example of how you can re-engineer an activity.

We're looking to how we merchandise our bananas. We are looking at how we merchandise some of our non-food products, etc. but this is just one-dimensional. And then you look at more complex approaches in Phase II and Phase III - multi-dimensional efficiency programs in that store.

But remember, we're looking for high impact scalable initiatives, and one hour of labour that could be reinvested into something else is a big number when you're talking about over 425 stores. And what we'll do is take the ideas, batch them and then scale them out into the stores network. So, that's what we're doing in terms of looking at our store productivity.

Slide 53 Revamping Our Systems Evolve

Evolve is one of the biggest IT projects anywhere in this country, probably anywhere in retail – spending £310 million. We've got 500 people working on this project and it's a six year programme to revamp our systems, to make us really, really fit for future. And when you think about our systems; what are we putting in? We're putting in tools that can help people do their jobs better; new point-of-sales systems now in over 60 stores, labour planning systems, which help our customer service managers with the scheduling of people on the tills. – now in over 300 stores.

We put Oracle into Manufacturing to help us in our production sites, so real systems to make real differences. And I've had some experience of these very large systems rollouts across businesses. And I can tell you it's a very well managed process, and what's interesting about this is that there is no big green button day.

Today, all parts of the business is running on one part of legacy system and one part of new. Every area is doing a bit of the old and a bit of the new. And it's a very tightly managed. It's tightly managed because we've got great people on it, and it's tightly managed because we got a good governance system right up through to Richard Pennycook and then on to the Board. So very carefully managed, but this is critical because as we get this right it will give us a huge opportunity as we go forward.

Slide 54 Indirect Procurement - Going Further

The third area to attack and driving efficiency is cost, and what I call indirect procurement. Some of you may know it as Goods Not for Resale. Today, 30% of our business goes through this program. I want it to go to 100% -- 100%. We're spending £800 million in Goods Not for Resale. Everything will go through, shelving will go through, capital equipment will go through, buildings will go through, bags will go through, paper will go through, and on-and-on. We're going to drive this further because this is money that can be reinvested back into the business, be into the P&L or into value and service, and I'm putting a leadership structure in place to support the programme.

Slide 55 Increasing Network Efficiency

And the fourth area of driving efficiency is increasing our distribution network efficiency. We've expanded it over the years. We've simplified, and we've invested in new systems like voice-pick, and I'm going to continue doing that. And if you look at the numbers, Sittingbourne that opened last year, removed 22 million kilometres of travel from the system just because we had a new warehouse in. Overall in our network, we've taken out 10 pence per case. These are big numbers. And pick accuracy is now, 150 basis points better than it used to be. And so I want to continue that and continue driving the efficiency of our network, it is the backbone of our business.

Slide 56 Three Areas Of Focus

The third area I want to talk about is capturing growth. I talked about driving sales, talked about driving efficiency and the third is capturing growth. And when I joined this business I knew that there were opportunities to grow this business. There is a lot of opportunity and many of you see the same opportunities I am seeing, lots of opportunity. I want to focus on three today.

Slide 57 Strategic Growth Options

We have talked about core grocery, that's driving the core business. From what I talked about earlier, we make £850 million odd in this business. I want to take that further as I've highlighted. But what are the other opportunities? Manufacturing, convenience and online.

Slide 58 Driving More Advantage From Food Production

So let me talk to you about manufacturing and food production. We have very unique food production capabilities in this business. It's not an ideology. It's not something that we know. It's right in the DNA of this business.

I saw that when I first joined this business. I was in one of our manufacturing sites in Colne and we were in receiving. I met this guy, Mick who was a livestock buyer and he was receiving in a flock of southern Cornwall lambs. It was the first flock of the season. And only days later in the stores we had fresh lamb; from the field to fork nobody else does it like we do. And not only do we fresh lamb, but we have cooked lamb, because that went through our cooked meat facility. So it's something that we really believe in and why do we believe in it? Because it gives us quality and provenance which is critical. It gives us insight into other areas.

So imagine if you are bakery buyer. We own three bakery plants so when a FMCG supplier comes to us and starts talking about bakery costs, we know what's going on in bakery. It gives us great flexibility. When the weather's good, we turn on the hamburger line. When the weather's good, we're making more hamburger buns. When the weather's poor, we're slowing it down. And finally, it takes cost out of the business that can be reinvested into the business, So a very big focus here.

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Today, we are the second largest manufacturer of fresh food in this country. We've got 15 sites and you saw that we bought two sites earlier this year in July. We're very committed. And at the same time I said to you I am not going to give you numbers. Well on this one actually I am going to give you some numbers, because this is where our thinking is a bit further advanced. And we see a £50 million EBITDA impact at the end of three years in this area. So you can think of that as £15m, £15m and then £20m. So a strong impact from this integrated system.

Slide 59 Exploring Convenience

The second area I want to talk to you about is convenience. This business is a £31 billion business, with 48,000 convenience stores in this country. It's growing at twice the rate of the grocery market and the multiples today have just 6% of the stores.

And so what we're going to do in the first half of next year is launch three stores. We are going to trial three stores in the convenience format, because we do something different. We've got a fresh offer that is unique. And the opportunity to take a fresh and affordable offer into convenient locations is something I want to explore and I want to make sure that we understand it fully.

Slide 60 Exploring Online

And the third area, I want to talk to you about capturing growth is testing online. This is another huge area, £65 million spent every single day online, and £11 million spent just in grocery and half the UK population is now shopping online, and 10% of the shoppers have shopped on a grocery channel. We need to know how to respond to that. We need to understand how to do it. And so in 2011, I'm going to be launching a trial in one region to see how our customers respond and how it affects our profitability. There is no point in going online if you don't make money. And if you end up losing money there and subsidising those customers by penalising the 11 million customers that shop with us in store each week, that doesn't make sense. But we need to know how to respond, what we can do to respond to this changing market. That's what I'm going to be focusing on.

Slide 61 Summary

So three areas of focus; in summary, driving top line, increasing efficiency, looking for new areas to capture growth.

Slide 62 Stepping Back

And when I step back, I say, can we do all of this? Yes! We've got an excellent foundation. There is a huge opportunity for this business. We've got a structured plan in place, we got great team on board and I know we can do this. I know we can do it.

Slide 63 My Vision

And I think back to what I said earlier, we are different, different in the way we go to market in fresh, lots of opportunity so we can be better than ever. Thank you.

Q&A

<Q - James Grzinic:
 Yes, good morning. James Grzinic from Jefferies. One for Dalton and I guess a follow-up for Richard on that. Have you done much work in terms of thinking about the stores externally? It seems you've done a lot of thinking in terms of rearranging the space within the walls, what about changing the architecture of stores?
And I guess as a follow up, Richard what you're thinking in terms of dry assets, how much do you have in the estate on dry assets and how tempted are you by yield compression over the past 12 months?

<A - Dalton Philips, (Chief Executive Officer)>:
I'll take the first one, changing the stores externally. We've changed from a business that used to be in the 30,000 square feet range and now we are doing the whole gamut right down to a store of 7,500 square feet. You're talking about the look and feel?

<Q - James Grzinic>:
No more in terms of extension potential?

<A - Dalton Philips>:
Extensions - we'll add about 70,000 square feet of expansion this year on to our existing portfolio. But I think that there is a first thing. I want to maximize the space that we've got currently inside which is the Liberate project, I just described, though when the expansion opportunities arise we'll grab them.

<Q - James Grzinic>:
In terms of what will allow you to do in exploring new categories as well, whether you think longer term it is something you should be looking at as well.

<A>: - Dalton Philips>:
We'll, the focus for the moment is on fresh and really driving the difference. So I think as we go, as we expand internally on this project ,that we are going to deliberate, I mean, I think there is a huge opportunity in health, I think there's a huge opportunity in ethnic. You know, we've got some non-food trials going on at the moment. Maybe there is an opportunity there. So I think one has maximized the space internally. We'll do it in one task first. We take extensions when we can, as I said 70,000.

Richard, do you want to take the second part of that?

<A - Richard Pennycook, (Group Finance Director)>:
I think just for that in the context of the balance sheet which we talked about in March, I mentioned £650 million of headroom on OUR existing facility. We know, and we have some

banking colleagues in the room, that if we wanted to go to the bond markets for further financing, it would be available to us. So, going to the property market for financing is something you do when you've probably explored those avenues. I have always said that property financing, even at the sort of 4.5% yields that we saw in peak markets, was more expensive than those other two routes.
I think the other thing that we'll be bearing in mind and will certainly talk more about in March is accounting. I've been waiting for 20 years now for a leasing standard to finally bring operating leases on to the balance sheet. It looks as though it may finally be about to happen. That is finally going to put property financing in the headlights, and we want to see how that settles before we would do anything.

<Q - Alastair Johnston>:
Hi, it's Alastair Johnston from Citi. Just a follow-up on the last question, I know some of your interim numbers, but can you give a number in terms of the difference between gross and net sales area at Morrison? Is it significantly different from other operators and how much different does it need to be given that you make pizzas and such like in-store ?

<A> - Dalton Philips:
We have a higher ratio than our competitors. So, we actually have less net-to-gross than our competitors, but we also have a very responsive supply chain system internalising our store to get that availability. So, it's something I'm going to look at. And particularly in that space expansion it's how do we maximize our space.

<Q - Alastair Johnston>: And you said on the slides that you can maybe find 5 to 15% new space from specific stores. Is that across the whole estate? what sort of percentage you're looking at?

<A>: Dalton Philips>:
Oh, listen, I'm going to take one store. I'm going to do it in one store and ensure it works. So you can get the space. I'm convinced you're going to get the space. Then you've got to make sure that you get the right range that customers want and that customers like it. And then if that works, there is opportunity. But you can sweat space more and its profitable growth when you sweat exiting space.

<Q - Alastair Johnston>:
Thanks. Just one for a Richard on tax. Should we be building into our model as the tax rate is coming down 1% per year or do you think that's a bit premature at this point in time perhaps?

<A - Richard Pennycook>: I think, it's okay to see the tax coming down in line with the headline rate. As you know, we've said that we've got about 2% inefficiency against that headline rate and you can track that forward.

<Q>: James Tracey>:
Hi, it's James Tracey from Redburn Partners. First of all welcome Dalton. I've got two questions. The first question is you mentioned big opportunities from the six-year IT project. I'm not looking

for numbers at this stage, but can you give us more colour on where the benefits will come from? Do you envisage a move to fully automated stock reordering? And the second question is on inflation guidance. Why do you still expect the low growth in the second half given the strong rise in global commodity prices you've mentioned? And also do you say it is a temporary spike or are you not going to pass on the higher input costs or are you just being conservative on inflation?

<A>: Richard Pennycook>:

I think I'd look at this in a couple of ways. First of all some of the things that we are doing in the IT program are giving us the immediate direct benefits we talked about. Sales can check out earlier on, for example, that's technology-enabled business benefit. But then as we roll forward with the program, it also unlocks capability that we just don't have today. So, two examples of that: Dalton has been talking about what we are going to do with that macro space in order to work that space harder, you got to drive the supply chain harder. Our systems coming in will enable us to do that, in a way that the legacy systems would find more difficult. Second example as we get convenience store trials on the ground, we may explore pricing alternatives as our competitors do in terms of that small format. We haven't decided yet, but what I've always said in terms of the systems program, is we can't have the systems as a barrier to things we may want to do commercially. So, when we get those convenience trials going, if we decide that there is a price file appropriate for those stores, the new systems will enable us to do that whereas, the old systems wouldn't.

<A>: Dalton Philips>:

And these systems: I mean you've got to see them in action. Now we're scheduling cash sales, effectively to the minute.. So it makes it so much easier to do some of the things that our competitors might have been doing for long time, and real systems making real differences to real people in the stores.

In terms of inflation we've had very low inflation for the first half as you've seen. There is pressure on inflation at the moment. We're seeing a lot of movement on the commodity side as you know as well as I do. Wheat is up 60%, oil is up 13%, at the moment. And then you're seeing a lot of seasonal variations going on which customers are somewhat used to seeing so apples for example at the moment, because of what happened in Chile, apples were up 22%. At the same time you've seen very low retail prices, we've got bread on at the moment at 30p, the lowest price the market has seen in a number of years. Milk's 4pints for 50p. So, I see inflation in the low 1% to 2%. The numbers that have been quoted out there, seem higher than that. I don't see if anything more than 1 to 2. There is pressure. Where it will land in the supply chain, it's not quite clear. We are holding back at the moment. We don't want be accepting prices that the customer doesn't want to pay for.

<Q - Andrew Kasoulis>:

Andrew Kasoulis from Credit Suisse. Can we take it from what you didn't say, that the next couple of years you won't be looking outside the U.K.; you won't be looking for non-food diversification; you won't be looking at bank or other types of retailing services? And also from what you didn't say, can we expect you will say something on the dividend and the cash flow come March of next year? In other words, you have very, very strong cash flow, very, very low gearings so can we expect the dividend to only go one way in March?

<A>: Dalton Philips>:
Well, what I did say and probably didn't do a good enough job of explaining, is that in March I'm going to come back and I'll explain more on some of these other potential growth opportunities. I mean there are a great, many out there. And I see them and you see them. The question is, which ones do we want to get into? Today it's about online and convenience. Do we want to be an international where we're unknown and don't understand the market? I've got a sister who I spoke to yesterday, who is in Cambridge; she can't shop in Morrisons because there isn't one there . so international? - I need to get a store in Cambridge.

So more work there in terms of dividend and balance sheet, We're going to come back to you in March and talk about those because it's all wrapped up in the same thing.

<Q>: Matt Truman
Hi. It's Matt Truman from JP Morgan. On the different prices for the different stores sizes, should we expect local pricing beyond just convenient stores but in other stores? Will you explore that opportunity with the new systems? And the second one is; can you elaborate on the SKU reduction? Did you say 5 to 15%? What proportion of sales does that represent and what's the timing on that? Thank you.

<A>: Dalton Philips>:
it's a great question on pricing. We're proud of the fact today that we've got single pricing right across the market. At the same time as we go into convenience, it is potentially a very different model. And that's something that we're going to have to work through . Our systems don't even allow us to have multiple pricing even if we wanted to. As we go into the convenience, we're going to have to look at that and test that and understand how to price. And that's what the teams are going to be working on.

And then the second question about the SKU reduction. Look, health is going like crazy. Ethnic, this is a really ethnically diverse country. It's more ethnically diverse than we sometimes think and there is a huge opportunity. So take 5 to 15% space out, we can add back in categories which will then represent health, ethnic but there are also non-food opportunities too. We've got a trial on kids clothing at the moment. I don't know yet know where that will go but the work is going on. But what I do know is that if we can get somewhere between 5 and 15% extra product into our existing base in one store, boy, that's good, imagine what we can do if we scale out.

Obviously there will be a reduction in certain categories compensated with growth. So, for example, canned meat. We have a very strong canned meat section, but it's the category that's dying. So let's reduce that and let's look at categories that are exploding. But do I need have sixteen balsamic vinegars? That doesn't add value to anybody. And yes, if I could reduce that to 12 balsamic vinegars that would help free up other space.

<Q - Christopher Hogbin>:

Hi, there. Chris Hogbin from Sanford Bernstein. Two questions if I can? You won't want to give too much away in terms of top line and the efficiency of your core business, I understand your hesitance in give numbers, but do you actually see that these are things that can add up to be transformational, either to your relative growth to the industry, or to your margin. Or is it something that you see is required to just kind keep pace with the market and keep your current margin structure?

And then secondly, on the extension beyond the core, you talked about having strong operators, you talked about being differentiated. What do you see is the risk in moving online, moving to convenience, in terms of executions or being able to maintain your point of differentiation?

<A>: Dalton Philips>:

OK, I'll take the first one and Richard why don't you pick up the second. So it is transformational Chris. I wouldn't be getting up every morning, if I didn't think this is transformational.

We're good in fresh. We've got a lead in fresh, but how much more can we lead on fresh? We are the only people with vertical integration. It's unique and so I think there is a huge opportunity to go further in fresh. That's why we're testing in a Lab store and then scaling.
In terms of efficiency one hour is 1.2 million pounds. One hour per week is 1.2 million pounds so this big stuff . How much comes back to margin we'll see. But I think it's really transformational. I think there is enough in there to sustain this company for a while. So I feel very confident about that.

<Q - Christopher Hogbin>: I guess the question was more we have lot of retailers that they are taking cost out of that business but the margin doesn't change, the sales. The question is, is this pay-to-play to kind of keep up with the industry because there one else is doing the same? Where do you actually think you can go from here,. We can see Morrison has been significantly outperforming the market for three to five years. Will your margin materially change from the rate at is it the moment or is all this excitement that keeps the stores dynamic, but actually you just need to do that to just standstill?

<A>: Dalton Philips>:

Well, in retail you always having to tighten and tighten and tighten. There is an expression that if you're not moving forward , then you're moving backward in retail. This is a business that hasn't fallen behind in the last few years and it isn't going to fall behind now. And I think there are real points of differences. This isn't just about being tricky in the fresh offer and getting a little bit better. You saw the gap in the chart in fresh, that's fundamentally what we do. We sell fresh foods and groceries cheaper and with better value than our competitors. I think there is a lot just in that. In terms of the execution, Richard do you want to talk about the concerns there?

<A - Richard Pennycook>:

Sure. I guess just to finish off on that other point .Part of what we're saying today is this isn't just a recovery running out of steam. We've talked about profitable growth for a long-time now which is the balance of top-line reinvesting for our customers. So your pay-to-play and margin progression points, we've been doing that very consistently. The things we're highlighting today is that we see plenty more mileage to go for in that area.

But then on those new areas for growth, I think the key thing is that we're going to do it in a way which is right for Morrison. So, we're not just going to follow what others have done and we need to figure that out. And the example around Manufacturing, I think gives you a good sense of the sequencing on this. So a year ago, internally we were doing some of the strategic thinking about how we might want to expand Manufacturing further. Back in March when we last saw you, we said that we'd really like to invest further in Manufacturing. Today you've heard that we've gone and done it. We found some really interesting categories to get deeper into in terms of our Manufacturing business. And we can see the opportunity for more. So if you like that's a real life example of how we want to do this. So in terms of internet and convenience, we are at that early stages, and have said that we want to go and have a look. And with both of them, we'll be having a look in the context of what can be different for Morrison's because that's how we attract customers. But secondly what can be profitable for shareholders? So I don't think we feel remotely bad about the fact that we're ten or twelve years behind others in terms of getting into the internet space. That's ten or twelve years where we haven't seen any industry profit generated from being in that space. And we're only going to do this if we can see a route through it that will create value to shareholders.

<Q - James Collins>:
Thanks. It's James Collins from Deutsche Bank. I've got a couple of questions. Firstly and going back to online. What are , do you think, the unique challenges and advantages for Morrison's in doing online grocery, relative to its peers. And when you talk about convenience what exactly do you mean? You clearly already have some stores below 10,000 square foot threshold. When you say convenience, do you mean sub 3,000 square feet or is that a more broad definition?

On your assessment of the Morrison estate as it is right now. I think probably of the former Safeway stores, there were lot which are a non-conforming, and which were relatively rough conversions. To what degree you think there is still an opportunity to make those stores better conforming?

And then the last one just on that manufacturing £50 million of EBITDA. What's the incremental investment that you're looking at to get a £50 million EBITDA? Thanks?

<A>: Dalton Philips:>
Okay. Thanks James. We've got an opportunity in online to reach the point that others have but with second mover advantage. There are effectively four ways of doing it; ghost store, store-pick, click and collect at stores or performance centre. We'll be looking at those, but it ultimately comes back to the close of your question which is, what are you going to do that is different? What we do is something different. We've got great fresh food and 50% of our fresh is coming through own production facilities. If we can collect that and gain really differentiated fresh food online, profitably, it's happy days. But that's quite a challenge.

In terms of convenience, we are looking sub 3,000 square feet for a number of reasons. For the extended opening hours obviously. There are 48,000 convenience stores in this country. We are already down to 7,500 square feet. So if we can drop down to 3,000 that would be a great opportunity.

In terms of the non-conforming Morrisons estate. We have stores, Safeway stores which are "non-conforming". But I was in New Milton three weeks ago, when we opened the new store down there. It's 8,000 square feet on the high street, has restricted parking and is very non-conforming. The store is going like crazy, it's doing really well. So for non-confirming stores we're getting more comfortable in terms of upgrading the estate. Some of those do need work and that's why I've talked about this revitalise a lot. How do you modernise them? We can bring them up to where we are now in terms look and feel or we can try and anticipate what is the future look and feel the customers are going to be expecting,. We got to take the opportunity to show our fresh food production in store. If we're going to do it in store, we got to highlight it and that's what that work is around. And in terms of the Manufacturing, the capital investment for that program is about £200 million. Richard do you want to talk about how that flows through?

<A>: Richard Pennycook>:
Sure. James just to put out in the context of our previous guidance. So three year Capex guidance was £2.2 billion – 800 million this year and then two years of £700 million. This is incremental investment on top of that. So we are looking at a circa another 200 million to pursue those Manufacturing opportunities.

<Q - Simon Dunn>:
Good morning. It's Simon Dunn from Liberum Capital. I just wanted to ask two questions of Dalton and one numbers one to Richard. Obviously you talk about food as a proportion of GDP and the long term inflation effect, but at the same time we see a bit of contradiction in a sense given, you know, you also admit that there is a lot of selling below cost in milk and so you are seeing -- you are seeing the industry itself dilute some of that inflation effects deliberately. So when you talk about the longer term sense of that spend portion of GDP rising – in other words saying if some of that inflation being fed through into industry growth. Do you – are you predicting a sort of reduction in promotional activity and decline in portion of spend? Or is there another behavioural change coming which, I think, will enable you to unlock sublime to the bottom-line in terms of industry sales growth and ultimate profitability? That was question one.

And question two relates to the comment on non-food, and particularly related to the interaction with online. You mentioned you're trialling children's wears. Ares there other trials planned and would those be potentially taken online as well?

And then the third question, it just relates to depreciation. I just know that depreciation didn't see much growth in the first half. Is that a one-off effect and will there be a more sort of normalized increase in depreciation in the second half i.e. more in line with the sales?

<A>: Dalton Philips:>

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In terms of the promotion. I mean this market is very promiscuous, and you've seen up to 40% of product being sold on promotion, not just with us but in the sector. I don't think it's not good for the industry and I am sure it's good for the customer because it ends up being dilutive and you got everything on promotion. We've traditionally promoted hard and we are going to stay the course. We thrive on having great value and that's why we got 800,000 more customers this year versus last. But I would like to see that level come down. Do I need six teas on special or should I take three or four and really go for them? So, it's a bit of the industry and it's a bit of us.

<Q - Simon Dunn>:
So, I mean if we take the example of Asda on alcohol.. Asda comment about promotional intensity, if you see that becoming an industry trend, I mean which you would tend to follow is that kind of sense?

<A>: Dalton Philips>:
We don't sell alcohol below cost, anyway. But you've got be providing a good basket for your customers but 40% on deal is too much. And it has huge consequences in the supply chain, up-down, up-down, so we don't like it, but we're not about to back down.

<Q - Simon Dunn>:
There was more is the online trial a sort of a store based one and is it going to include non-food above and beyond that?

<A>: Dalton Philips>:
We'll take a region or an area and we'll test it. As I said early there are four ways of testing food fulfilment opportunities and we'll look at those. But it will be the store range that will be online.

<Q - Simon Dunn>: It's a store base sort of picking model?

<A>: That is what we are going to work you through, because it could store based, it could be a ghost store, it could be click and collect or it could be a fulfilment and that's what we need to work through. I think the key is – this going to be profitable. I could charge ahead tomorrow. After all if we can open a store in eight or nine days we can get an online presence in nine days. I don't want to do that. For ten years the industry hasn't made money. Let's figure it out how to do it right.

<Q - Simon Dunn>:
And the third one was on the depreciation schedule?

<A>: Richard Pennycook>:
No change in guidance, so a £155 million in H1, £165 million in H2, and £320m for the full year.

<Q - David McCarthy>:

it's Dave McCarthy at Evolution. Just wanted to look at your forecast on market growth. With the IGD figures out there you're forecasting 20% growth in the market. And by the way I know the internet is the slowest growing proportion of that. But where is this 20% growth coming from, because you're only looking for 7% population growth. And I guess in a way related to that, I wanted to ask you about food prices, because you talked very much about a value proposition which is very key to what you're doing and then you seem to be saying that an increase in your import costs is good news, because you're talking about the price of wheat going up et cetera, et cetera. So interesting how you kind of square that circle? And then I just wanted to revisit capex again, because still it's got to my head that you are spending £800 million this year and £700 million next year. The space that you're adding for that is 400,000 square feet this year with 500,000 next year. So when I look at it over a period and even allowing for some infrastructure investment, the price per square foot does seem to be considerably higher than anybody else.

<A>: Dalton Philips>:
Well, I'll take the first part of that on the food pricing and Richard if you want to come back to capex and the market growth So low food prices are good for customers, Dave. So that's good. Inflation -- there is talk about is inflation good for retail or not, if it's not good for customer, ultimately it's not good for the retailer. But I think what Richard was trying to highlight earlier is that as we see prices firm out there, the demand for food is increasing, and as the economy picks up, it's going to increase more. So, prices are going to be underpinned by firm demand.

<A>: Richard Pennycook>:
On the capex, the £800 million guidance, I think in terms of the amount that we are paying for the space, we don't see that changing. Our guidance is based on a very high freehold component, and were that to come out in terms of the mix with more leasehold, then that would change the numbers. But, we are as you know preferring to go for freehold. There's a lot of other investment in there. So the systems program's in there, the new Regional Distribution Centre down in the South West is in there too. So, if the concern is that there is some sort of over payment going on for the space that we are opening, we are not seeing that. I think we've talked before about build costs being pretty attractive. So as a result of capacity of the market, we've seen build costs come down 10 to 15%. We haven't seen land prices change, particularly because there is that latent demand from all of us in the sector, but we are certainly not seeing inflation in the cost of building those stores.

<Q - David McCarthy>:
So just going a step further on that and getting back to what Dalton said. The capex you are spending, that's not going on new stores. It can only go into one of the number of areas, it goes into margin enhancing, value enhancing, et cetera at different points. But at the end of the day, it either goes into driving sales or driving margin. Where should we look for the benefits of this non-space Capex

<A>: Richard Pennycook>:
I think just to complete the picture, there is capex which goes into driving sales or growing margins. There is an element of capex within the depreciation figure, which is replacement capex, and all businesses of this nature have that too

Sir Ian Gibson, Chairman

Ladies and gentlemen, we have to move on. Thanks for coming to our interims presentation today. Thanks for some interesting questions. And we look forward to see you at our prelims. Thank you.