Morrisons
Since 1899

BUILDING A BROADER, STRONGER BUSINESS

Wm Morrison Supermarkets PLC Annual Report and Financial Statements 2017/18

Overview

BUILDING A BROADER, STRONGER BUSINESS

Morrisons is becoming broader and stronger, aiming to be more popular and accessible for customers. Growth is capital light, meaningful and sustainable, built on strong free cash flow and balance sheet foundations

READ MORE AT

www.morrisons-corporate.com/annual-report-2018

Throughout the Directors' report and Strategic report:

Unless otherwise stated, 2017/18 refers to the 53 week period ended 4 February 2018 and 2016/17 refers to the 52 week period ended 29 January 2017. 2017 and 2018 refer to calendar years.

Highlights

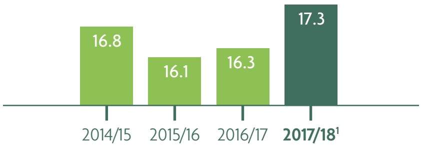
Measuring the progress of Fix, Rebuild and Grow

FINANCIAL HIGHLIGHTS

Group revenue

#

£17.3bn +5.8%

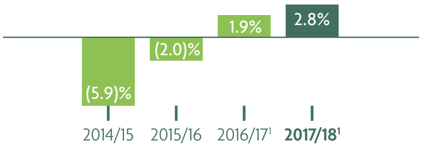


1 Group revenue on a 53 week basis

Group like-for-like (LFL) sales (exc. fuel)*

#

+2.8%

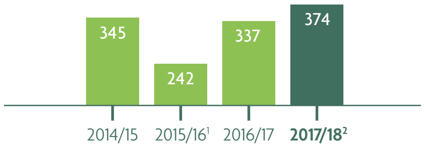


1 2016/17 and 2017/18 include wholesale contribution to LFL sales

Underlying profit before tax (UPBT)*

#

£374m +11.0%



1 2015/16 reported UPBT. UPBT before £60m one-offs was £302m
2 UPBT on a 53 week basis. £369m 52 week equivalent

Free cash flow*

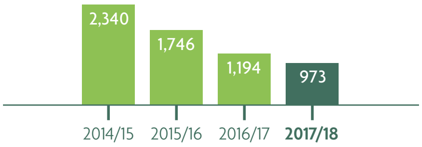
SH

£350m inflow

Net debt*

SH

£973m down £221m year-on-year



Total dividend

SH

10.09p +85.8%

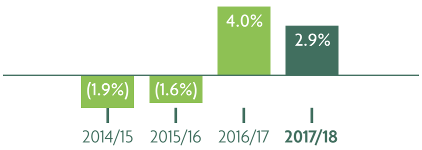
* Alternative Performance Measures as defined in the Glossary on page 127

NON-FINANCIAL HIGHLIGHTS

Like-for-like (LFL) customer transaction numbers

#

+2.9%



LFL customer transaction numbers, year-on-year change. Excludes online

Customer satisfaction

C

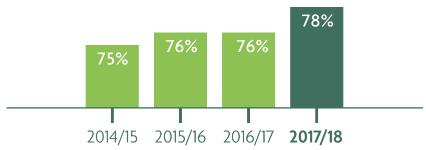
+7% pts

Customer satisfaction measured at January each year, year-on-year change

Colleague engagement index

CO

+2% pts



Colleague engagement index as measured in the annual 'Your Say' survey

OPERATIONAL HIGHLIGHTS

- Meaningful, sustainable sales and profit growth with strong cash flow
- Improving capability, and becoming more differentiated for all stakeholders
- Proposal to return surplus capital to shareholders through a total ordinary dividend of 6.09p per share and a special dividend of 4.00p per share
- Started a rolling programme to supply McColl's stores nationwide with both branded products and our own revived Safeway brand
- Store-pick online service extending Morrisons.com into further new areas
- 'Morrisons at Amazon' expanded into more postcodes and more cities

Alignment of highlights to our stakeholder ambitions:

C Customers S Suppliers CO Colleagues SH Shareholders # All

Our core purpose

We make and provide food we're all proud of, where everyone's effort is worthwhile, so more and more people can afford to enjoy eating well

Resources and relationships

Customers

Over 11 million customer transactions take place every week

Colleagues

Over 105,000 friendly and skilled colleagues, and a high quality management team

Sites

491 conveniently located supermarkets

18 manufacturing sites

9 distribution centres

Increasing digital presence

Brand

A well known brand which is becoming more popular and accessible to more customers

Financial strength

A strong balance sheet, with a largely freehold estate, low debt and a net pension surplus

Continued generation of significant and sustainable levels of free cash flow

Our business

Food maker

We have thousands of food makers in our stores and in our manufacturing sites

- Our skilled food makers make fresh food daily in our stores on Market Street for our customers
- We make fresh food in our manufacturing sites across the UK
- Over half of the fresh food we sell, we make ourselves
- We work with our suppliers to carefully source the products we don't make ourselves

Our business...

Our food making skills provide products that are fresh, good quality, great value and unique to us

Controlling the whole supply chain means we know where our food comes from and can provide our customers with what they want, when they want it

...delivered through our six priorities

1. To be more competitive
2. To serve customers better
3. Find local solutions

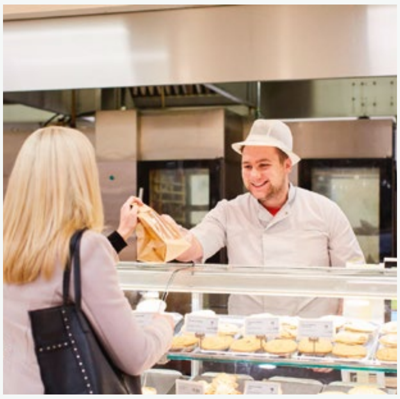
...and supported by our five ways of working

1. Customers first
2. Teamwork
3. Freedom in the framework

Outcomes for our stakeholders

Distributor
We have a national distribution network that moves the food we make and buy

- Our stores are serviced by eight regional distribution centres and one national distribution centre
- This supports our growth through other channels



Retailer
We sell the products we make and buy, in our stores and online

- Listening informs improvements we make
- We have a Morrisons price list, providing good quality fresh food and great value
- Our shopkeepers care deeply about service
- Our More Card helps us to understand and serve our customers better
- Over 60% of the UK population has access to our online offer and we continue to expand our reach

Wholesaler
We are a wholesaler, providing products to retail partners and wholesale customers

- We aim to make our brands more popular, accessible and increase volume through our existing assets
- We leverage the strength of our brand and manufacturing capability to deliver good quality products at great value
- Revival of the Safeway brand for wholesale

Understanding our customers powers the decisions we make. Customers trust our brand and see us as competitive and locally relevant

Through stores, manufacturing, online and our wholesale partners, we can leverage our brand to achieve **meaningful and sustainable capital light growth**

See page 8 for more detail

4 **Develop popular and useful services**

5 **To simplify and speed up the organisation**

6 **To make the core supermarkets strong again**

See page 15 for more detail

4 **Listening and responding**

5 **Selling, controlling costs, growing profits, removing waste**

1. Customers
- More customers, buying more from us, more often
- Customers can get what they want, when they want it

See page 12 for more detail

2. Colleagues
- Engaged and motivated colleagues
- Colleagues sharing in the success of the business
- A fair day's pay for the work they do

See page 14 for more detail

3. Suppliers
- Establishing lasting relationships
- Working together with simplified terms

See page 16 for more detail

4. Shareholders
- A strong balance sheet
- A cash generative business with falling debt
- Sales, profit and dividend growth

See page 17 for more detail

Environmental and social value
- Making a positive contribution to society
- Reducing food waste and taking care of the environment
- Ethical trading practices

See page 21 for more detail

Chairman's statement

A TURNAROUND SHARED BY ALL STAKEHOLDERS

"The Board spend time balancing the need to deliver adequate short-term returns with the imperative of investing back in the shopping trip, such that we can deliver long-term sustainable growth"

Andrew Higginson, Chairman

HIGHLIGHTS

10.09p
Total dividend

12.19p
Underlying basic earnings per share (2016/17: 10.86p)

It is now three years since David and the team started the Morrisons turnaround journey. The business is in good shape. Like-for-like sales have been positive for more than two years, the balance sheet and cash flow are strong, and we are developing successful relationships with retail and wholesale partners such as Ocado, Amazon, Rontec, Timpson and, more recently, McColl's and Sandpiper in the Channel Islands.

We were pleased with our strong performance last year, becoming more competitive for customers and delivering strong sales, profit and return on capital employed (ROCE) growth in a very tough environment, despite being faced with some substantial input inflation and other cost pressures.

There is still a very long way to go. Morrisons has many opportunities to grow and develop into a broader, stronger business.

To achieve success for the long term, the Board will give management headroom to execute the Fix, Rebuild and Grow strategy. We are determined not to repeat the missteps of the food retail industry in recent years, where inappropriate targets sometimes contributed to behaviours and strategies that were not in the best long-term interests of stakeholders. Our targets for management are designed to prioritise consistent and sustainable long-term growth over short-term profit.

The Board was disappointed to receive only a low vote of support for the Directors' remuneration report at the 2017 Annual General Meeting (AGM), and has been grateful for subsequent shareholder consultation and feedback. We are pleased the new remuneration policy, commencing this year, was well supported, and hope to now move forward with interests and opinions aligned.

Key to aligning all those stakeholder interests will be continuing to improve the shopping trip for customers. As I have said before, this may seem simple but it is not easy. We are making good progress. Fresh Look is transforming the look and feel of our stores; new and improved ranges are bringing excitement, freshness and provenance to our offer, and; our unique team of food makers and shopkeepers are reconnecting with customers and serving them better.

This last point is especially important for us; our dedicated and hard-working colleagues are the driving force behind the turnaround and, as they continue to improve the shopping trip for customers, we are paying them more in hourly wages and a higher annual bonus. Our hourly pay rate for front line colleagues has increased by 27% in just three years, and the average colleague bonus payment has more than doubled over the last two years. In addition, over 1,000 of our most senior colleagues, including store managers, are benefiting from our Long Term Incentive Plan. As I said in last year's Annual Report, the management team are making a big difference at Morrisons, and they will be well rewarded over the long term for consistent success, but this will be a turnaround shared by all the Morrisons team.

As I noted last year, a sustainable turnaround will be accompanied by a sustainable dividend, and I am pleased that we recently announced a final ordinary dividend of 4.43p per share. As we continue to Fix, Rebuild and Grow, Morrisons will remain highly cash generative and our commitment to capital disciplined growth will be unwavering. We intend to return surplus capital to shareholders, and are proposing a special dividend of 4.00p per share which, together with the ordinary, means a 10.09p total dividend for the year, up 85.8% on last year. In future we will continue to be guided by the principles of our capital allocation framework, and retain a strong and flexible balance sheet. We will review options for uses of our strong free cash flow each year.

Andrew Higginson
Chairman

Governance Highlights

Board composition and membership – page 28

- The Board comprises of seven independent Non-Executive Directors and two Executive Directors
- There is an appropriate mixture of skills and experience on the Board, which has been further strengthened with the appointment of Tony van Kralingen and Kevin Havelock
- There is a clear division of responsibilities between the roles of Chairman and the Chief Executive
- All Directors stand for re-election annually at the AGM
- Our Senior Independent Director is Rooney Anand

Board effectiveness – page 28

- Consilium Board Review undertook an external review of Board effectiveness this year, and reported that the Board has a well balanced set of capabilities, and that governance and compliance is strong
- The Directors have all attended an appropriate number of Board and Committee meetings and commit sufficient time to the Group

External Auditor – pages 36 and 37

- The Audit Committee is satisfied that the Group's statutory auditor, PwC, who were appointed in 2014/15, are performing effectively
- The Board has a policy on the engagement of the external auditor to supply non-audit services

Accountability – page 29

- The Board is satisfied with the effectiveness of internal control and that risk is being managed effectively across the Group

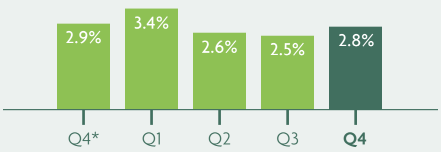
Chief Executive's statement

BROADER, STRONGER, MORE COMPETITIVE

"2017/18 was a year of continued progress and strong performance. A broader, stronger Morrisons is emerging"

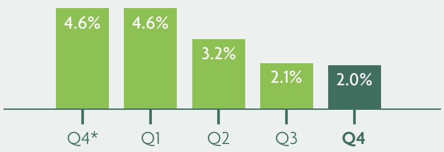
David Potts, Chief Executive

2017/18 quarterly Group LFL sales (exc. fuel)



Definition
See the Glossary on page 127 for a definition.
*2016/17

2017/18 LFL quarterly number of transactions



Definition
LFL number of transactions, year-on-year change. Excludes online.
*2016/17

2017/18 was a year of continued progress and strong performance. A broader, stronger Morrisons is emerging. Capability is improving, the offer is more consistent and more competitive, and we are becoming more differentiated for all stakeholders. All three phases of our turnaround – Fix, Rebuild and Grow – are running concurrently and providing meaningful and sustainable growth opportunities.

The year was not without its challenges, most notably the inflationary pressures on imported food prices caused by weak sterling. However, the team responded well, creating self-help opportunities from these challenges, and further improving Morrisons offer for customers.

We continued to listen and learn from customers and colleagues. We again improved all aspects of the shopping trip, served customers better, and became more competitive.

Our core supermarkets are showing strong annual growth on growth as we enter a fourth year of turnaround. Two year like-for-like (LFL) was in the 4%-5% range for most of the year, and accelerated to above 6% during the important Christmas and New Year period.

Growth was driven by more customers and more volume. Put simply, more and more customers found more things they wanted to buy at Morrisons. New and improved ranges in areas such as Home & Leisure and 'Eat Smart', and more innovation meaning multi-year growth in 'Best', 'Free From' and 'Nutmeg'. For example, in its second Christmas, our premium 'Best' range grew sales by 25%.

Our Fresh Look refit programme extended to another 80 stores during the year, and we have now completed around half of our stores. In addition, many of the Fresh Look learnings are being applied across the whole estate as we go. For example, the majority of our cafés, Fruit & Veg, and Florist departments were updated with a new look and feel during the year. We are very pleased with the Fresh Look results. A modernised Morrisons is emerging, with its roots firmly in fresh food and Market Street, for which we are rightly renowned.

The growth on growth is not just in sales. Our turnaround is colleague-led, and customers are again telling us that our service is improving and our colleagues are friendly. Our customer satisfaction scores improved again, and have now been growing for three years. This was helped by our new automated ordering system which was fully operational by the end of the year, improving availability, reducing cost and freeing up time for our colleagues to serve customers better.

One of the biggest opportunities created by the inflationary pressures was to improve our price position further and become more competitive for customers. As a uniquely vertically integrated British food maker and shopkeeper, we are ideally placed to do this, and we are working hard to save customers every penny we can. For example, we recently bought a potato processing plant in Scotland, which is enabling us to have closer relationships with local farmers. We have also invested in industry leading robotics and innovation which is improving product quality and consistency, and is providing lower prices for customers. We are just starting a similar project in our newly acquired egg packing business in Yorkshire.

This, and other ongoing work focusing on our brand at our prices, means we are making good progress towards our own Morrisons price list. I was especially pleased last year that, despite input cost pressure on many commodities, our good work meant the price of a basket of key 2017 Christmas items was the same as in 2016.

We made further progress in the year with our plans for a broader, stronger Morrisons.

In wholesale supply, we are open for business. We signed a major new agreement with McColl's, and have started a rolling programme to supply all McColl's stores nationwide with both Safeway products and national brands. In addition, we recently announced we will be supplying around 40 Sandpiper stores in the Channel Islands, many of which will convert to Morrisons Daily. We are on track for our target of £700m of annualised wholesale supply sales by the end of 2018.

For online, we are adding extra capacity to Morrisons.com through new store-pick capability in areas outside of those covered by the Dordon customer fulfilment centre (CFC), for example in North East England.

We are also growing as Amazon grows its food offer, and are now supplying 40 Rontec-owned Morrisons Daily stores on its forecourts.

Despite this strong progress, our approach remains restless and relentless.

Our colleagues have many ideas of how we can keep improving for years to come. For example, capability in technology and data is improving, but we still have substantial opportunities – in automated ordering, in-store administration, distribution, and procurement of goods not for resale – to save on cost and recycle the savings back into improving the offer further.

I am pleased we made further good progress with our plan for £75m-£125m of incremental profit from wholesale, services, interest and online, and that debt has fallen to less than £1bn as we guided. We are striving to keep growing sales, profit and ROCE, and generate significant levels of free cash flow, which we expect to be capital light, meaningful and sustainable. The recent announcement proposing a special dividend reflects our good progress so far and our expectations for continued growth.

All of the progress – in morale, customer transactions, customer satisfaction, sales, profits, ROCE, and cash flow – are interlinked. They are as a result of Morrisons colleagues listening to customers and responding to improve the shopping trip. Our people really are the key. I would like to thank every colleague for helping make 2017/18 a success, and know they will make every effort to keep up the pace of progress into 2018/19 and beyond.

David Potts
Chief Executive

The progress we have made on

OUR SIX PRIORITIES

"We continued to listen and learn from customers and colleagues. We again improved all aspects of the shopping trip, served customers better, and became more competitive"

David Potts, Chief Executive

To be more competitive

To serve customers better

Find local solutions

Develop popular and useful services

Simplify and speed up

Make core supermarkets strong again

We are listening and responding

- As a British business with a largely British supply chain, the impact of weaker sterling on imported food inflation is an opportunity to help save customers every penny we can
- We work hard with growers, farmers and suppliers to focus on being more competitive on the products which matter the most to our customers
- Our unique manufacturing skills help us to drive prices lower, particularly on fresh food
- 'Price Crunch', 'Way Down' and 'Morrisons Makes It' are building a great value Morrisons price list
- We are making good progress on improving the quality and packaging of our own label range while keeping prices low
- Our premium own label range, 'Best' continues to grow, with a broader range and twice as many products as last year
- We introduced improved ranges in Home & Leisure, 'Eat Smart', 'Free From' and 'Food to Go'

We are listening and responding

- The shopping trip across the store is becoming more consistent and customer satisfaction has improved
- A new automated ordering system is improving availability, reducing stock levels and helping to lower costs
- Investment in new and improved checkouts gives customers more choice and shorter queues
- Colleagues in-store are more visible, showcasing their craft skills, particularly on Market Street
- More customers are able to shop with us online, via a new store-pick delivery service
- A new 'Flowerworld' website has been launched, offering fresh bouquets with free next day delivery
- 'Food to Order' is available all year round, in-store and online including a large selection of 'Free From' products

We are listening and responding

- Local solutions enable us to tailor our offer to each store's catchment
- We continue to improve our offer during key events and tailor ranges around different demographics and seasons
- We have hosted hundreds of local suppliers at 16 different regional food maker events across Britain
- We are identifying and sourcing more products from the nation's best local growers, farmers, fishermen and other food makers
- Through the Fresh Look programme, we continue to incorporate local solutions based on listening to how we can improve the store
- Data from our More Card helps us understand how we can improve the shopping trip store-by-store

We are listening and responding

- Existing services are increasingly popular and continue to perform well
- We have modernised almost all of our cafés, and introduced over 50 new standalone barista bars
- In addition to our plans with Rontec for Morrisons Daily, we are developing more convenience opportunities on our own forecourts

- Parcel pick up services continue to be popular. We have Amazon lockers in over 400 stores, and Doddle is now in over 160 stores
- Timpson continues to grow and is now in around 180 stores
- We are utilising our car parks better through partnerships with car wash and tyre change concessions

We are listening and responding

- We are simplifying and speeding up the organisation end-to-end, focusing on providing colleagues with simpler and more efficient ways of working
- We continue to work with suppliers to build strong, long-term and mutually beneficial relationships
- We have started to introduce more automation in our warehouse management systems, which will improve forecasting and demand planning
- There remain opportunities to simplify procurement processes for goods not for resale and we have developed partnership programmes with suppliers in many key areas

We are listening and responding

- Fresh Look extended to another 80 stores during the year and have now completed around half of our stores
- Many local Fresh Look learnings have been applied across the whole estate
- We continue to make improvements across Market Street, particularly in Fruit & Veg and Florist departments
- 'Nutmeg' womenswear has been further expanded and is now in almost 100 stores, with plans for more next year

Case studies

A YEAR OF PROGRESS IN OUR STRATEGY TO FIX, REBUILD AND GROW

We have continued to make progress in our turnaround.

These case studies illustrate the progress this year in building a broader, stronger Morrisons and delivering against our six priorities.

1. To be more competitive
2. To serve customers better
3. Find local solutions
4. Develop popular and useful services
5. Simplify and speed up
6. Make core supermarkets strong again

Wholesale

We are open for business as a wholesaler, and are making good progress. During the year, we announced a major new wholesale supply agreement with McColl's. As part of this agreement we are reviving the Safeway brand which we have been developing since the end of 2016. Many products will be made by our own skilled food maker colleagues in one of our 18 manufacturing sites. 'Morrisons at Amazon' continues to grow and expand into new areas, and a further 32 Rontec owned and operated Morrisons Daily convenience stores were opened, taking the total to 40. We also recently announced a new wholesale agreement with Sandpiper in the Channel Islands.

1 4

Manufacturing

During the year, we invested in our supply chain for British potatoes. We acquired a potato facility in Angus, Scotland, as well as investing in increasing capability in existing manufacturing sites.

Owning more of the supply chain means we can work closely with farmers and growers to improve product quality and consistency, lower the cost of production and provide our customers the lowest possible prices.

1 5 6

Fresh Look

Through Fresh Look we are improving our stores each day, one by one, by resetting and introducing new ranges, and providing the tools and environment our team of food makers and shopkeepers need to deliver great customer service. It is important we take the time to listen to customers, both before and after, the Fresh Look is completed, and that we keep disruption to a minimum. So far we have improved around half of our stores, and will complete the rest in a phased programme over the next few years.

1 2 3 4 5 6

Morrisons ordering

We have introduced a new automated ordering system into all stores, which has given greater visibility of stock and helped to improve availability and lower costs. The system did not require a large capital investment and utilises cloud technology, and store-specific sales data to accurately forecast stock requirements. We have identified further efficiency opportunities upstream within our depots, manufacturing sites and with suppliers.

2 5 6

Mastercraft

Mastercraft is our national competition to find our best food makers and shopkeepers from across our stores and sites. Our colleagues demonstrate their expertise, knowledge and passion for their craft in our biggest annual celebration of how we make and provide food we are all proud of. There were 12 categories this year including Butchery, Bakery, Fishmongers, Fruit & Veg, Deli, Floristry, Cake Shop, Wine & Spirits, three apprentice categories and an 'innovation' category which was new for 2017. The event was a huge success and truly showcased the breadth of skills and the talented colleagues we have at Morrisons.

1 2 6

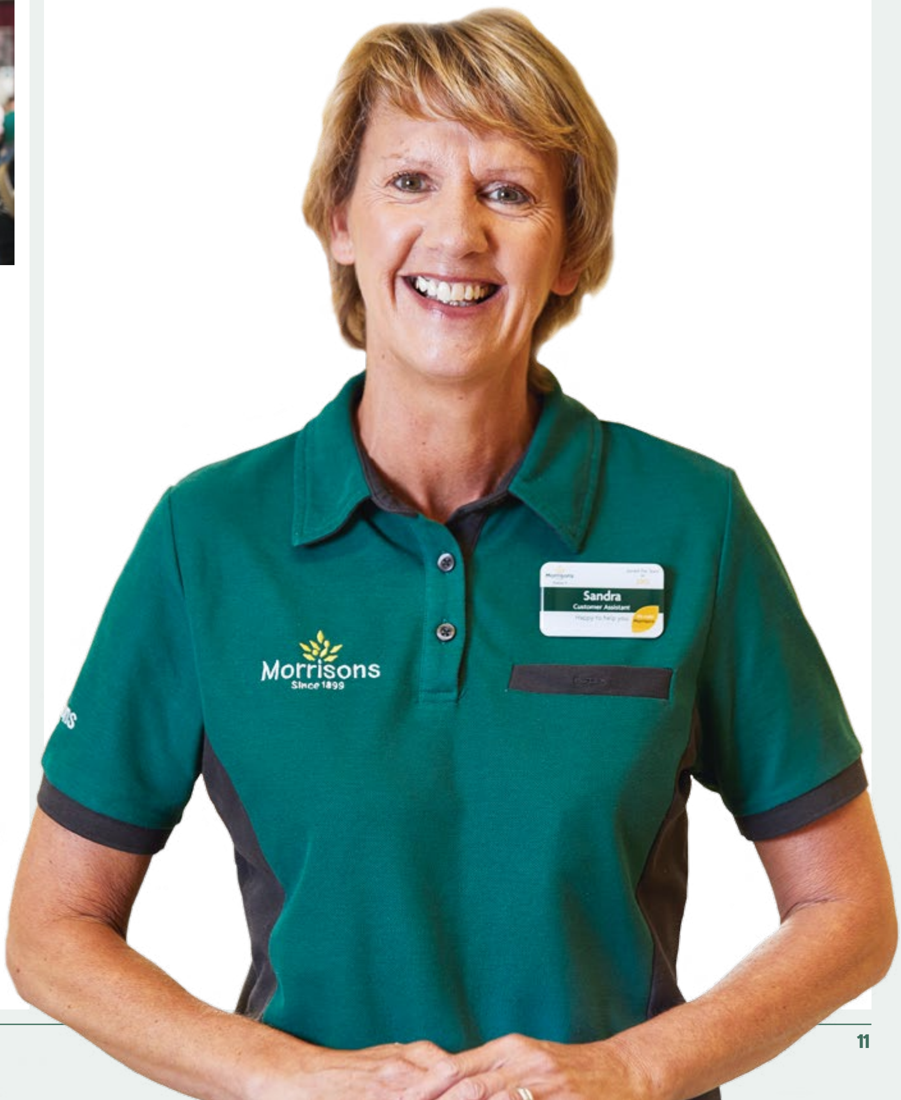
Local solutions

Customers tell us that local is important to them. They value local products and want to support their community, so we listened and launched a search for the next generation of local food makers nationwide through The Nation's Local Foodmakers. Throughout the year, we hosted 16 different events where we met hundreds of local farmers, growers, fishermen and other food makers.

Local solutions enable us to tailor our offer in each store and we take pride in working with smaller, local suppliers to create a range that is locally relevant for our customers and reflects our individual stores' demographic. Locally grown fruit and vegetables are now seasonally available in 350 stores, and locally sourced meat is now available in all Scottish, Welsh, Yorkshire, Lincolnshire and, most recently, South West stores.

Our Skipton store in Yorkshire features over 500 local products across categories such as crisps, yogurts, cereals and pies. The store has specific local point of sale, feature bays and regular tasting sessions. We are proud that 100% of the beef and pork on the Butchery counter in Skipton is sourced from Yorkshire.

1 2 3 6



HIGHLIGHTS

Over 11m

Customer transactions per week on average

40,000

Customers connected with each month

Our four stakeholder ambitions

OUR CUSTOMERS

Listening and responding to our customers

With over 11 million transactions per week on average, it is important that we listen to our customers and respond quickly wherever possible. We continue to increase the breadth and depth of our customer listening activities across the business and more colleagues now spend more of their time listening to customers.

Improving the customer shopping trip by listening hard and responding quickly remains fundamental to our plan. Our colleagues are doing an outstanding job of serving customers better and we are listening to customers in more ways than ever. Every month, we connect with around 40,000 customers through a combination of our large online panel of customers, our regular in-store listening programme and monthly customer surveys.

The 'My View' online customer panel is an important way for customers to give us immediate feedback so that we can respond quickly.

Through this programme of listening, customers have told us that healthy eating, price, increased convenience and simplicity in stores are all becoming more important in their lives. This customer feedback has helped us to make significant improvements.

Our customer service contact centre connected with over 1.7 million customers during the year by telephone, email, letter or social media. Our contact centre colleagues put the customer at the heart of everything they do.

Improving the customer shopping trip

As food makers and shopkeepers we are committed to improving the customer shopping trip. More customers than ever are highly satisfied with the service they receive in our stores, and they have told us that we have improved in a number of important areas. For example, customers told us they continue to see improvements in reduced queues. We also focused on improving shop floor service, and customers told us that we have made significant improvements in staff friendliness, store cleanliness and ease of navigation. Customers also tell us that we have made improvements in the availability of products on our shelves.

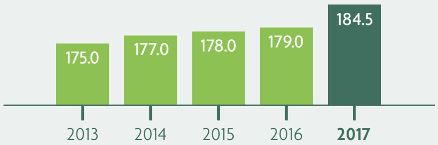
Customers continue to rate us highly on our food maker credentials, recognising the skill and expertise of our in-store crafts people and our unique Market Street offer. Customers have told us they appreciate the fact that our in-store experts make and provide more fresh food from scratch than anyone else in Britain. The 'Morrisons Makes It' campaign, which showcases unique products made by our specialists, has been well received by customers. Customers continue to associate us strongly with buying from British suppliers and working closely with farmers and growers. We are working hard to build this national association at a regional and local level through The Nation's Local Foodmakers programme.

Our brand continues to play an important role at Morrisons. Understanding our customers and focusing on the things that matter most, such as price, quality and range, help us ensure that our brand remains relevant and attractive.

We have improved the quality of our products within both the 'Savers' and Morrisons ranges, and removed unnecessary packaging making the product more visible. We have doubled the size of our 'Best' range to over 1,000 products and we are continuing to see strong growth. We have also extended our range of 'Free From' and made it easier for customers who want to buy these specific products to find them in our stores.

In 2017, we won over 300 awards for the quality of our own brand products, with some highlights being Own-label Range of the Year for 'Best' at the Grocer Gold Awards; Supply Chain Innovation of the Year for our automated ordering system at the IGD Awards; Innovator of the Year at the International Wine and Spirits Competition; and Multiple Beer Retailer of the Year and Multiple Cider Retailer of the Year at the 2018 Drinks Retailing Awards. Demonstrating the opportunity to extend our 'Nutmeg' brand beyond clothing, we also won Best Disposable Nappy for our 'Nutmeg' Ultra Dry Nappy at the Mumii Awards.

UK grocery market size (£bn)



Source
Institute of Grocery Distribution (IGD)

2017 Composition of UK grocery market size

Source
Institute of Grocery Distribution (IGD)

Being more competitive

In September 2017, we introduced 'Way Down Price Crunch' which communicates our great value prices, and prices which have been held down lower for longer. With more prices being 'Crunched' for customers, and a higher average discount, 'Crunch' sales have achieved record levels. Customers have responded positively, telling us that 'Way Down Price Crunch' provides a clearer and more confident communication that we are lowering prices across the store, and that they can expect to make more noticeable savings.

More Card

The Morrisons More Card continues to grow in popularity. More and more of our customers are regularly collecting points and receiving rewards, which they can use to make savings when they shop with us.

We continue to innovate, and have recently introduced a student specific programme for the More Card which encourages students to join when they start higher education.

The More Card continues to be a very important way to listen to our customers allowing us to better tailor our offer to meet our customers' needs. We are using what we learn about our customers in a number of different ways and responding accordingly, from providing personalised rewards that are based around customers actual shopping behaviour, to developing our pricing strategy and making sure the range in each individual store is relevant to the customers who shop in it.

The Market

During the year, the UK grocery market continued to be competitive. The backdrop is still one of some uncertainty for UK consumers, with the longer term outlook for the UK economy and the wider implications of Brexit still unclear.

Input inflation, as we had expected, was a factor during the year as a result of weaker sterling pushing up import prices. In these times of uncertainty value is even more critical to customers, as their budgets do not expand if prices are higher, so we continue to work hard to manage the impacts of retail price inflation.

However, we believe these challenges can continue to bring the best out of Morrisons. We are listening hard to customers and colleagues, which is helping us better respond to these changes as they occur. We are improving every day and our team of food makers and shopkeepers continue to find ways to be more competitive and serve customers better.

Our vertically integrated supply chain means we are less reliant on imported products. As a British manufacturer sourcing home-grown products wherever possible, and as British farming's biggest single supermarket customer, we are well placed to mitigate some of the wider economic pressures. We continue to work hard with growers, farmers and other suppliers to save customers every penny we can.

Whilst much of our continued turnaround is in our own hands, we are aware of, and respond to, changes in customer sentiment and trends in the market. We expect the trends towards digital shopping, more frequent shopping and convenience to continue, and these are real opportunities for a broader, stronger Morrisons.

Wholesale, online and popular and useful services provide opportunities for Morrisons in these significant and growing channels, and help increase the size of the market in which we operate. We are serving more customers online in new areas through a new store-pick delivery service launched with our partner Ocado. We will be extending that further into more new areas in the coming year, as well as taking some capacity in Ocado's new customer fulfilment centre at Erith. New wholesale partnerships with McColl's and Sandpiper, together with existing partners Amazon and Rontec, and our own Morrisons Daily stores, make Morrisons more accessible to more customers, through new channels.

However, supermarkets continue to represent around half of the UK grocery market and it is forecast this sub-sector will represent the majority of the market for many years. Therefore, our focus on the core supermarkets is a key priority in our turnaround. The Fresh Look programme, guided by listening and incorporating local solutions, continues to be rolled out and improvements in growing areas such as Clothing and 'Food to Go' are important to strengthening the offer in our core supermarkets.

We cannot predict the future but, as long as we continue to do what is right for our customers, we expect to emerge from this period of uncertainty a broader, stronger business.

HIGHLIGHTS

78%

Colleague Engagement Index Score (2016/17: 76%)

Over

7,000

Number of colleagues involved in 'Your Say' forums

Our four stakeholder ambitions

OUR COLLEAGUES

Listening hard and responding

Listening to colleagues at all levels and across the organisation is critical to the business and its turnaround. Through our annual 'Your Say' survey and ongoing forums, we have listened more than ever to the views of our colleagues.

Three-quarters of colleagues completed the 2017 'Your Say' survey. Feedback included over 80,000 comments on how we can make Morrisons a better place to work and shop. For the second consecutive year, our colleague engagement score increased across the business and overall we have achieved an engagement score of 78%, with every single business function in positive growth.

Our 'Your Say' forums have been up and running for over a year, and over 7,000 colleagues have been involved in identifying ways of making Morrisons a better place to work and shop. Our national forum saw colleagues from all areas of our business join members of the Executive Committee to discuss and agree ways to continue to improve Morrisons.

Fair day's pay and colleague bonus

It is important that colleagues feel valued and that they share in the success of the business. We listen closely to the feedback in this area through our 'Your Say' survey. Positive responses to the question 'I receive a fair day's pay for the work I do' has increased again. We also continue to invest in colleagues, with pay increasing from £8.20 per hour to £8.50 during the year, and again to £8.70 from April 2018, for our front-line store colleagues.

We have introduced an improved bonus scheme for junior managers and the average colleague bonus payout in March 2017 was over 25% higher this year than the previous year. During the year, we also introduced a new pension scheme which provides colleagues with a more affordable way to save, enabling them to make contributions starting at 1% of salary, which are matched by the Group.

Store management structures

We have continued to listen to our colleagues and customers and review our structures to make sure we are in a strong position to serve our customers better. Over the past two years, we have introduced a number of new ways of working and invested in stores by improving some of our technology and systems, as well as offering new products and services.

During the year, we have carried out a full review of our store structure and announced that we are proposing to introduce a new management structure which is simpler, with clearer management accountabilities that establishes an improved balance of colleague and management roles in each store. We will be investing in more colleague roles across stores to serve our customers better. This will mean that we reduce the number of management roles by c.1,500, whilst simultaneously creating c.1,700 more colleague roles in stores. We will continue to look to mitigate the impact as much as possible. All those impacted will be given the opportunity to apply for alternative roles in stores or elsewhere in the business.

Tools and training to do the job

During the year, we introduced our 'MyMorri' digital platform which gives all colleagues online access to their payslip, colleague handbook and a dedicated news channel to keep up-to-date with all relevant company information. We have introduced 'My Perks' on this platform giving colleagues access to discounts across many high street retailers. Since the launch, we have seen over 95% of our colleagues use 'MyMorri'.

We also introduced a new online learning management system, 'My Learning'. This provides a single platform to access relevant training materials and an electronic employee record regarding legal training. Our 'My Job' programmes continue to be delivered across the business to develop technical and leadership skills. This year we delivered a programme to 2,500 colleagues.

An opportunity to develop, progress and grow

To give our colleagues the opportunity to develop, progress and grow, we introduced the internal 'Pathways' programme which give a clear, visible route to progression. We had over 500 successful applications starting on the first of the team manager, senior manager and store manager programmes.

We have also introduced 21 designated training stores aligned to geographic regions, where we now train both technical and behavioural skills consistently across the business.

Over 850 colleagues completed our 'Leading with Purpose' programme up to December 2017. This programme, which is delivered by Leadership Team members, enables colleagues to understand their role in the turnaround of Morrisons and in delivering our core purpose.

Our graduate programmes continue to increase in size with 76 graduates starting their careers on one of our eight schemes. Over 50 colleagues have started our new look degree apprentice programme, and our apprenticeship programmes continue to grow with over 300 colleagues starting an apprenticeship in areas including Butchery, Bakery, Fishmongers, Engineering and Floristry. We held our annual in-house Mastercraft competition in November 2017 to celebrate the talent of our very best food makers and shopkeepers from across the business and once again it was a huge success. For more details, see page 11.

HIGHLIGHTS

18%

Percentage of store managers who are female (2016/17: 7%)

Over

95%

Colleagues who have accessed 'MyMorri'

Five ways of working

Our five ways of working underpin everything we do and how Morrisons operates. They provide a clear and consistent way of doing things and apply to every colleague in Morrisons across our stores, sites and central teams.

Customers first

Our customers are at the heart of everything colleagues do. We care about our customers and do everything we can to always put them first.

Teamwork

Through teamwork, colleagues can help each other to get things done, knowing that we can do more together. Each colleague plays their part in the team, respecting and enjoying working with others to get better results. To ensure we serve our customers better, especially at the times of the year that mean the most to them, such as Christmas, all colleagues working in central roles help out in stores.

Freedom in the framework

Freedom in the framework means colleagues have the freedom and are trusted to make decisions to help achieve our priorities.

Listening and responding

Listening and responding quickly wherever we can is at the heart of our turnaround. Taking the time to listen to all of our stakeholders is embedded in the way we work across the business.

Selling, controlling costs, growing profits and removing waste

All colleagues are food makers and shopkeepers and are encouraged to do everything they can to help sell more, manage our costs more effectively, and identify opportunities to improve how we do things.

Diversity

We pride ourselves on being a diverse and inclusive business. All colleagues and people in the communities in which we work are welcomed and treated with respect, regardless of their background. We remain committed to maintaining an environment that enables colleagues to be at their best more of the time, offering equal opportunities for colleagues to develop, progress and grow. During the year, Morrisons employed over 58,000 female colleagues and over 47,000 male colleagues.

We remain committed to improving representation of females in senior leadership roles. The Board comprises seven men and two women, while 73% of the Leadership Team are male and 27% female. We continue to make progress with our ambition to increase the number of female store managers and have moved from 34 (7%) in 2016 to 86 (18%) as of November 2017. We introduced 'Women in Leadership' workshops across the business to give colleagues the opportunity to discuss the barriers and concerns that our female colleagues face and to share details on personal development and opportunities in Morrisons.

Gender continues to be a key area of focus for Morrisons. Since September 2017, over 400 colleagues have joined a new LGBT+ network.

Looking forward to 2018, the recently established diversity and inclusion working group will define the future plans based around such things as gender, culture, LGBT+ and disability.

HIGHLIGHTS

Percentage of Morrisons branded fresh meat, milk and eggs sourced in Britain

100%

Our four stakeholder ambitions

OUR SUPPLIERS

Strong supplier relationships informed by listening

Our aim is to develop mutually beneficial relationships with our suppliers, based on responsible and fair trading terms and practices in line with the Groceries Supply Code of Practice (GSCOP). Having effective relationships with suppliers ultimately helps us serve our customers better. We are pleased with the progress we have made in simplifying the way we buy and sell. This has helped us work with our suppliers in a transparent and fair manner. We are encouraged that our progress in this area is being recognised in our own listening surveys with suppliers and in industry surveys, including the Groceries Code Adjudicator's (GCA) annual supplier survey.

During the year, we undertook our own surveys to listen to our suppliers and buyers to help us improve our relationships and develop long-term partnerships with our suppliers. We have been working with a number of partner suppliers from across all categories, where there is a joint focus on driving the quality of our offer. Long-term planning and collaboration has allowed us to lower end-to-end costs in the supply chain and improve our quality proposition, so we can serve our customers better.

We have also simplified the way we work with suppliers throughout the buying process. For example, our dedicated supplier helpdesk provides a single point of contact, and we continue to improve the speed with which we resolve queries.

Our supply chain

We continue to invest in our vertically integrated business model to have greater control over the supply chain in order to become more competitive and improve our quality position.

As food makers and shopkeepers we are the single biggest supermarket customer for British farmers, and we are proud to support the British economy. 100% Morrisons branded fresh meat, milk and eggs are sourced in Britain. We continue to have direct relationships with British farmers, which both strengthens the agricultural industry and supports rural communities. Our customers support the farming community through purchasing products in the 'For Farmers' range (milk, cheese, butter, cream and bacon), where a clear element of the selling price goes back to farmers.

We also take pride in working with smaller, local suppliers to create a range that is locally relevant for our customers and reflects the demographics of individual stores. During the year, we launched our nationwide search for the next generation of local food makers through The Nation's Local Foodmakers. For more details on these events, see page 11.

The Groceries Supply Code of Practice (GSCOP)

GSCOP applies to designated grocery retailers in the UK, adding specific regulations into the trading relationships between retailers and their suppliers. We actively engage with the relevant regulatory bodies, the GCA and the Competition and Markets Authority (CMA), to build best practice. We meet regularly with the GCA and provide updates on our activity and details on specific areas of interest to the GCA.

The 2017 GCA supplier survey reported Morrisons as the second most improved retailer. We continue to work hard to listen and respond to our suppliers, so we can improve processes and build better, stronger relationships.

We encourage and welcome feedback from suppliers and conduct our own regular surveys that provide valuable insight on further improvements we can make to continually improve relationships. Our Code Compliance Officer (CCO) spoke to suppliers in every category at supplier conferences throughout the year.

Matters raised by suppliers or the GCA have been focus areas for the business during the year and we have worked hard to understand and address them. Key developments during the year have included:

- Investing in improved systems, including introducing a Supplier Portal, which is provided free of charge for all suppliers;
- Establishing a 'Good Faith Receiving' process for suppliers delivering into our fresh warehouses; and
- Enhancing the dedicated supplier helpdesk, which is committed to resolving supplier queries within five working days.

We continue to provide training, guidance and support to all colleagues in our Trading teams together with bespoke training for relevant colleagues in our Supply Chain and Finance teams.

Governance in this area includes a group comprising senior Leadership Team members from all relevant functions. Routine updates are provided to our Executive Committee and to our Corporate Compliance and Responsibility Committee, including developments regarding the operation of the Code. We formally report details of activity over the year and specific concerns raised with our CCO to the GCA and to the CMA at the financial year end.

GSCOP related enquiries are dealt with in accordance with the regulations. Any matter not resolved directly with a buyer is escalated to the relevant Category Director and, if requested, to our CCO. During the year, our CCO received a small number of supplier enquires, none of which remained outstanding at the year end.

Contact details and further information can be found at www.morrisons.co.uk/gscop

Our four stakeholder ambitions

OUR SHAREHOLDERS

"Another strong year where we made progress against the key financial measures"

Trevor Strain, Chief Financial Officer

Introduction

2017/18 was another strong year, where we made good progress against the key financial measures fundamental to becoming a broader, stronger business.

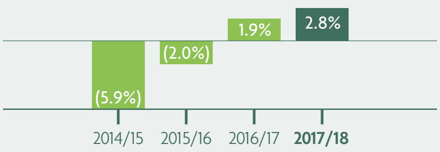
We are now in our third year of positive like-for-like (LFL) sales growth and are pleased to have made good progress with wholesale, an important part of Morrisons meaningful and sustainable future growth opportunity. Delivering 11% underlying profit growth is a strong performance in any year, but is especially so in the context of 2017/18 where the market conditions were challenging.

We are managing the business for all our stakeholders for the long term, and are prioritising improved competitiveness, customer satisfaction and colleague engagement. There were cost pressures in the year, but we successfully absorbed these and were able to reinvest the benefits of higher sales volumes back into improving the shopping trip for our customers.

Our focus on free cash flow continues, and we are committed to being capital disciplined – spending capital to maintain assets, reduce costs or improve returns. Net debt is below £1bn and we have a strong, and strengthening balance sheet, with significant freehold property ownership and a net pension surplus. These are firm foundations on which to rebuild and grow.

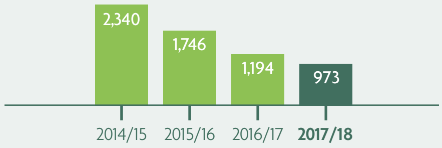
A final ordinary dividend of 4.43p per share is proposed. Reflecting continued adherence to the principles of our capital allocation framework, and our expectations for sustained future growth and strong free cash flow generation, the Board has also proposed a special dividend of 4.00p per share.

Group LFL sales (exc. fuel)



Definition
See the Glossary on page 127 for a definition.

Net debt (£m)



Definition
See the Glossary on page 128 for a definition.

HIGHLIGHTS

Revenue
£17.3bn

Underlying profit before tax
£374m

Our four stakeholder ambitions continued

Summary income statement

	2017/18 £m	2016/17 £m
Revenue	17,262	16,317
Operating profit	458	468
Net finance costs	(80)	(145)
Share of profit of joint ventures	2	2
Profit before tax	380	325
Underlying profit before tax	374	337
Underlying earnings per share	12.19p	10.86p
Basic earnings per share	13.30p	13.11p

Revenue

Total revenue during the period was £17.3bn, up 5.8% year-on-year. Revenue excluding fuel was £13.5bn, up 4.4%. 2017/18 was a 53 week year. On an equivalent 53 week basis, total revenue including fuel was up 3.8% and revenue excluding fuel up 2.5%.

Group LFL sales excluding fuel were up 2.8% over the year, comprising supermarket growth of 1.9%, online growth through central fulfilment of 0.4% and a contribution from wholesale of 0.5%.

The year had some challenges, especially inflationary pressures on imported food prices caused by weaker sterling, but we continued to become more competitive for our customers. We were pleased that quarter four was the ninth consecutive period of positive LFL sales growth.

Fuel continued to trade well, and we were very competitive throughout the period with sales up 11% to £3.7bn.

Operating profit

	2017/18 £m	2016/17 £m
Operating profit	458	468
Underlying adjustments:		
– Impairment and provision for onerous contracts	(6)	(6)
– Profit/loss on disposal and exit of properties and sale of investments	(19)	(32)
– Pension scheme set-up credit	(13)	–
– Other exceptional costs	25	2
Underlying operating profit	445	432

Operating profit was £458m (2016/17: £468m). Before the exceptional items described below, underlying operating profit was £445m (2016/17: £432m).

Following the annual impairment and onerous contract review, a net credit of £6m has been recognised. In the second half of the year, as planned, we launched a new defined contribution pension scheme. The actual cost of back-dated contributions was lower than expected, primarily due to participation rates. This resulted in a credit of £13m. Property profits were £19m in the year, and there was a charge of £25m primarily relating to restructuring. All of these items were reported outside of underlying profit before tax.

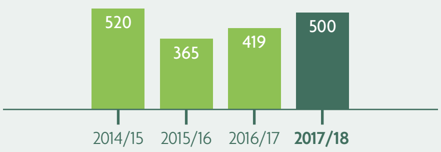
Underlying profit

	2017/18 £m	2016/17 £m
Reported profit before tax	380	325
Underlying adjustments:		
– Impairment and provision for onerous contracts	(6)	(6)
– Profit/loss on disposal and exit of properties and sale of investments	(19)	(32)
– Costs associated with the repayment of borrowings	16	56
– Pension scheme set-up credit	(13)	–
– Net pension interest income	(9)	(8)
– Other exceptional costs	25	2
Underlying profit before tax	374	337
Underlying profit margin	2.2%	2.1%

Reported profit before tax was £380m (2016/17: £325m) including a benefit of £5m from the 53rd week. Underlying profit before tax, which excludes exceptional items, was £374m (2016/17: £337m).

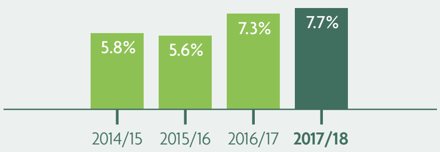
Basic earnings per share increased to 13.30p (2016/17: 13.11p), and underlying earnings per share increased to 12.19p (2016/17: 10.86p).

Capital expenditure (£m)



Definition
Measured as additions to property, plant and equipment, investment properties, intangible assets, assets held-for-sale and investments as per the cash flow statement.

Return on Capital Employed (ROCE)



Definition
See the Glossary on page 128 for a definition.

HIGHLIGHTS

Operating working capital inflow over four years

£949m

Total payments in tax

£1,114m

Debt, cash flow and working capital

Summary cash flow

	2017/18 £m	2016/17 £m
Cash generated from operations before onerous capital payments	926	1,207
Onerous capital payments	(42)	(94)
Cash generated from operations	884	1,113
Proceeds from sale of property, plant and equipment and sale of investments	108	123
Capital expenditure	(500)	(419)
Dividends paid	(129)	(118)
Dividends received	8	8
Purchase of own shares	(4)	(5)
Tax and interest	(136)	(129)
Costs incurred on repayment of borrowings	(17)	(42)
Proceeds on settlement of share options	26	–
Other non-cash movements	(19)	21
Movement in net debt	221	552
Opening net debt	(1,194)	(1,746)
Closing net debt	(973)	(1,194)

We made further progress on cash in the year, with net debt falling by £221m to £973m. Operating working capital inflow was £35m, taking the total over four years to £949m.

Cash capital expenditure was £500m, and cash outflow on previously provided onerous commitments was £42m. Proceeds from disposals were £108m taking total proceeds since the start of the programme, to £1bn.

Interest

Net finance costs were £80m (2016/17: £145m). During the year, we completed tender offers of £241m across two sterling bond and one euro bond. There was an exceptional cost of £16m incurred relating to these early repayments. Before this exceptional cost and impact of IAS 19 pension income, underlying net finance costs were £73m (2016/17: £97m).

Tax

We understand the importance of the tax contribution we make, and we take our responsibility towards the communities in which we operate and towards our colleagues, customers, investors and suppliers seriously. We have a tax management framework which ensures the needs of all of our stakeholders are considered. The Group is committed to paying all of its taxes in full and on time. The Group consistently ranks as one of the largest contributors across a range of UK taxes. In 2017/18, Morrisons made net payments of £1,114m to the UK government of which £596m was borne by Morrisons and the remaining £518m was collected on behalf of our colleagues, customers and suppliers.

Corporation tax payments made during the year were £74m which was in line with the current tax charge of £73m in the income statement.

Summary balance sheet

	2017/18 £m	2016/17 £m
Fixed assets and investments	7,761	7,761
Working capital	(2,045)	(2,009)
Provisions and tax	(792)	(767)
Net pension asset	594	272
Net debt	(973)	(1,194)
Net assets	4,545	4,063

Pensions

The net pension asset on the balance sheet is £594m, an increase of £322m since last year. During the year, one of the schemes entered into a transaction to insure part of the scheme's liabilities (a 'buy in'). We continue to work with the pension trustees to identify further opportunities to de-risk the schemes. We also amended our approach for setting discount rate assumptions. We believe this new approach better reflects the profile of the scheme's liabilities.

We launched our new defined contribution scheme in September 2017. This provides another option for colleagues to save for their retirement, with colleague contribution rates starting at 1% of salary, matched by the Group.

Capital expenditure

Capital expenditure was £500m, (2016/17: £419m). In the year we completed 80 Fresh Look refits, meaning we have now refitted around half of the estate. We also invested in maintenance and productivity in areas such as Morrisons ordering and new self-scan checkouts.

Borrowings

We continue to apply our policy of maintaining a conservative debt maturity profile and continue to reduce the level of debt. In the year, we completed a tender offer across three of our bonds – repaying £241m. Liquidity remains strong and we have not drawn down on our £1.35bn revolving credit facility since October 2015.

Our four stakeholder ambitions continued

Return on capital employed (ROCE)

Return on capital employed increased to 7.7%. The growth opportunities we are focused on require relatively low capital expenditure and are accretive to profit and returns.

Key balance sheet metrics

	2017/18	2016/17
Interest cover	6.1 times	4.6 times
Net debt/EBITDA	1.1	1.4
Gearing	21%	29%
ROCE	7.7%	7.3%

Financial strategy

Capital allocation framework

1 Invest in maintaining the estate and reducing cost
2 Maintain debt ratios to support investment grade rating
3 Invest for profitable growth
4 Pay dividends in line with stated policy
5 Return surplus capital to shareholders

Our capital allocation framework is set out above and remains unchanged. Our first priority is to invest in our stores and infrastructure, and to reduce costs. Second, we will seek to maintain debt ratios that support our target of an investment grade credit rating. Third, we will invest in profitable growth opportunities. Fourth, we will pay dividends in line with our stated policy, and then any surplus capital will be returned to shareholders.

Shareholder returns

Our policy is for the ordinary annual dividend to be sustainable and covered around two times by underlying earnings per share. The final ordinary dividend will be 4.43p, bringing the ordinary dividend for the full year to 6.09p.

In addition to the final ordinary dividend, the Board is proposing a special dividend of 4.00p per share, taking the total dividend for the year to 10.09p, an increase of 85.8%.

The principles of our capital allocation framework guide us to reinvest to deliver profitable growth and return surplus capital to shareholders. In recent years, we have made strong progress with the turnaround and our Fix, Rebuild and Grow strategy. While there is still much we plan to do, a new Morrisons is now emerging. We are growing sales and profit, and expect that growth to continue to be meaningful and sustainable in the future. We are generating significant levels of free cash flow, which we also expect to sustain. The special dividend reflects our good progress so far and our expectations for continued growth.

Looking forward, we will retain a strong and flexible balance sheet. We will be guided each year by the principles of our capital allocation framework in assessing the uses of free cash flow.

The components of our financial plan remain unchanged. We will continue to focus on improving the total return for our shareholders.

Trevor Strain
Chief Financial Officer

YOUNG LIVES vs CANCER
CLIC SARGENT

HIGHLIGHTS

£9m
Raised for British farmers through the 'For Farmers' range

Over 3m
unsold food products donated to charity

Corporate responsibility

RESPONSIBLE RETAILING

Our corporate responsibility programme ensures we operate in a way that is right for our customers, colleagues, suppliers and shareholders, while making a positive contribution to society and taking good care of the environment.

This section showcases some of the highlights during the year as well as our future plans.

This report should be read in conjunction with our annual Corporate Responsibility Report which can be found at www.morrisons-corporate.com/cr

The Corporate Responsibility Report details the disclosure requirements for the new Non-Financial Reporting requirements of the Companies Act 2006. These include:

- environmental – information on the actual and potential impacts of our operations on the environment, and on how current and foreseeable environmental matters may affect our development, performance or position;
- social and employee matters – information including diversity issues, employment issues, health and safety in the workplace, consumer relations, impacts on vulnerable consumers, responsible marketing and community relations;
- respect for human rights – what we expect from our management, colleagues and business partners in relation to human rights, including core labour standards; and
- anti-bribery and corruption – how we manage anti-bribery and anti-corruption matters and occurrences. Our anti-bribery and anti-corruption policy is available online at www.morrisons-corporate.com

Working towards a global agenda

The UN Sustainable Development Goals officially came into force in 2015. They apply to all and aim to end all forms of poverty, fight inequalities and tackle climate change on a global scale. These goals can only be realised with participation of all sectors including business. We at Morrisons recognise the importance of the goals and the true value of collaboration in order to create change.

At Morrisons, we want to address these global challenges in a meaningful way that is relevant and aligned to our business strategy. As a result, we have ensured we are aligned to at least one goal where possible.

Our focus areas this year:

Help British farmers to be competitive, profitable and sustainable

We buy animals and whole crops direct from British farmers. By owning our own abattoirs, manufacturing and packing facilities, we can utilise the whole animal and all of the crop, meaning farmers get a fair price and we can reduce waste.

- During the year, we reinforced our commitment to British products by announcing our intention to sell only 100% fresh British Morrisons branded meat.
- Our 'Milk for Farmers' range comes from a dedicated pool of British farmers, who produce to a higher welfare standard. The extra 10p per litre paid by customers is shared among all the farmers in the Morrisons dairy group. Since the 'For Farmers' range launched, we have raised over £9m for farmers.

Ensure the authenticity, provenance and safety of our products

The high standards we set for our own brand suppliers, manufacturing sites and stores ensure that we provide safe and legal products that meet the demands of our customers.

- We have been working hard with our suppliers to reduce campylobacter levels in fresh Morrisons branded chicken and we have developed an independent monitoring programme.
- Our 'Culture of Excellence' programme ran for the second year in our manufacturing business. This programme continues to play a key role in improving our food safety and quality ways of working. All 18 manufacturing sites have been audited and each has robust plans in place to further improve our culture of excellence targets for the coming year.

Reduce food waste

Smarter supply chains help us reduce avoidable food waste. This reduces environmental risk, creates efficiencies and it is important for our stakeholders.

- Through our unsold food programme our stores partner with local community groups to donate any unsold food that is safe to eat. During the year, we donated over three million unsold food products, working with over 420 community groups.
- We launched our 'Wonky Veg' range in 2015, and now sell 18 varieties and over 500 tonnes per week of 'Wonky Veg'.

Corporate responsibility continued

Look after our colleagues

It is important that our colleagues reflect the communities in which we operate, and feel supported and engaged to enable us to deliver great customer service and achieve our six priorities.

Please see page 14 for further details on our ambitions and progress for our colleagues.

Source responsibly

We must ensure that our supply chains remain sustainable and that we conserve the natural resources that we depend on.

- During the year, 87% of wood and wood derived products were Forest Stewardship Council (FSC) certified, approved alternatives or recycled for own brand household and beauty products and 72% FSC, approved alternative or recycled in own brand Home & Leisure products.
- For the third year running we published details on the wild capture fisheries we source from, ensuring greater transparency. More information can be found at www.sustainablefish.org

Ensure fair working conditions for our suppliers

Our Ethical Trading Code sets out rights for workers, including guidance on wages, working hours, safe and hygienic conditions and discrimination. Compliance with the Ethical Trading Code is part of our standard terms of supply.

- We are members of the Supplier Ethical Data Exchange, and share common ethical information.
- We are a founder sponsor of the anti-slavery initiative Stronger Together. During the year, 587 colleagues at a manager level attended Stronger Together training on identifying and tackling modern slavery.

Make it easier for our customers to live healthier lives

We have introduced a range of measures to help our customers make healthier choices, including product reformulation, clear nutritional information, healthier ranges, and strong promotions on fruit and vegetables.

- We are rolling out colour coded nutrition labels across our own brand pre-packed food and drink.
- We display calorie information on our customer café menus.
- During the year, we launched a range of value vegetable boxes including organic, British and 'Wonky Veg'. The boxes are designed to make eating fresh food more affordable and contain enough fresh vegetables to feed a family of four for five days.

Make a positive difference to the communities we serve

We are committed to supporting good causes that matter to our customers, colleagues and the communities we serve.

- Each of our stores work with local communities on a number of initiatives, and support a range of other important charity campaigns including Marie Curie Great Daffodil Appeal, the Poppy Appeal and Children in Need.
- Last year the Morrisons Foundation donated £10m to 400 charities including £0.6m in colleague match funding.
- Our three year national charity partnership with CLIC Sargent began in February 2017 and we have raised over £3m so far to support young cancer patients and their families.

Reduce general operational waste and carbon emissions

Reducing operational waste and carbon throughout our supply chain is part of what we do everyday. This has environmental benefits and ensures efficiency throughout our operations.

- 95% of our store waste is diverted from landfill and all of our manufacturing sites are zero waste direct to landfill.
- We are signatories to Courtauld 2025, which is a collaborative industry-wide commitment to cut the waste and greenhouse gas emissions associated with UK food and drink by 20% before 2025.
- As a result of our efforts to reduce energy use across our estate, since 2005 our operational carbon emissions fell by 34% against our target of a 30% reduction by 2020.
- We are committed to reducing unnecessary packaging, using recyclable or recycled material wherever possible we work with suppliers on packaging innovation to ensure our packaging is only there to protect and preserve the product it contains, preventing food waste. To help customers, we use On Pack Recycling Label to clearly identify the products that can be recycled.
- We have prohibited the use of plastic microbeads ahead of legislation as well as plastic stem cotton buds in our own brand cosmetic and personal care products. In 2018, we will be removing the sale of single use plastic bags, phasing out plastic drinking straws as well as offering customers the option to refill their water bottles for free in our cafés.

Group greenhouse gas emissions for year ending 31 December[1]

Emission source	2005/06 Baseline year	2016/17 Prior year	2017/18 Current year	Change vs baseline
Combustion of fuel and operation of facilities				
Natural gas	99,039	165,306	165,684	67%
Haulage	144,497	119,611	107,473	(26%)
Business miles	41,656	33,209	31,984	(23%)
Fugitive emissions				
Refrigerant	502,358	235,934	196,624	(61%)
Energy purchased for own use				
Electricity	767,786	587,954	503,585	(34%)
Other				
Staff travel	1,680	983	1,300	(23%)
Waste	66,000	29,932	47,553	(28%)
Online deliveries	–	15,155	17,046	–
Total	1,623,016	1,188,084	1,071,249	(34%)
Intensity ratio: kg CO_2e per sq ft gross internal area	53.9	32.0	29.1	(46%)

1 The information above is taken from our Group Carbon Footprint, prepared internally and independently verified by Jacobs. We have reported for the calendar year 1 January to 31 December in order to remain consistent with our historical footprint reports. We have used the Government's Environmental Reporting Guidelines (2013) to prepare these numbers, and the emissions factors from the UK Government GHG Conversion Factors for Company Reporting (2017). These guidelines state the baseline year should be recalculated if there have been structural changes that would significantly impact on the organisation's base year figures. For this year, we have revised our historical emissions figures given the acquisition and disposal of a number of sites and revisions to carbon conversions factors.

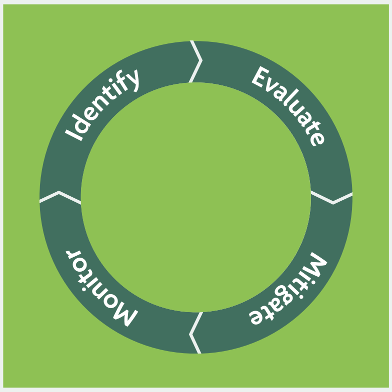
The Group Carbon Footprint includes all major sources of carbon emissions from the operation of the Group's supermarkets, manufacturing and distribution sites and operation of its haulage fleet. Some minor exemptions include our Hong Kong office which deals with energy locally, a number of distribution sites operated by third parties who are responsible for the energy and carbon, and five sites which have fuel oil (less than 0.1% of the total footprint).

Risk

MANAGING OUR RISKS

The achievement of our six priorities depends on our ability to make sound, risk-informed decisions. Managing risk and uncertainty is an integral part of doing business

The risk management process



The risk management framework

Top down

Board of Directors
Maintains sound risk management and control systems, assesses principal risks

Audit Committee
Sets risk management framework, assesses effectiveness of risk and control systems and maintains oversight of risk monitoring

Executive Committee
Assesses principal and operational risks and undertakes regular monitoring of risk

Risk and Internal Audit
Coordinates risk management activity through review of risk registers, agreement of risk mitigation plans and preparation of risk reporting

Operational Management
Reviews operational risks, operates controls and implements risk mitigation plans

Bottom up

Risk management approach

We manage uncertainty as we respond to changes in our industry and the wider political-economic climate by maintaining a business-wide understanding of our key risks and how to manage them. This assists in delivering our promises to all of our stakeholders and means that we are in a better position to achieve our objectives, respond to emerging risks and create opportunities.

The risk management process

Our risk management framework has been built to identify, evaluate, mitigate and monitor those risks which threaten the achievement of our six priorities. The framework incorporates both a top-down approach to identify the Group's principal risks and a bottom-up approach to identify operational risks.

At the core of the risk management process are the risk registers for each of the key business functions. These detail the main operating risks and are used to assess the gross level of risk (likelihood and impact), mitigating controls, and the resultant net level of risk and risk mitigation plans with dates and target level of risk. Target levels of risks are assigned to each risk based on the risk appetite framework established and agreed with the Board. The risk registers are owned and managed by operational management, with the head of each function certifying annually that these have been reviewed and action plans are in place where required. The risk registers are formally reviewed and challenged by a sub-group of the Executive Committee.

The Group risk register is formally reviewed twice a year by the Executive Committee. The register details the Group's principal risks, owners, the level of risk and mitigating actions. The Executive Committee's assessment of these risks takes into account the operating risks, strategic risks, external factors and any emerging risks. The principal risks are monitored every month by the Executive Committee using key risk indicator reporting, supplemented by more detailed reviews as appropriate to identify any changes in the risk landscape.

The Risk and Internal Audit function facilitates the preparation of both functional and Group risk registers. It supports the Audit Committee in reviewing the effectiveness of our risk management and internal control systems and has established a rotational monitoring process for key financial controls.

Where potential weaknesses are identified, the Risk and Internal Audit teams work with the business to agree robust actions to mitigate these.

The Audit Committee supports the Board in maintaining a robust risk management framework by approving the risk management process and reviewing the Group's principal risks and key risk indicator reporting on a regular basis. Read more on risk governance in the Audit Committee report on page 36.

Principal risks

The Directors have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, achievement of the six priorities, solvency or liquidity. The Directors consider these to be the most significant risks facing the business, they do not comprise all the risks that the business is facing. These principal risks are set out on the following page.

The impact of the UK's exit from the EU continues to be an important area of discussion. There are some continuing uncertainties around the impact of the Brexit negotiations, particularly in relation to the impact on imported food prices, labour availability and costs, consumer confidence and potential changes to access to EU labour. These uncertainties impact a number of the established Group risks and have therefore been factored into the assessment of the relevant risk where appropriate and the required mitigation plans. A dedicated steering group is in place that monitors the risks associated with the outcome of the Brexit negotiations and the mitigating actions the business has put in place.

As we expand the wholesale business the potential impact on ongoing operations is an area of focus. This increases complexity, and there are plans in place to address this.

Certain risks are inherent in the business and are fundamental to the achievement of all of our key priorities. Other risks could directly impact the achievement of certain key priorities.

Risk continued

PRINCIPAL RISKS

The risks, which are shown in no particular order, are disclosed along with their alignment to the six priorities and the movement in residual risk during the year. Residual risk is stated after considering the actions taken by management in response to new and emerging issues impacting the identified risks.

Risk	Description	Mitigation
Business Interruption ↑ #	There is a risk that a major incident, such as a significant failure of technology, a natural disaster or strike action, could cause significant disruption to business operations. The Group's response must be appropriate to minimise disruption and reputational damage. The growing wholesale business increases the complexity of operations and technology.	• We have recovery plans in place covering our stores, depots, sites and offices; • These plans include, where appropriate, secondary locations which would be used as backup in case of an incident; • Business continuity resilience exercises are undertaken to test processes and management's ability to respond effectively; • A Crisis Management Group is in place to oversee these plans and to manage and respond to any major incidents; • We conduct supplier risk assessments and have contingency plans in place, where possible, to manage the risk of loss of supply; and • The Technology plan is aligned with the business strategy and considers the future needs of the business including greater investment in cloud technologies to provide further resilience.
Competitiveness ↔ 1	The Grocery sector continues to have high levels of competitive activity. The continued impact of the EU referendum, and subsequent negotiations, on exchange rates and the supply chain has affected costs of goods. If we do not engage with our suppliers and effectively manage our trade plan to remain competitive there is a risk this will adversely impact performance.	• We review and actively manage our pricing, trade plan and promotional and marketing campaigns; • We have simplified how we work with suppliers building joint business plans, ensuring a competitive customer offer; • We continually review our range, category plan, and quality and respond to customer feedback, for example the 'Best' premium own brand range has grown to meet customer demand; • Competitor pricing positions and market trends are reviewed on a weekly basis; and • Our strong balance sheet and strong cash flow will allow us to continue to invest in our proposition.
Customer ↔ 1 2 3 4 6	There is a risk that we do not meet the needs of our customers in respect of price, range, quality and service. We need to be responsive to changes in customer confidence and trends which have been impacted by changes to the economy and the UK's planned exit from the EU. If we do not provide the shopping trip that customers want, we could lose sales and market share.	• One of our six priorities is 'to serve customers better' and we have a range of activities to support that; • A large scale programme of customer listening groups is in place to gain a deep understanding of what our customers want and, where we can improve, these have informed key activities such as our store Fresh Look programme and changes to range; • We closely monitor research on customer perceptions and respond quickly wherever possible. For example, with a steering group to address any particular risks arising from the UK's planned exit from the EU; and • We have worked with wholesale partners to make Morrisons products accessible to more customers and have continued to expand the geography covered by our online offering.
Data ↔ #	A security breach leading to loss of customer, colleague or Group confidential data is a key aspect of this principal risk. A major data security breach could lead to significant reputational damage and fines. The risk environment is challenging, with increased levels of cybercrime and regulatory requirements.	• The Group's Data Steering Group has the responsibility for overseeing data management practices, policies, regulatory awareness and training; • Information security policies and procedures are in place, including encryption, network security, systems access and data protection; • This is supported by ongoing monitoring, reporting and rectification of vulnerabilities; • Focused working groups are in place – looking at the management of data across the business including colleague data, customer data, commercial data and financial data; and • A project team is in place which is implementing the plan to meet General Data Protection Regulations (GDPR) in advance of May 2018.

Key

- ↑ Increase in net risk
- ↔ No change in net risk
- ↓ Decrease in net risk

Link to our six priorities

- 1 To be more competitive
- 2 To serve customers better
- 3 Find local solutions
- 4 Develop popular and useful services
- 5 To simplify and speed up the organisation
- 6 To make the core supermarkets strong again
- # Underpins all six priorities

Risk	Description	Mitigation
Financial and Treasury	The main areas of this principal risk are the availability of funding and management of cash flow to meet business needs. There is a risk of a working capital outflow if there was a significant reduction in payment terms to suppliers. Some suppliers benefit from access to supply chain finance facilities. The withdrawal of these facilities may require some terms to be reviewed. In addition, fluctuations in commodity prices and foreign exchange rates could impact the Group's profitability.	• The Group's Treasury function is responsible for the forward planning and management of funding, interest rate, foreign currency exchange rate and certain commodity price risks. They report to the Treasury Committee and operate within clear policies and procedures which are approved by the Board; • The Group's treasury policy is to maintain an appropriate borrowing maturity profile and a sufficient level of headroom in committed facilities. This includes an assumption that supply chain finance facilities are not available for the benefit of suppliers; • There are governance processes in place to control purchases in foreign currency and management of commodity prices; and • For livestock and produce, we track prices and forecasts and enter into long-term contracts where appropriate to ensure stability of price and supply.
Food Safety and Product Integrity	There is a risk that the products we sell are unsafe or not of the integrity that our customers expect. It is of utmost importance to us, and to the confidence that customers have in our business, that we meet the required standards. If we do not do this it could impact business reputation and financial performance.	• Monitoring processes are in place to manage food safety and product integrity throughout the Group and supply chain; • Regular assessments of our suppliers and own manufacturing and store facilities are undertaken to ensure adherence to standards; • Our vertical integration model gives us control over the integrity of a significant proportion of our fresh food; • Management regularly monitors food safety and product integrity performance and compliance as well as conducting horizon scanning to anticipate emerging issues; and • The process is supported by external accreditation and internal training programmes.
Health and Safety	The main aspect of this principal risk is of injury or harm to customers or colleagues. Failure to prevent incidents could impact business reputation and customer confidence and lead to financial penalties.	• We have clear policies and procedures detailing the controls required to manage health and safety risks across the business; • An ongoing training programme is in place for front line operators and management; • A programme of health and safety audits is in place across our stores, depots, sites and offices with resources dedicated to manage this risk effectively; and • Management regularly monitors health and safety performance and compliance.
People	Our colleagues are key to the achievement of our plan, particularly as we improve the business. There is a risk that if we fail to attract, retain or motivate talented colleagues, we will not provide the quality of service that our customers expect. Business change and the challenging trading environment may impact on colleagues leading to an increase in this risk. There is uncertainty about potential changes to employment regulations when the UK leaves the EU and this could result in a retention and recruitment risk, particularly at some manufacturing sites.	• We have fair employment policies, and competitive remuneration and benefits packages; • A Group-wide reward framework is in place and roles are evaluated against an external framework, driving stronger consistency of rewards; • Our training and development programmes are designed to give colleagues the skills they need to do their job and support their career aspirations; • Line managers conduct regular talent reviews and processes are in place to identify and actively manage talent; • Colleague engagement surveys, listening sessions and networking forums are used to understand and respond to our colleagues; and • A steering group is in place to monitor and take action on any particular people risks relating to the UK's exit from the EU.
Regulation	The Group operates in an environment governed by numerous regulations including GSCOP (Groceries Supply Code of Practice), competition, employment, health and safety, and regulations over the Group's products. There is uncertainty about any potential changes to regulations relating to the UK's exit from the EU. In all cases, the Board takes its responsibilities very seriously and recognises that breach of regulation can lead to reputational damage and financial damages to the Group.	• We have a GSCOP compliance framework in place including training for relevant colleagues and processes to monitor compliance; • We have a senior level working group in place to review and improve GSCOP compliance activity; • We have an independent whistleblowing line for suppliers to provide feedback to the Group and a Code Compliance Officer so that action can be taken as necessary; • We have a senior level steering group in place to monitor and take action on any potential regulatory change resulting from the UK's exit from the EU; • We have training, policies and legal guidance in place to support compliance with Competition Law and other regulations; and • We actively engage with government and regulatory bodies on policy changes which could impact our colleagues and our customers.

Risk continued

Viability statement

The Group's business model and strategy, as outlined on pages 2 to 3, are central to an understanding of its future viability. The Group continues to progress against its turnaround strategy, focusing on strengthening the core supermarkets and delivering capital light growth whilst maintaining discipline and control in relation to costs and maintaining a strong balance sheet.

The Directors have assessed the viability of the Group over a three year period to January 2021. The Group's business model is not dependent on any particular contract or resource with fixed end dates. The period was selected because the Group's forecasts associated with the detailed strategic and financial plans are prepared over this period and were considered to be the most robust and appropriate means to support its viability statement.

The Board assesses the Group's prospects primarily through the strategic planning process. The latest strategic planning update with the Board was held in November 2017 with involvement of all relevant functions across the business.

As part of the strategic planning process, the Directors make a number of assumptions about business performance and the ability of the Group to raise debt financing. The Group carefully plans and reviews the maturity profile of debt facilities to avoid coterminous maturity dates and liquidity forecasting gives visibility of headroom under committed facilities over the period of the financial plans.

Key metrics in the plan, such as cash flow, interest cover, liquidity and the ability to raise debt financing, were subject to sensitivity testing by flexing a number of the main financial assumptions in order to assess the impact of principal risks in severe but plausible scenarios.

The scenarios which have been modelled encompass the Group's principal risks.

Principal Risks	Description
Competitiveness and Customer	Failure to remain competitive (e.g. through price or keeping pace with changes in the market).
	Increased inflation, labour and import costs as a result of the UK's decision to leave the European Union.
Business interruption and Compliance	A serious data security or regulatory breach resulting in a significant monetary penalty and a loss of reputation among customers.
Financial and treasury	A banking crisis leading to one or more of the members of the Group's banking syndicate choosing not to, or being unable to honour the facility agreement.

Furthermore, reverse stress testing was performed to understand the level of performance decline that the Group could withstand.

Based on this assessment, and taking into account the Group's current position, the Directors have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the three year period of their assessment.

Approval of the Strategic report
Pages 1 to 26 of the Annual Report form the Strategic report. The Strategic report was approved by the Board on 13 March 2018 and signed on its behalf by:

Jonathan Burke
Company Secretary
13 March 2018

Corporate governance report

Chairman's governance statement

"I am pleased to introduce on behalf of the Board, Morrisons Corporate governance report for the financial year 2017/18"

Andrew Higginson, Chairman

As we Fix, Rebuild and Grow Morrisons, a robust and effective governance framework allows our colleagues the agility and flexibility for improvements to be made to every aspect of the Group. We continue to make good progress in the Group's turnaround and this is reflected in improving like-for-like sales, customer satisfaction and colleague engagement. This governance framework ensures that our key stakeholders are put at the heart of all decisions we make to drive long-term value creation for all.

Board effectiveness

The Board and management team continue to work well together. The Board draws on the Directors' range of experience, knowledge and skills to help Fix, Rebuild and Grow Morrisons for all stakeholders.

We are delighted to welcome Tony van Kralingen and Kevin Havelock to the Board. Both Tony and Kevin bring a wealth of experience from the fast moving consumer goods industry. Tony has spent much of his induction period listening to shareholders and other stakeholders to help guide his approach as Chair of our Remuneration Committee. Kevin joined the Board on 1 February 2018 and has started his induction programme.

An external review of the effectiveness of our Board was undertaken by Consilium Board Review during the Summer. This review found that the Board has a well-balanced set of capabilities; and that governance and compliance is strong. The review provided the relatively newly established Board an opportunity to reflect on its effectiveness and as such many insightful and helpful suggestions were made that are in the process of being implemented.

Diversity

We truly value diversity and a culture of inclusion across our colleague base, and the Board itself. A broad range of skills, experience and knowledge is required in our Group as this is invaluable to the improvements we will continue to make.

The Board continues to meet the Group's policy to maintain female representation at not less than 20%. At the end of the financial year, 22% of the total Board composition was female.

Colleague voice at the Board

Throughout Morrisons we have a culture of listening hard and responding quickly. This culture also extends to our Board.

Board members have met hundreds of Morrisons colleagues through the various functional updates, store and site visits and personal shopping experiences. The Board also receives updates on the 'Your Say' survey in which three-quarters of colleagues within Morrisons have shared their thoughts about the Group. More information on the 'Your Say' survey can be found in our colleagues section on page 14. The national 'Your Say' forum, which includes a representative from each store region, manufacturing site and distribution centre, gathers twice a year to discuss issues that are important to the colleagues they represent. David Potts, along with other senior members of the Group's management team, have been in attendance to discuss colleague views. Tony van Kralingen will be attending these forums throughout 2018/19.

Engagement with shareholders

We take the opinions of all our stakeholders very seriously, and as such, we continue to focus on engagement with our shareholders. Since his appointment, Tony van Kralingen has begun a comprehensive shareholder engagement programme and has personally spoken with holders representing over 42% of Morrisons current register.

In such a competitive industry, we have and continue to make tough decisions every day. The Board and the Group will continue to listen hard to our stakeholders and respond quickly where we can.

Andrew Higginson
Chairman

Corporate governance report continued

Compliance with the UK Corporate Governance Code

The Board considers that its corporate governance policies and procedures are appropriate and that the Group has applied the principles and, save as described below regarding the 2017 AGM results, complied with the detailed provisions of the 2016 UK Corporate Governance Code (the 'Code') throughout the financial year 2017/18 and to the date of this Annual Report.

The Code is available on the Financial Reporting Council's website, www.frc.org.uk

The Board's corporate governance compliance statement sets out how the Group complies with each of the provisions of the Code. It is available in the investor relations section of the Group's website, www.morrisons-corporate.com

Compliance with the remuneration areas of the Code are covered in the Directors' remuneration report which can be found on page 38.

Leadership

The role of the Board

The Board met eight times in the year which is considered sufficient to fulfil its duties. Details of attendance at each Board and Committee meeting is provided on page 30.

The formal schedule of matters reserved for the Board remains unaltered from 2016/17 and is set out in the corporate governance compliance statement which can be found in the investor relations section of the Group's website, www.morrisons-corporate.com

Division of responsibilities

The Board is committed to a clear division of responsibilities between the Chairman and the Chief Executive. This has been reviewed by the Board during the year and is also set out in the corporate governance compliance statement.

The Chairman

Andrew Higginson met the independence criteria detailed in the Code on appointment.

Senior Independent Director

Rooney Anand was appointed as the Senior Independent Director on 1 January 2016 when he joined the Board. Rooney has extensive knowledge of the retail and fast moving consumer goods industries.

The Senior Independent Director provides shareholders with an alternative contact to the Chairman, the Chief Executive and the Chief Financial Officer. The Senior Independent Director also carried out the Chairman's performance review.

The Chairman arranges regular discussions between all the Non-Executive Directors (including himself) as a group without management present.

Effectiveness

The Board's composition

The majority of the Board comprises Non-Executive Directors. The Non-Executive Directors bring a varied range of skills and experience to the Group. Details of their experience outside the Group are set out in their respective biographies on page 30.

The Board is satisfied that all Non-Executive Directors, including the Non-Executive Chairman, remain independent according to the definition contained in the Code. The criteria used to determine independence are set out in the corporate governance compliance statement, which can be found in the investor relations section of the Group's website, www.morrisons-corporate.com

Directors' interests

The interests of the Executive and Non-Executive Directors of the Group, and their immediate families, in the shares of the Group, along with share options, are contained in the Directors' remuneration report set out on pages 38 to 51. At no time during the year did any of the Directors have a material interest in any significant contract with the Group or any of its subsidiaries.

Board appointments

The Nomination Committee leads the process for Board appointments. More information on this Committee can be found on pages 33 and 37.

The Nomination Committee considers that the Board and Executive Committee contain the skills and experience necessary in light of the Group's current activities and strategic direction.

Time commitments

The minimum time commitment expected of the Non-Executive Directors is 12 days per year, including attendance at the Annual General Meeting (AGM), Board meetings and site visits, plus adequate preparation time.

The Board is satisfied that each of the Non-Executive Directors commits sufficient time to the business of the Group and contributes to the governance and operations of the Group.

This has been confirmed by the external Board effectiveness assessment referred to on page 34.

Training and development

Induction programmes are agreed by the Chairman for each new Non-Executive Director's appointment.

The Chairman assesses the development needs of members of the Board on an annual basis.

Provision of information and support

The Chairman, supported by the Company Secretary, ensures that the Board receive information on a timely basis.

Each Director has access to the advice and services of the Company Secretary. They may also take external advice at the Group's expense in relation to their duties.

Board and committee performance and evaluation

An external assessment of the Board was facilitated by Consilium Board Review during the year. Consilium Board Review does not have any other connection with the Group.

The outcomes of this assessment can be found on page 34.

Re-election of Directors

All the current Directors submit themselves for re-election at the AGM to be held on 14 June 2018.

After reviewing the outcome of performance evaluations, the Board confirms that the contributions made by the Directors offering themselves for election or re-election at the AGM in June 2018, continue to be effective and that the Group supports their re-election.

Accountability

Financial and business reporting

The way the Group generates value and the Board's strategy for delivering the Group's objectives is described in the Business model on pages 2 to 3, and our six priorities section on pages 8 to 9. The information regarding the Takeover Directive disclosures are on page 52. The consideration of going concern is described on page 52. The viability statement is on page 26.

Risk management and internal control systems

The Board is satisfied with the effectiveness of internal control and that risk is being managed effectively across the Group. More information can be found on page 36.

Role and responsibility of the Audit Committee

The role and responsibility of the Audit Committee is outlined in the Board structure on page 33.

The Board is satisfied that Belinda Richards has recent and relevant financial experience appropriate to her position as Chair of the Audit Committee. Belinda is considered to have sufficient financial experience, having been a corporate finance partner at Deloitte for over ten years. Additionally, she serves on the Advisory Group of the Audit Committee Chairmen at the Financial Reporting Council and is a member of the Governing Council of the Centre for the Study of Financial Innovation.

Relations with shareholders

Shareholder engagement

The Board is committed to communicating the strategy to analysts, investors and shareholders on a regular basis through a planned programme.

The Investor Relations programme includes:

- formal presentations of full and half year results;
- trading statements;
- regular meetings between institutional investors, the CEO, the CFO and the Investor Relations team in the UK and overseas following the full and half year results;
- regular meetings between the Chairman and major shareholders to discuss any aspect of the Group or its governance arrangements;
- attending key investor conferences;
- communication between the Chairman of the Remuneration Committee and major shareholders on remuneration policy and significant changes in remuneration arrangements;
- responding to enquiries from shareholders and analysts through the Investor Relations team; and
- dedicated shareholder and investor sections on the website.

In addition, the Investor Relations team provides a regular update to the Board and feedback from meetings held between executive management and institutional shareholders. The Group's brokers seek independent feedback from analysts and investors following the full and half year results meetings which is reported to the Board.

2017 AGM results

At last year's AGM, our 2017 Directors' remuneration report was approved with 52% of the votes cast in favour. As our Chairman explained in a press statement issued shortly following the announcement of the results of last year's AGM, we had consulted widely with shareholders before the AGM on our new remuneration policy, which received strong support with more than 92% of the votes cast in favour. We were therefore surprised not to get a higher vote in favour of the 2017 Directors' remuneration report. When we announced the results of last year's AGM we did not expressly state, in accordance with the Code, the actions we intended to take to understand the reasons behind the vote result. Needless to say, however, since the appointment of Tony van Kralingen as the Chair of the Remuneration Committee, we subsequently engaged extensively with shareholders to understand the reasons behind this voting result, and further details of this engagement are set out on page 39 of this year's Directors' remuneration report.

Use of the AGM

The 2018 AGM will be held on 14 June 2018 at the Group's headquarters at Gain Lane, in Bradford.

The whole Board is expected to attend and be available to answer any questions shareholders may have.

Notice of the 2018 AGM of the Group is to be sent to shareholders with an accompanying letter from the Chairman. The format of the meeting is:

- a summary presentation of results is provided before the Chairman deals with the formal business;
- all shareholders present can put questions to the Chairman, Chairmen of the Committees, and the Board during the meeting and informally afterwards;
- the Board encourages participation of individual investors at the AGM; and
- following the meeting, details of the voting on the resolutions will be made available on the website www.morrisons-corporate.com/investor-centre/shareholder-information/generalmeetings/

The Directors recommend shareholders vote in favour of each resolution, believing them to be in the best interests of the Group. Shareholders will be notified of the availability of the Annual Report and Financial Statements on the website unless they have elected to receive a printed version.

Board of Directors and Executive Committee

ALWAYS LISTENING

Composition of the Board

The Board is independent and contains an appropriate mixture of skills and experience. The Board is satisfied that all Non-Executive Directors, including the Non-Executive Chairman, remain independent according to the definition contained in the Code[1]. The criteria used to determine independence are set out in the corporate governance compliance statement which can be found in the investor relations section of the Group's website, www.morrisons-corporate.com. Each of the Non-Executive Directors has committed and is able to commit an appropriate amount of time in fulfilling effectively their role and responsibilities on the Board.

1. Andrew Higginson
Chairman
C R N

2. David Potts
Chief Executive
C

3. Trevor Strain
Chief Financial Officer

4. Rooney Anand
Senior Independent Non-Executive Director
C R N

5. Neil Davidson
Non-Executive Director
A C R N

6. Belinda Richards
Non-Executive Director
A C R N

7. Tony van Kralingen
Non-Executive Director
A C R N

8. Paula Vennells
Non-Executive Director
A C R N

1. Andrew Higginson

Appointment
Andrew joined the Group as Deputy Chairman and Chairman Elect in October 2014 and became Chairman at the end of January 2015.

Experience
Andrew brings significant Board, commercial, retail and leadership experience to the Board. Andrew is a former Executive Director of Tesco PLC having spent 15 years on the Main Board, first as Finance and Strategy Director, and latterly as Chief Executive of their Retailing Services business. His early career was with Unilever, Guinness, Laura Ashley and the Burton Group. Andrew was previously the Chairman of Poundland Group PLC, Senior Independent Director of BSkyB PLC and a Non-Executive Director of the Rugby Football Union.

External Roles
Chairman of N Brown Group PLC
Non-Executive Director of Woolworths Holdings Limited
Chairman of Evergreen Garden Care

2. David Potts

Appointment
David joined the Group as Chief Executive on 16 March 2015.

Experience
David is a vastly experienced retailer who joined Tesco PLC at the age of 16 and worked there for 39 years. He rose to become CEO of its Ireland business, its UK retail stores business and then CEO of Tesco Asia. David was also on the Tesco PLC Board from 1998 until he left in 2011. Prior to his appointment as CEO of Morrisons, David held several advisory positions with a number of private equity and consultancy firms and developed his own retail concept to sell general merchandise. He also worked on two extensive retail projects in the UK.

External Roles
None

3. Trevor Strain

Appointment
Trevor joined the Group in June 2009 as Commercial and Operations Finance Director. In June 2011, he became Finance Director Corporate and took responsibility for the Company's productivity programmes. Trevor joined the Board as Chief Financial Officer on 10 April 2013.

Experience
Prior to joining Morrisons, Trevor worked for Tesco PLC in a number of roles until his appointment as UK Property Finance Director in 2006 and subsequently UK Planning and Reporting Finance Director. Trevor began his career with Arthur Andersen and is a member of the Institute of Chartered Accountants in England and Wales.

External Roles
None

4. Rooney Anand

Appointment
Rooney joined the Board as a Non-Executive Director and Senior Independent Director on 1 January 2016.

Experience
Rooney is a highly experienced retail and fast moving consumer goods (FMCG) executive. Following a career with United Biscuits and then Sara Lee, he joined Greene King PLC in 2001 as Managing Director of its brewery company. He was appointed CEO in 2005.

External Roles
Chief Executive Officer of Greene King PLC
Chairman of Purity Soft Drinks Limited

5. Neil Davidson

Appointment
Neil joined the Board as a Non-Executive Director on 1 October 2015. He became Chair of the Corporate Compliance and Responsibility Committee on 1 January 2016.

Experience
Neil has had an extensive career in manufacturing, starting with Northern Foods PLC where he rose to become Managing Director of its milk division. He subsequently became CEO of Express Dairies PLC and then Arla PLC. He is currently Chair of the Youth Sport Trust and has also been a Non-Executive Director of Produce Investments PLC, Persimmon PLC and Northern Recruitment Group PLC.

External Roles
Chairman of OptiBiotix Health PLC

6. Belinda Richards

Appointment
Belinda joined the Board as a Non-Executive Director on 1 September 2015. She became Chair of the Audit Committee on 1 January 2016.

Experience
Belinda had a career in professional services for over 25 years, where she operated as a senior adviser in corporate finance and strategy. She was a corporate finance partner at Deloitte and Global Head of Merger and Separation Advisory Services until 2010. Belinda serves on the Advisory Group of Audit Committee Chairmen at the Financial Reporting Council, is a member of the Governing Council of the Centre for the Study of Financial Innovation and is a Trustee of the Youth Sport Trust.

External Roles
Senior Independent Director and Remuneration Chair of Grainger PLC
Non-Executive Director of Monks Investment Trust PLC
Non-Executive Director of Phoenix Group Holdings (PGH)
Non-Executive Director of Schroder Japan Growth Fund PLC

7. Tony van Kralingen

Appointment
Tony joined the Board as a Non-Executive Director on 1 September 2017.

Experience
Tony has a very broad experience across a number of disciplines including marketing, supply, procurement and manufacturing and human resources. Tony served 35 years at SABMiller PLC, 14 of which he was on the Executive Committee. He held a number of positions including Group Director: Integrated Supply, Chairman and Managing Director SAB, and Chairman and CEO: Plzensky Prazdroj. He is also currently an Honorary Professor of Global Corporate Strategy at Nottingham University.

External Roles
Chair of Crown Commercial Services

8. Paula Vennells

Appointment
Paula joined the Board as a Non-Executive Director on 1 January 2016.

Experience
Paula has significant experience in commercial, marketing and supply chain. Paula is currently Chief Executive of the Post Office, a role she has held since April 2012. Paula joined the Post Office in 2007. Previously she was Group Commercial Director of Whitbread PLC having started her career with Unilever and L'Oréal. Paula has held directorships in sales and marketing with a number of major retailers including Dixons Stores Group and Argos.

External Roles
Chief Executive of the Post Office
Non-Executive Chair of First Rate Exchange Services Limited

1 On 6 February 2018, Belinda Richards was appointed Trustee of the Youth Sport Trust, a national charity, of which Neil Davidson is Chairman. The Board has considered this cross-directorship and is satisfied that it does not compromise the independence of Belinda or Neil.

Executive Committee

The Executive Committee is driving a culture of listening to all of our key stakeholders within the business.

9. Kevin Havelock
Non-Executive Director

A C R N

9. Kevin Havelock

Appointment
Kevin joined the Board as a Non-Executive Director on 1 February 2018.

Experience
Kevin has significant fast moving consumer goods (FMCG) industry experience, most recently having been a member of the Executive Committee at Unilever and President of Global Refreshment, which comprises of Unilever's drinks and ice cream brands. Kevin is a Trustee of the British Council and a Trustee of The Eden Project.

External Roles
Non-Executive Director of Fevertree PLC

Jonathan Burke
Company Secretary

Appointment
Jonathan was appointed as the Group's Company Secretary on 15 February 2017, replacing Mark Amsden.

Experience
As a qualified accountant and Company Secretary, Jonathan has worked at Morrisons for over 25 years holding various finance, compliance and project roles. He also previously held the role of Company Secretary between 2001 and 2009.

Attendance at meetings

	Board	Nomination	Remuneration	Audit	CCR
Andrew Higginson	8/8	4/4	6/6	–	5/5
David Potts	8/8	–	–	–	5/5
Trevor Strain	8/8	–	–	–	–
Rooney Anand	8/8	4/4	6/6	–	5/5
Neil Davidson	8/8	4/4	6/6	6/6	5/5
Kevin Havelock	–	–	–	–	–
Tony van Kralingen	3/3	1/1	2/2	3/3	2/2
Belinda Richards	7/8	4/4	6/6	6/6	5/5
Paula Vennells	8/8	4/4	6/6	6/6	5/5

On the rare occasions that a Director is unavoidably unable to attend a meeting, the Director will still receive and consider the relevant papers allowing them to share and discuss any comments or input with the other members of the Board before the meeting.

Committee key

- A Audit Committee
- C Corporate Compliance and Responsibility Committee
- R Remuneration Committee
- N Nomination Committee
- ● Committee Chairman

1. David Potts
Chief Executive

C

2. Trevor Strain
Chief Financial Officer

3. Andy Atkinson
Group Customer and Marketing Director

4. Darren Blackhurst
Group Commercial Director

C

5. Clare Grainger
Group People Director

6. Gary Mills
Group Retail Director

1. David Potts

See Board of Directors on page 30

2. Trevor Strain

See Board of Directors on page 30

3. Andy Atkinson

Appointment
Andy joined Morrisons in 2011 and was appointed as Group Customer and Marketing Director in January 2016 having held the interim position for over five months.

Experience
Andy previously held a number of senior Commercial and Trading roles within the organisation. Prior to joining Morrisons, Andy held a variety of senior commercial roles within Boots, progressing to Commercial Director. Andy started his career at Coca-Cola before roles at Walt Disney and then L'Oréal.

4. Darren Blackhurst

Appointment
Darren joined Morrisons in June 2015 as Group Commercial Director.

Experience
Darren started his career at Tesco in 1988, holding a number of buying roles in fresh food and grocery. In 1994, he was seconded to Tesco's French business Catteau before holding a number of category director positions. Darren became Commercial Director for Tesco Lotus Thailand in 2002. He joined Asda in 2006 as Executive Trading Director for Food and in 2008 was appointed Chief Merchandising Officer. In 2011, he joined Matalan as Chief Executive before moving to B&Q as Commercial Director in 2014.

5. Clare Grainger

Appointment
Clare joined Morrisons in February 2009 and was appointed Group People Director on 1 September 2015.

Experience
Clare started her career at Asda and held a number of roles both within Head Office and the Retail division. She progressed through a variety of senior human resources (HR) roles including Head of HR at HBOS/Lloyds Banking Group, where she led a number of programmes to drive differentiation in both sales and services.

6. Gary Mills

Appointment
Gary joined Morrisons in August 2015 as Group Retail Director.

Experience
Gary has more than 30 years' retail experience, with Stewarts Supermarkets in Northern Ireland and then with Tesco PLC where he held a variety of senior positions including Retail Director for Convenience and Retail Director for the North and Northern Ireland. Gary's experience covers all areas of retail and all formats, including supermarkets and convenience stores.

Corporate governance report continued

Leadership around the business

David Potts, Chief Executive

Clare Grainger, Group People Director

Gary Mills, Group Retail Director

Andy Atkinson, Group Customer and Marketing Director

The decisions delegated by the Board to its Committees during the financial year 2017/18 are shown in the table below and on the following page. See pages 34 and 37 for details of activities.

Function	Main Board	Executive Committee
Members	Andrew Higginson (Chair) David Potts Trevor Strain Rooney Anand Neil Davidson Kevin Havelock[1] Tony van Kralingen[2] Belinda Richards Paula Vennells 	David Potts (Chair) Trevor Strain Andy Atkinson Darren Blackhurst Clare Grainger Gary Mills 
Key objectives	Overall conduct of the business and strategy setting.	Implementation of strategy and actions in respect of financial planning and performance; day-to-day management of operations.
Responsibilities	• Understanding, reviewing and responding to views of all stakeholders; • Developing and approving the strategy and key policies of the Group; • Managing culture and values; • Monitoring progress towards achieving all Board objectives; • Monitoring of financial performance, critical operational issues and risks by reviewing performance against strategy, objectives, business plans and budgets; • Approving communications to shareholders, including the Annual Report and Financial Statements, half-yearly financial report and interim management statements; • Approving changes to the Group's capital structure, external financial reports, major expenditure; and • Approving membership of the Board on recommendation of the Nomination Committee.	• Developing and implementing the strategy; • Understanding, reviewing and responding to the feedback from stakeholders including customers and colleagues; • Maintaining oversight of: – financial performance, reporting and control; – risk management; – operational improvement programmes; and – review and supervision of operational activities; • Making recommendations to the Board in respect of: – budgets and long-term plans; – dividend levels; – Group risk register; and – ad-hoc events; • Managing succession planning for all colleagues including senior management; and • Organising Sub-Committees which are responsible for key operational oversight and decision making including: – management of capital expenditure; – departmental performance reviews; – oversight of improvements to process for suppliers; and – GSCOP Compliance.

1 Kevin Havelock was appointed to the Board, Audit, Corporate Compliance and Responsibility Committee, Remuneration and Nomination Committee on 1 February 2018.
2 Tony van Kralingen was appointed to the Board and as Chair of the Remuneration Committee on 1 September 2017. He was appointed to the Audit, Corporate Compliance and Responsibility Committee and Nomination Committee on 9 September 2017.

Structure of the Board and its Committees

Chairman
Key objective: Governance of the Board

Main Board

- Executive Committee
- Audit Committee
- Corporate Compliance and Responsibility Committee
- Remuneration Committee
- Nomination Committee

Audit Committee

Belinda Richards (Chair)
Neil Davidson
Kevin Havelock[1]
Tony van Kralingen[2]
Paula Vennells

Effective governance of financial reporting, internal controls and risk management systems; review of significant accounting judgements, assumptions and estimates; management of the relationship and appointment of the external auditor; monitoring and review of the effectiveness of the Group's Risk and Internal Audit function.

- Reviewing and making recommendations to the Board on:
  - the integrity of financial reports, including reviewing significant financial reporting issues and considering how these issues have been addressed;
  - whether the Annual Report is fair, balanced and understandable;
  - the effectiveness of the Group's internal control and risk management system;
  - the effectiveness of the Risk and Internal Audit function;
  - the independence, effectiveness and appointment of the external auditor, approval of their fees; and monitoring of the Group's policy on non-audit services;
  - approval of Tax and Treasury policies; and
  - pensions.

Corporate Compliance and Responsibility Committee

Neil Davidson (Chair)
Andrew Higginson
David Potts
Rooney Anand
Darren Blackhurst
Andrew Clappen[3]
Kevin Havelock[1]
Tony van Kralingen[2]
Belinda Richards
Paula Vennells

Developing and implementing of the Group's policies on corporate compliance and corporate responsibility. Reviewing and ensuring compliance with those policies and ethical and governance standards.

- Maintaining oversight of strategy and process in areas of corporate responsibility, including:
  - Groceries Supply Code of Practice (GSCOP);
  - food safety and food integrity;
  - health and safety;
  - gender pay;
  - cyber security;
  - ethical trading;
  - modern slavery;
  - environmental and competition compliance;
  - governance and reputation;
  - General Data Protection Regulation (GDPR); and
  - The Morrisons Foundation and charitable giving.

Remuneration Committee

Tony van Kralingen[2] (Chair)
Andrew Higginson
Rooney Anand
Neil Davidson
Kevin Havelock[1]
Belinda Richards
Paula Vennells

Developing and implementing of the Group's remuneration framework and policies for Directors and colleagues including all incentives, bonuses and pensions.

- Setting the remuneration policy for the Group's Chief Executive, Chairman, Executive Directors and Executive Committee;
- Agreeing remuneration of the Executive Directors and Executive Committee;
- Engaging with shareholders in respect of remuneration polices;
- Reviewing the terms and operation of the Share Ownership Guidelines; and
- Reviewing the Chief Executive and Chairman's expenses.

Nomination Committee

Andrew Higginson (Chair)
Rooney Anand
Neil Davidson
Kevin Havelock[1]
Tony van Kralingen[2]
Belinda Richards
Paula Vennells

Advising the Board on Board and senior management appointments and succession planning; monitoring of the composition of the Board and its Committees.

- Evaluating the current and required mixture of skills and experience on the Board;
- Reviewing succession planning for the Board;
- Sourcing and selecting Board candidates (more information can be found on page 37);
- Maintaining general oversight of people and capability within the business, and their diversity (more information can be found on page 37);
- Reviewing the talent pool for the Executive Committee and levels below Executive Committee; and
- Reviewing and setting policy on diversity.

3 Andrew Clappen is the Group Corporate Services Director. Andrew joined Morrisons in 2012 and is responsible for the Corporate Affairs and Policy, Corporate Social Responsibility (CSR) & Ethical Trading, Agriculture and Technical Services (Food and General Merchandise Technology, Safety, Quality, Compliance and Health & Safety) of the Group. Prior to Morrisons, Andrew was the Senior Vice President responsible for Food Safety, Quality Assurance & Regulatory Affairs at Loblaw Companies Ltd in Canada.

Corporate governance report continued

Board and Committee activities

Main Board

Activities in 2017/18

During the year the Board has:

- set the strategy and plans for the Group;
- reviewed the results and forecasts and approved the regulatory announcements;
- reviewed the annual business plan and received regular updates from the Executive Committee regarding its delivery;
- ensured the conduct of the business in accordance with its values;
- reviewed the performance of the Chief Executive;
- approved the 2018/19 budget and commercial plans, including productivity savings required to invest in the customer offer;
- approved the plan for the Group's balance sheet and capital structure strategy;
- approved the proposed dividends;
- considered feedback received from customers, colleagues, suppliers and shareholders;
- discussed compliance to regulations with the Grocery Code Adjudicator (GCA);
- approved the Group's continued operations and growth opportunities in online, wholesale and manufacturing; and
- reviewed the governance structure and activities of the sub-committees of the Board.

Board evaluation

The assessment of the Board was completed this year in line with the UK Corporate Governance Code (the 'Code'). This assessment was facilitated by Consilium Board Review which does not have any other connection with the Group.

Six suppliers were asked to tender for this work, and Consilium Board Review was selected from a shortlist of three that were interviewed by the Chairman and Company Secretary.

Following a comprehensive briefing provided by the Chairman and Company Secretary, Consilium Board Review completed the review. This comprised of a paper questionnaire, individual interviews with each Director and key members of the Group's management team and attending the July Board and Committee meetings.

The review concluded that both governance and compliance are strong, and that the Board operates in an effective and efficient manner. It was also noted that the Board takes a serious and responsible approach towards governance, compliance ethics and controls, and that the Board has installed an effective governance framework.

The review recommended some actions that could be taken to further improve the performance of the Board. The Board action plan for 2018/19 will include:

- ensuring the Board agendas are set to allow additional time for the Board to consider strategic matters; and
- increasing the informal interaction time of the Board within the next year.

During the year, the Group also reviewed and considered the effectiveness of its principal advisers to ensure they remain appropriate and relevant to the Group's needs.

Executive Committee

Activities in 2017/18

During the year the Executive Committee has:

- driven trading performance and reviewed financial performance;
- reduced the cost base of the organisation;
- considered regular updates on customer views including attending customer listening sessions and shopping trips with customers;
- implemented the Group's six priorities;
- overseen the Group's compliance with its obligations under the Groceries Supply Code of Practice (GSCOP);
- overseen the Group's commitment to corporate social responsibility in particular in minimising food waste, in supporting the Group's charity partner CLIC Sargent and in supporting the charitable Morrisons Foundation;
- overseen the Group's continued development of its wholesale, online and manufacturing operations;
- approved capital budgets;
- determined the draft budget and long-term plan;
- reviewed the talent, capability and capacity within the Group;
- listened to views of colleagues including reviewing the 'Your Say' survey results and agreement of improvement actions;
- periodically reviewed performance against strategic objectives;
- determined principal risks for the Group;
- reviewed the General Data Protection Regulation (GDPR) compliance plans;
- reviewed changes to speed up and simplify the business;
- agreed improvements to the Group's technology infrastructure;
- recommended the dividend to the Board; and
- continued to review the Group's reduction programme in energy and plastic.

Audit Committee

Activities in 2017/18

During the year, the Committee has:

- considered the appropriateness of the Group's Annual Report and Financial Statements and Half-yearly report;
- considered the effectiveness of the internal controls and the work of Risk and Internal Audit and discussed key risks (described in more detail on page 36);
- considered reports produced by Internal Audit covering topics including regulatory compliance and the control environment;
- reviewed key policies including those governing tax and treasury;
- reviewed the recognition of commercial income and the controls in place over compliance with GSCOP;
- understood the Corporate Governance Code and reporting requirements; and
- assessed the proposed viability statement, reviewed and challenged the scenarios modelled.

In respect of financial reports, the Committee has focused on:

- the accounting judgements and estimates made by management that could have a significant effect on the Group's financial results;
- the clarity of disclosure of financial information including Alternative Performance Measures (APMs);
- whether the Annual Report, taken as a whole, is fair, balanced and understandable – the Directors' statement on this can be found on page 54 of this Annual Report; and
- reviewed the impact of upcoming changes to accounting standards, and management's assessment of the impact on future financial statements.

Financial reporting matters

The Audit Committee has considered whether suitable accounting policies have been applied and has reviewed key accounting judgements and estimates made by management. This section outlines the key judgements and financial reporting matters considered by the Committee during the year.

Impairment of property, plant and equipment, intangible assets and onerous property contracts

Impairment and onerous property contracts continue to be a focus area for the Committee on the basis of their materiality and level of inherent judgement and estimation. The Group's policy to assess impairment on an annual basis, or where changes in circumstances indicate impairment (or impairment reversal), is disclosed in note 3.1 of the financial statements. The impairment review is comprehensive, covering non-financial assets, principally the Group's property portfolio, technology assets and goodwill.

Management estimates the recoverable amount of assets to determine the extent of any impairment charge or whether a reversal of a previous impairment charge is required. This assessment led to a reversal of previous impairment of assets in certain cash generating units and an impairment charge being recognised on others, resulting in a net credit of £7m recognised, as disclosed in note 3.3 of the financial statements.

The Committee reviewed reports produced by management detailing the outcomes of the impairment assessment. This review focused on understanding the methodology, the basis of key assumptions (discount rate and long-term growth rate) and a review of the outcomes of the impairment assessment performed by management. The Committee has also reviewed management's key assumptions around the market valuation of the store portfolio.

In addition, for property contracts where the expected future cash flows are less than the future contract commitment, an onerous contract provision is recognised. This work resulted in a net £1m release in relation to provisions for onerous contracts being recognised and a net £2m increase in accruals for onerous commitments during the year. The Committee reviewed the key judgements and understood the reasons for any movements in provisions.

The Committee reviewed the key assumptions along with their impact on the impairment and onerous contract provisions and is satisfied the assumptions applied by management are appropriate.

Commercial income

The Group's definition of commercial income is disclosed in note 1.1 of the financial statements and is consistent with the definition in the prior year.

Commercial income is accounted for as a deduction from the cost of purchase, and it is recognised in accordance with signed supplier agreements, with most income subject to little or no subjectivity or judgement.

Commercial income continues to be an area of focus for the Committee, despite reduced complexity and size, due to industry focus and its judgemental nature. In considering the appropriateness of commercial income recognised in the year and the financial position at the year end, the Committee has reviewed reports from management and Internal Audit outlining the accounting judgements and the control environment. The Committee understood the key judgements in this area and considers them to be appropriate.

Stock

Stock is a material balance in the Group's financial statements, with stock held across a large number of locations. As such, this remains an area of focus for the Committee. Stock count procedures have remained consistent with the prior year.

Judgement is required in determining provisions for shrinkage and valuation and the Committee reviews these judgements as part of the annual review of judgements and estimates. The Committee has reviewed the level of stock provision and assumptions underpinning the provision and considers these to be appropriate.

Pensions

The Group operates a number of defined benefit pension schemes. Accounting for defined benefit pension schemes requires the application of a number of assumptions which have an impact on the valuation of the schemes' assets and liabilities. The IAS 19 valuations are performed by an independent actuary.

The Committee has reviewed the assumptions used in the schemes' valuations. The Committee has considered the appropriateness and sensitivity of the assumptions used by the independent actuaries in the valuation, including the discount rate. The Committee has concluded that the assumptions are appropriate.

The Committee considered the legal advice the Group has obtained with regard to the recognition of a pension surplus for the Group's defined benefit pension schemes, as disclosed in note 8.5 of the financial statements and considered the treatment appropriate.

The Committee reviewed the accounting treatment resulting from the set-up of the new defined contribution scheme. This resulted in a net £13m credit recognised in the year, as an adjustment to underlying earnings (as disclosed in notes 1.4 and 8.6). This credit represents the difference between the expected back dated contributions and the cost based on actual participation rates. The Committee concluded that this treatment was appropriate.

Presentation of financial statements

The Committee has considered the Guidelines on Alternative Performance Measures (APMs), issued by the European Securities and Markets Authority (ESMA) in 2016. The Group now includes additional disclosure on the APMs used by the Group in a Glossary on page 127.

In addition, the Committee has considered the use of APMs, in particular the items presented as adjustments to underlying earnings presented in the financial statements. The Committee is satisfied the classification of these items is appropriate and consistent and that the level of disclosure provided in note 1.4 is appropriate.

Corporate governance report continued

Board and Committee activities

Internal control and risk management

The Board has overall accountability for ensuring that risk is effectively managed across the Group. Risks are reviewed by the Executive Committee twice a year and results are brought to the Board.

The Group's principal risks are set out on pages 24 to 25.

On behalf of the Board, the Audit Committee has responsibility for reviewing the effectiveness of internal control including financial, operational and compliance controls.

In order to do this, as a matter of course in any one year, the focus of Committee includes:

- receiving and agreeing appropriate actions in response to regular reports from the Risk and Internal Audit function on:
  - the status of internal control and risk management systems across the Group;
  - the department's findings, annual plan and the resources available to it to perform its work; and
  - any concerns expressed by colleagues about possible malpractice or wrongdoing;
- reviewing financial whistleblowing reports from colleagues;
- reviewing the external auditor's report on internal financial control;
- seeking reports from senior management on the effectiveness of the management of key risk areas; and
- monitoring the adequacy and timeliness of management's response to identified audit issues.

These systems and processes have been in place throughout the period and up to the date of approval of this Annual Report.

The main features of the Group's internal control and risk management systems relating to the accuracy and reliability of financial reporting, including the process for preparing consolidated accounts, are:

- the recruitment of suitably qualified and experienced finance colleagues;
- the segregation of duties, clear lines of accountability and delegation of authority;
- policies and procedures that cover financial planning and reporting, preparation of financial information, and capital expenditure;
- a robust period end review process including review and commentary from process owners;
- a tiered review process for external financial reports involving internal stakeholders from relevant areas of the business;
- information and data security policies and procedures; and
- self certification by each function of the business.

The Committee regularly reviews the Group's process for risk management and internal control and annually conducts a formal review of these processes. No significant failings or weaknesses of internal control were identified during these reviews. Limited weaknesses and areas where controls could be further automated were identified. Clear action plans are in place to address these weaknesses and are captured as part of functional risk registers with defined management responsibility.

The Committee understands the importance of a robust risk management process and control environment and looks to progressively strengthen it over time.

Internal Audit

The Committee is regularly updated on the work and findings of Internal Audit throughout the year, including:

- approval of the terms of reference of the Internal Audit function;
- approval of the Internal Audit plan for the year;
- review of findings from work of Internal Audit completed during the year; and
- review of the effectiveness of the Internal Audit function.

The review of the effectiveness of Internal Audit conducted during the year took the form of a survey completed by Non-Executive Directors, members of the Executive Committee and Leadership Team and other key stakeholders. The effectiveness assessment also included a comparison to the Institute of Internal Auditors Best Practice standard. An external review of the effectiveness of Internal Audit is conducted every five years.

External audit tenure

As noted in last year's Annual Report, the Board appointed PricewaterhouseCoopers LLP (PwC) as external auditor in June 2014. The lead audit partner, Andrew Paynter has held the position for three years.

The Group confirms that it has complied with the provisions of the Competition and Markets Authority's Order in respect of The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014.

Each year the Audit Committee considers the effectiveness and independence of the external auditors in making the decision regarding the proposal of re-appointment of the auditors, which is tabled each year at the AGM.

Independence of the external auditor

The independence and objectivity of the Group's external auditors is a fundamental safeguard which the Committee keeps under review. In order to ensure the independence of PwC during the year, the Committee has:

- considered the terms, areas of responsibility, duties and scope of work of the external auditor as set out in the engagement letter;
- considered the Group's policy for provision of non-audit services;
- reviewed details of the non-audit services provided in the year;
- considered the letter from the external auditor confirming its independence and objectivity; and
- understood and approved the basis for the audit fee.

The policy on the engagement of the external auditor to supply non-audit services is set out in the investor relations section of the Group's website (see www.morrisons-corporate.com). PwC has provided certain non-audit services throughout the year. This was in line with the policy and the ratio of audit to non-audit services was within the 1:0.7 limit set in the policy. Details of the external auditor's remuneration is disclosed in note 1.6 of the financial statements. The Committee is satisfied that this non-audit activity carried out by the statutory auditors is subject to safeguards to avoid a threat to the auditor's independence or objectivity. These safeguards include separate teams for audit versus non-audit work.

Effectiveness of the external auditor

The Committee considered the effectiveness of PwC as auditor during the year. The Committee holds meetings with the auditor without management present. The purpose of these meetings is to understand the auditor's views on the control and governance environment and management's effectiveness within it.

When assessing the effectiveness of the external auditor, the Committee considered:

- the content and quality of the audit work plan for the Group;
- the detailed findings of the audit, including a discussion of any major issues that arose during the audit;
- management's responses to the auditor's findings;
- the quality and knowledge of the audit team;
- the level of professional scepticism and independence applied; and
- the output of an effectiveness survey completed by the Directors and management.

An independent assessment of the effectiveness of the external auditors is conducted annually by Internal Audit. The assessments takes the form of a questionnaire gathering feedback from key stakeholders including Non-Executive Directors, Executive Committee members and other key members of the management team. The survey covers the robustness of audit approach, quality of reporting and quality of people and services.

Corporate Compliance and Responsibility Committee

Activities in 2017/18

During the year, the Corporate Compliance and Responsibility Committee has reviewed:

- GSCOP compliance including training and results of internal reviews;
- cyber and technology security risk;
- health and safety incidents and actions taken and progress of health and safety initiatives;
- energy strategy and carbon reduction measures;
- ethical trading;
- redistribution of food waste;
- food safety and improvements;
- Market Abuse Regulation compliance;
- food integrity and testing;
- plastic waste;
- General Data Protection Regulation (GDPR);
- supply chain human rights;
- modern slavery; and
- non-financial whistleblowing reports.

More detail on the Group's Corporate responsibility activities can be found on page 21.

Nomination Committee

Activities in 2017/18

During the year, the Nomination Committee has:

- reviewed colleagues throughout the organisation including diversity, succession planning, capability and capacity. More information on this can be found on pages 14 to 15;
- recommended the appointments of Tony van Kralingen and Kevin Havelock to the Board; and
- considered the Board's structure.

Diversity

At the end of the 2017/18 financial year, the Board included two female members representing, 22% of its total composition. The Board's policy is that female representation should be maintained at not less than 20% and aspires that this should be higher than 30%. The Executive Committee comprises one woman and five men, resulting in 17% female representation. The diversity of the Leadership Team and a review of the diversity of the general population of Morrisons colleagues is outlined on page 15 of this report.

The Committee also adhere to the Group-wide policy on diversity and inclusion.

Other areas of focus

The Committee spent time reviewing succession planning for both the Board and Executive Committee as well as reviewing the talent pool for levels below Executive Committee.

Board appointments

The Committee follows a rigorous approach for selecting and recommending the appointment of Non-Executive Directors.

The Group appointed Ridgeway Partners to assist in identifying a long list of candidates with the requisite skills and experience for the role of Chair of the Remuneration Committee. Ridgeway was deemed independent with no other connections to the Group. From Ridgeway's search, Tony van Kralingen was identified as a suitable candidate for this role and added to a shortlist of potential candidates. Potential candidates were then interviewed by the Chairman and other Directors, following which Tony was put forward to the Nomination Committee for their consideration.

Through advisers Stork & May, the Group was advised that Kevin Havelock was stepping down from his role as Executive Committee Member at Unilever PLC. Kevin was seen as having an excellent balance of fast moving consumer goods industry based skills, particularly in relation to brand and digital marketing, that would considerably enhance the strength of the Board. Following interviews with the Chairman and other Directors, Kevin was proposed to the Nomination Committee for appointment to the Board as a Non-Executive Director. The Committee felt it highly unlikely that external searches would identify other candidates who would improve on the specific knowledge and expertise that Kevin offers the Group. Stork & May are deemed independent of the Group.

Directors' remuneration report

Annual statement by the Chairman of the Remuneration Committee

"On behalf of the Board, I am pleased to present the report on Directors' remuneration for 2017/18"

Tony van Kralingen, Remuneration Committee Chair

Dear Shareholder

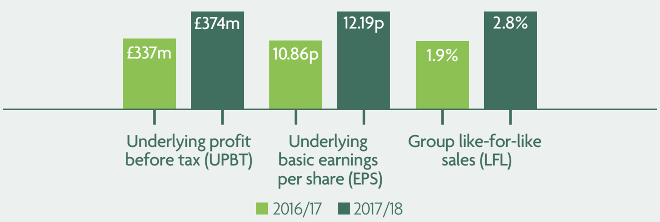
This is my first report having been appointed as a Non-Executive Director and Chair of the Remuneration Committee in September 2017. My priorities in the six months since my appointment have been to:

- understand the business, meet with management and colleagues and learn about Morrisons past, present and future;
- meet with our shareholders and their representatives to understand their views on pay following the 2017 AGM outcome;
- review 2017/18 pay outcomes relative to short and long-term business performance and the shareholder experience; and
- determine how the remuneration policy will be implemented in 2018/19, enhancing the level of transparency in our remuneration determination process.

I address each of these areas in turn below:

Understanding what makes Morrisons

I have joined a business in turnaround – to paraphrase Winston Churchill, this is not the beginning of the end, but it is perhaps the end of the beginning, and our aim is to ensure sustainable progress. Management assumed responsibility for a business which had experienced three years of continuous like-for-like sales decline, falling profits and increasing levels of debt. Talking to investors, I know they are understandably pleased with the performance of the business and recognise that management has been pivotal in fixing the core business. Equally they praise management for their innovative and capital light ways of delivering growth.



Alongside management's strong performance is a colleague-led turnaround. Central to this philosophy has been investing in colleague pay – over the last few years hourly pay for front line colleagues has risen faster than any of the supermarkets, from £6.83 per hour in 2015 to £8.70 per hour in April 2018 (an increase of over 25%). Colleagues are also sharing in the value they create, from the Sharesave scheme which matured in 2017/18 providing a significant gain, to the spend on colleague bonus which has increased again this year. In addition, all parts of our business reported improved colleague engagement, which has no doubt led directly to the increase in customer satisfaction.

Over the last few years we have also rediscovered the proud history that makes Morrisons unique – we are food makers and shopkeepers – and we are winning customers back.

From a shareholder perspective, in the three years since David Potts' appointment and embarking on Fix, Rebuild and Grow, the business has generated:

- nine consecutive quarters of positive like-for-like sales;
- 8% increase in underlying profit before tax, or 24% on a two year basis;
- c.£2bn of free cash flow; and
- 22% increase in share price.

In 2017/18, this positive performance continued with the key highlights including:

- a second annual increase in like-for-like sales (2.8%, excluding fuel);
- growing like-for-like customer transactions by 2.9%;
- an 11% increase in underlying profits before tax; and
- further strong free cash flow and a 4.00p special dividend, taking full year total dividend up 85.8% to 10.09p.

How our Directors' remuneration report is structured

Responding to feedback on Executive remuneration

In taking on the role of Remuneration Committee Chair, I was keenly aware of the voting outcome at the June 2017 AGM, where the new remuneration policy for Directors was approved with 92% in favour, but last year's remuneration report only received 52% in favour. I have engaged with shareholders to understand that gap, and listened to their concerns about remuneration. I wish to extend my sincere thanks to those who have taken the time to share their views and help us in this process.

Although there was inevitably some divergence of views expressed by investors on particular items, I observed two consistent themes relating to:

- a need for greater transparency in how targets are calibrated which contributed to the perception that there was a lack of stretch attached to the 2017-20 Long Term Incentive Plan (LTIP) targets; and
- a better understanding of the Committee's target setting process which created doubts as to whether our due diligence is sufficiently robust.

Notwithstanding that feedback, all shareholders we spoke to recognised the highly effective job that management are doing to turn the business around, and were keen that they are retained and appropriately incentivised.

How we are responding

Improving transparency

The feedback noted that the rationale and context to accompany the 2017-20 LTIPs could have been clearer, to help evaluate the level of stretch.

In response, the Committee has enhanced the narrative to accompany targets in this Directors' remuneration report and all relevant definitions are clearly presented in one place (see page 45) to remove any ambiguity and potential for misinterpretation, so our investors are able to make a fully informed determination of the target stretch.

Restoring confidence

Food retailing is fast paced, adapting to fundamental shifts in consumer behaviour. The performance of the sector is subject to intense scrutiny and what stretch performance looks like constantly evolves. Setting targets is therefore inherently challenging, but I wish to reassure our investors that the Committee subjects targets to a robust due diligence process as follows:

- targets are determined shortly before announcement of our preliminary financial results and prior to analysts updating their forecasts for both Morrisons and the food retailing sector, thus the Committee must exercise a degree of judgement;
- as Board Directors, each member of the Committee benefits from knowledge of business plans, strategic initiatives, projected cash flows and performance data which form primary reference points when determining the appropriateness of proposed targets. This information is supplemented by economic indicators, competitor analysis and the latest available analyst projections for the industry. The Committee also seeks the independent counsel of its advisers who subject targets to complex probability analysis; and
- having been presented with this information the Committee purposefully adjourns to allow for individual deliberation and provision of any additional information. On reconvening, each Committee member is asked to feedback their individual view on each target before the Committee collectively approve the targets by majority vote.

Pay for performance

Outcomes in 2017/18

It is the policy of the Committee to ensure that superior reward should only be received for superior performance. The food retail industry continues to be highly competitive for both customers and talented management. Looking at the industry, many of our competitors have reported decreasing profits and like-for-like sales, so both in absolute and relative terms, the team are outperforming the market.

Over the last 12 months management has delivered another four consecutive quarters of like-for-like sales growth (making nine in succession) resulting in the Company achieving:

- like-for-like sales growth of 2.8% (excluding fuel) and, for the first time since 2011, two consecutive years of positive like-for-like sales growth;
- underlying profit before tax of £374m, an increase of 11% on last year; and
- further progress in cost and productivity savings, and sustained improvements across a number of areas of the business including productivity and procurement of goods not for resale and loss prevention savings, resulting in cost reduction/productivity improvement of £195m.

As a consequence of this performance the Committee has approved a bonus payout of 98.7% of maximum for Executive Directors of which 50% will be deferred into shares which must be held for three years.

LTIP 2015-18

The 2015-18 LTIP outcome is the first to reflect the turnaround in Morrisons performance since David Potts was appointed, and started the Fix, Rebuild and Grow plan. At the time David assumed the role of Chief Executive, Morrisons reported full year like-for-like sales of (5.9)% and net debt at £2.3bn. The team has strengthened the balance sheet, grown like-for-like sales and done so profitably. This has resulted in a share price which has outperformed the FTSE 100 (1 March 2015 to 1 March 2018) over the period, and shareholders are rightly pleased with the performance.

The performance over the period is summarised below:

Measure[1,2]	Min (25%)	Max (100%)	Weighting	Actual performance
Total sales (exc. fuel)	£12.7bn	£13.2bn	20%	£13.5bn
Adjusted free cash flow	£850m	£1,600m	60%	£2,053m
Underlying earnings per share (EPS)	10p	15p	20%	12.19p

1 See the definitions on page 45.
2 Additional detail on page 48.

It is also important to note that during this period, management increased external guidance for working capital improvement (from £600m to £1bn) and for disposal proceeds (from £1bn to £1.1bn); this has resulted in management exceeding the targets significantly on free cash flow – a measure that investors have told us is extremely important to them, as well as on sales, which is a key measure of the health of a food retailer.

The LTIP is vesting at 96.3% of maximum, which the Committee believe is reflective of the value created for shareholders over the period.

Implementation in 2018/19

Base Salary

The Committee awarded both David Potts and Trevor Strain an increase of 2.4% (in line with the wider workforce). David has again waived his increase, and his salary therefore remains unchanged since his appointment.

Annual Bonus

The performance measures and weightings remain unchanged. Subject to no longer being commercially sensitive, the performance against targets will be disclosed in next year's report.

LTIP

In line with the policy approved by shareholders last year, awards will be 300% of salary. Performance measures and weightings are unchanged from the previous year. Further detail on the targets can be found on page 44.

I look forward to your support at the 2018 AGM.

Tony van Kralingen
Remuneration Committee Chair

Directors' remuneration report continued

At a glance

Looking at how we've performed through the perspective of shareholders, customers and colleagues

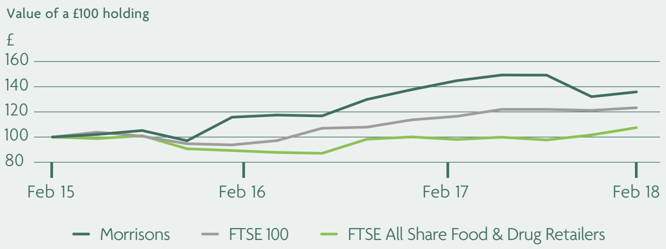
Three year summary of financial measures

Measure[1]	2017/18[2]	2016/17	2015/16
Underlying profit before tax (UPBT)	£374m	£337m	£302m[3]
Underlying basic earnings per share	12.19p	10.86p	7.77p
Group like-for-like (LFL) sales (exc. fuel) (%)	2.8%[4]	1.9%[4]	(2.0)%
Cumulative adjusted free cash flow (2015/16 onwards)	£2,053m	£1,656m	£874m

1 Definitions of these measures are set out on page 45.
2 2017/18 is a 53 week year. Underlying profit before tax and underlying basic earnings per share are with with reference to the 53 week period. Group like-for-like has been calculated on a 53 week versus 53 week basis.
3 2015/16 UPBT adjusted for £60m one-off costs.
4 2017/18 and 2016/17 include wholesale contribution to LFL. No impact on 2015/16 LFL sales.

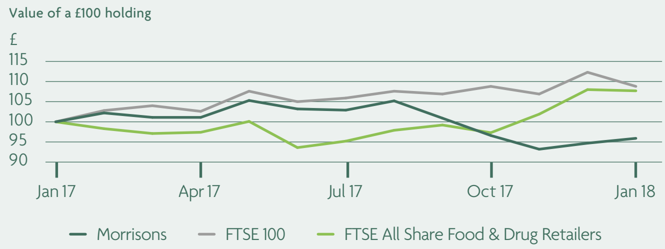
Key shareholder performance indicators

Three year total shareholder return (TSR)



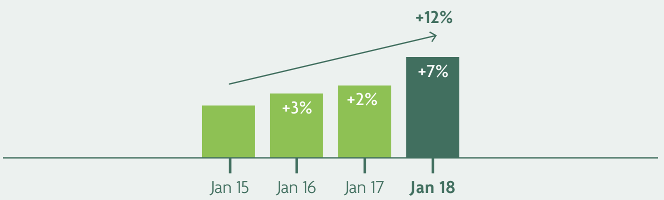
The graph above shows the Group's total shareholder return (TSR) compared with the TSR of the FTSE 100 and FTSE All Share Food & Drug Retailers indices over the three year period to 2 February 2018 (the last trading day before the year end).

12 month total shareholder return (TSR)



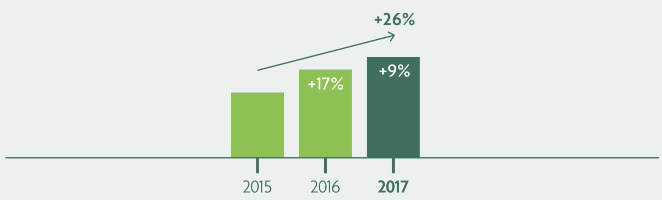
The graph above shows the Group's total shareholder return (TSR) compared with the TSR of the FTSE 100 and FTSE All Share Food & Drug Retailers indices over the 12 month period to 2 February 2018 (the last trading day before the year end).

Customer satisfaction



The above graph demonstrates the continued progress the Group has made in terms of customer satisfaction over the last three years.

Colleague satisfaction with pay



Colleagues' satisfaction with their pay continues to improve as a result of the positive changes we have made to colleague pay in each of the last three years, as portrayed above, and described in the section on pay and conditions across the business on page 45.

Directors' remuneration report continued

Directors' remuneration policy
Approved 15 June 2017

This part of the report sets out a summary of the Group's policy for the remuneration of Executive and Non-Executive Directors as approved by shareholders on 15 June 2017 at the AGM. The full policy can be found on page 37 in the 2016/17 Annual Report and Financial Statements (www.morrisons-corporate.com/annual-report-2017). The policy took effect from this date and may operate for up to three years.

The principles that underpin our Directors' remuneration policy are:

1 Doing what is right for the business in the long term	**2** Continuing to deliver sector superior returns to shareholders	**3** Providing clear alignment of Directors and shareholders	**4** Ensuring competitive pay in a talent hungry market	**5** Ensuring lock in of Directors as we deliver Fix, Rebuild and Grow

Executive Directors – policy table

ELEMENT	OPERATION	OPPORTUNITY	PERFORMANCE MEASURES AND PERIOD
Base salary	The Committee's policy is to set base salaries competitively to attract and retain the best talent, which is critical to the Group's success and delivery of the strategy. Base salary is part of a total remuneration package which rewards stretching performance aligned to the Group's strategy. Base salaries are set by the Committee on appointment and then normally reviewed annually. In setting and reviewing salary levels, the Committee considers the responsibilities of the role, progression in the role, individual performance (including any change in responsibilities), skills, experience, and pay levels and structure throughout the Group. The Committee also has regard to rates for similar roles in comparator companies, both in FTSE 100 retailers and UK-based companies of a similar size and complexity, but seeks to avoid the automatic ratcheting effects of following benchmark levels of salary.	Salary increases will ordinarily be in line with salary increases across the Group. The Committee may award increases above this level where this is warranted due to a change in the scope or responsibilities of the role, to reflect progression in the role (for example, staged increases for a recent appointment) or to remain competitive in the market. Current base salary levels are disclosed on page 44.	Not applicable.
Benefits	The Group provides a market competitive benefits package for Executive Directors to support in the ability to recruit and retain the best talent. Executive Directors are entitled to a car allowance (or other car benefit), transport costs, private health provision, life assurance and normal colleague discount entitlement. Executive Directors are also entitled to participate in the all colleague Sharesave schemes (and any other all colleague share plan which the Group may operate) on the same terms as all other UK-based colleagues. The Committee reviews benefit provision from time-to-time and retains flexibility to add or remove benefits if necessary to ensure that benefit provision remains market competitive or to meet the operational needs of the business (for example, through the payment of relocation expenses).	The maximum car allowance is currently £24,000. The cost to the Group of providing other benefits depends on the nature of the benefit and can vary from year-to-year. Benefit provision will be maintained at a level which is competitive.	Not applicable.
Pension	The Group provides a market competitive retirement provision for Executive Directors which is aligned with retirement benefits available throughout the Group. Executive Directors are entitled to membership of the Group's cash balance pension arrangement known as the Morrisons Retirement Saver Plan. Individuals contribute 5% of capped base salary in return for a guaranteed cash balance. A 10% cash salary supplement in lieu of Group pension contributions applies on base salary above the capped amount. A cash alternative to pension provision is provided where the Group's standard pension provision is not appropriate, for example, where an Executive Director has reached the Lifetime Allowance. Executive Directors may elect to receive this cash salary supplement in lieu of pension of broadly the same value as would accrue on an annual basis in the pension plan.	The Morrisons Retirement Saver Plan guarantees a value of the cash balance in the plan of 24% of pensionable pay (assuming retirement at age 65 years) adjusted for inflation capped at 2% p.a. A maximum 10% cash salary supplement applies above capped base salary. Where an Executive Director receives a cash salary supplement only, the maximum supplement payable is 25% of salary.	Not applicable.

Directors' remuneration report continued

Directors' remuneration policy

Approved 15 June 2017

Executive Directors – policy table

ELEMENT	OPERATION	OPPORTUNITY	PERFORMANCE MEASURES AND PERIOD
Annual bonus	Annual bonus awards are designed to incentivise and reward achievement of the Group's short-term financial and strategic objectives and personal performance objectives. Compulsory deferral is designed to encourage retention and further align the interests of the Executive Directors with shareholders. Bonus awards are made annually subject to a mix of financial and non-financial performance measures. Achievement of each performance element is assessed independently and the level of payout is determined by the Committee after the end of the relevant financial year. 50% of any bonus payable is paid in cash with the other 50% deferred in shares under the deferred share bonus plan (DSBP), normally for a period of three years. The Committee has discretion to allow a higher level of deferral. Dividend equivalents accrue over the vesting period and are paid at the time of vesting on the number of shares that vest.	The maximum bonus potential for Executive Directors is 200% of base salary. The number of shares subject to the deferred award is determined by reference to the bonus and the share price on the date of award.	Annual bonus awards are subject to the following performance measures: • 50% is based on underlying profit before tax; • 30% is linked to achievement of a number of strategic scorecard measures; and • 20% is linked to achievement of personal objectives. The measures and weightings are set by the Committee on an annual basis, and may be changed if the Committee decides this is appropriate to support delivery of the Group's strategy. Each element is assessed independently at the end of each year. Achievement of threshold performance will result in a payout of 20% of the underlying profit element (i.e. 10% of the maximum bonus potential). Achievement of one of the strategic scorecard measures or one of the personal objectives is regarded as threshold performance for that element. Deferred share awards are not subject to any further performance conditions. Awards will normally vest three years after the date of award but may be forfeited if the individual leaves employment before the vesting date. The Committee has discretion to award 'good leaver' status.
LTIP	Awards under the LTIP are designed to incentivise and reward achievement of the Group's long-term strategic objectives and creation of sustainable value for shareholders through execution of the strategy. Awards are made annually subject to performance measures set by the Committee, which are aligned with business strategy and the Group's financial plan. The Committee has the discretion to change the weightings of measures, remove measures or introduce new measures to support delivery of the Group's objectives and strategy. Achievement of each element is assessed independently. Awards will normally vest three years after the award is made. The Committee retains discretion to introduce a holding period which would apply after the award has vested. Dividend equivalents accrue over the performance period and are paid at the time of vesting on the number of shares that vest.	The maximum annual individual award level under the plan is 300% of salary. The annual award level for Executive Directors is 300% of salary.	LTIP awards are subject to the following performance measures: • 40% is based on cumulative adjusted free cash flow; • 40% is based on total sales growth (excluding fuel and VAT); and • 20% is based on underlying basic earnings per share (EPS) growth. Achievement of threshold performance will ordinarily result in vesting of 25% of each element with 100% vesting for maximum performance. However, the Committee has discretion to reduce the level of vesting at threshold. There is a ROCE underpin which allows the Committee to adjust vesting of awards if ROCE is below the weighted average cost of capital (WACC). For all awards, the Committee has the discretion to adjust the vesting calculations as set out in the 'Implementation of the remuneration policy in 2018/19' section. The Committee has the discretion to amend the weightings, introduce new measures and exclude measures in order to best align to long-term shareholder interests. Malus and clawback policies apply.

Other key features of policy:

Service contracts

Our policy is for Executive Directors to have rolling service contracts with a notice period of 12 months. On an exceptional basis, to complete external recruitment, a longer initial period reducing to 12 months might be used.

At its discretion, the Group may pay in lieu of notice. Payment in lieu of notice could potentially include up to 12 months base salary, benefits and pension, but is payable in instalments and subject to mitigation.

Under the Annual Bonus and LTIP scheme rules, the Committee has discretion in relation to termination of employment.

Termination payments summary

CIRCUMSTANCES OF TERMINATION	SALARY AND CONTRACTUAL BENEFITS	ANNUAL BONUS PLAN	UNVESTED DEFERRED SHARES	UNVESTED LTIP AWARDS
Resignation or gross misconduct	Paid to date of termination	No bonus paid for year of termination	Award lapses when employment ends	Award lapses when employment ends
Injury/ill health, disability, death, retirement (with agreement of the Group)	Paid to date of termination	Eligible to be considered for a bonus, calculated on a time pro-rata basis	Deferred shares are retained and will typically vest on the normal three year cycle. The Committee has discretion to bring forward vesting in exceptional circumstances	Eligible to be considered for good leaver status, which gives entitlement to retain the award granted calculated on a time pro-rata basis
Negotiated termination at the discretion of the Committee	Paid to date of termination	As above	As above	At the Committee's discretion, may be eligible to be considered for good leaver status, which gives entitlement to retain the award granted calculated on a time pro-rata basis

Approach to new hires

Prior to appointment, the Committee will apply the following principles in agreeing the remuneration of Executive Directors:

- the overall package will be sufficient to attract and retain the best talent to effectively deliver the Group's strategy, taking into account similar positions in the market, experience of the candidate and current remuneration;
- the Committee will look to align the base salary, benefits, pension benefits, Annual Bonus and LTIP, in line with the remuneration policy whilst taking into account the individual circumstances (including compensation for loss of remuneration from a previous employer) of candidates and existing Executive Directors; and
- the maximum variable pay opportunity will be 500% of salary. Up to 200% may be earned under the Annual Bonus Plan, and up to 300% may be granted under the LTIP. This would be separate to arrangements required to recruit the preferred candidate.

Chairman and Non-Executive Director fees

Fees for the Non-Executive Directors (NEDs) are determined by the Chairman and the Executive Directors, and are reviewed from time-to-time with regard to the necessary time commitment, and the level of fees in comparable companies. The Chairman's fee is determined by the Remuneration Committee and the Board, and is reviewed on the same basis. Fees for the NEDs are made up of a base fee, plus additional fees for Committee chairmanship, Committee membership and for the appointed Senior Independent Director. The Chairman receives a single fee only with no additional fees for other duties to the Group.

Current NED fees are as follows:

Fee type	Annual Fee
Chairman	£400,000
Senior Independent Director	£20,000
NED base fee	£61,200
Committee chair fee	£20,000
Committee membership fee	£7,000 (per Committee)

Benefits and other items in the nature of remuneration

The Chairman has use of a car and driver and receives private health provision. The Chairman and NEDs are entitled to normal colleague discount. Neither the Chairman nor any of the NEDs participate in any Group incentive scheme.

Directors' remuneration report continued

Implementation of remuneration policy in 2018/19

Base salary

Annual base salaries for the Executive Directors are set out below:

The Committee awarded David Potts and Trevor Strain a pay rise of 2.4%, in line with the wider workforce. As in previous years, David has waived his pay award and his salary remains unchanged since his appointment at £850,000. Trevor Strain's new salary is £610,560.

Benefits and pension

David Potts and Trevor Strain receive a pension supplement of 25% and 24% of base salary respectively. This is consistent with Morrisons Retirement Saver Pension Scheme, which guarantees a cash balance of 24% of salary for each year of membership for store managers and above.

Annual Bonus

The structure of the bonus, including maximum potential (200% of salary) and the requirement to defer 50% of any bonus in shares under the DSBP is in line with the Directors' remuneration policy (summary on pages 41 to 42).

The performance measures and weightings are unchanged from previous years:

Measure[1]	Weightings (% of maximum bonus opportunity)
Underlying profit before tax	50%
Strategic scorecard	30%
Personal objectives	20%

1 Performance measures are defined on page 45.

Scorecard measures for 2018/19 will continue to focus on strategic objectives in the areas of like-for-like sales growth (20%) and productivity improvement/cost reduction (10%).

Personal objectives will be linked to strategy.

Detail on the performance targets is regarded as commercially sensitive at this time and cannot be disclosed here. Subject to no longer being regarded as commercially sensitive, targets will be disclosed in next year's remuneration report.

LTIP

2018-21 LTIP target setting

In setting this year's targets, the Committee reviewed past LTIP targets and performance, the Group's strategic plan, current market performance, and those analysts' estimates that were available at the time. The Committee also analysed the targets through a variety of lenses to assess the level of stretch. Unattainable or inappropriate targets, such as exaggerated focus on short-term margin expansion, are not in the best long-term interests of any stakeholders. Instead, the Committee is striving to set targets that achieve the right balance between continuing to drive the turnaround, maximising shareholder returns and incentivising management to prioritise consistent and sustainable growth over short-term profit.

Through the consultation process it was clear that shareholders feel the current performance conditions and weightings are aligned to the strategy, and therefore these remain unchanged. The Committee also noted the benefit of consistent measures to allow performance over time to be clear.

In line with the policy approved by shareholders, the LTIP awards for David Potts and Trevor Strain for 2018/19 will be 300% of salary.

LTIP targets 2018-21

The targets for the 2018-21 LTIP are in the table below:

Measure[1,2]	Weighting	Threshold	Mid point	Maximum
Total sales growth (exc. fuel)	40%	£1.1bn	£1.3bn	£2.0bn
Adjusted free cash flow	40%	£730m	£820m	£1bn
Underlying basic EPS growth	20%	5%	7%	10%

1 Performance measures are defined on page 45.
2 Vesting is on a straight-line basis between threshold and maximum.

The Committee has the discretion to adjust these calculations for material exceptional events or actions (which may include strategic changes to capital expenditure approved by the Board and material acquisitions or disposals) which were not in the contemplation of the Committee at the time the targets were set and which might otherwise materially distort the outcome, in order to ensure the vesting of the LTIP is an accurate and fair reflection of performance. If the Committee exercises its discretion to amend the calculation, a full disclosure of the reason for the amendment and an explanation of the impact will be given in the relevant annual report on remuneration.

Given the pending changes on lease accounting (which impact all companies reporting under IFRS) for the purposes of the LTIP reporting, standards in place at the time of grant will be used in calculation of vesting.

There is a ROCE underpin which allows the Committee to adjust vesting options if ROCE is below weighted average cost of capital (WACC).

Sales growth

The maximum growth target is an increase of £2bn over a 2017/18 52 week equivalent base (excluding fuel) of £13.3bn which is equivalent to c.5% total sales growth per annum (excluding fuel). This is a significant step up in the growth ambition, in the context of a company that had experienced 16 quarters of continuous sales decline only three years ago.

During consultation, some shareholders asked whether potential food inflation could boost sales. At Morrisons, inflation does not typically help sales performance as our customers' budgets do not increase as prices go up. The Committee will take into account, as they deem appropriate, any impact of inflation or deflation on sales performance.

For the sales targets, as set out in the Directors' remuneration policy, the Committee will retain the discretion to adjust the targets in the event of material disposals or store closures during the performance period which were not taken into account at target setting.

Adjusted free cash flow

Our definition of free cash flow for the purposes of the LTIP is the same as in previous years. The definition is provided on page 45. This year's target follows a successful three year programme of property disposals and working capital which is now mostly complete, with c.£2bn of improvements delivered. For the three year period since 2015/16 delivery adjusted for property disposals, working capital and onerous capital payments was c.£700m. This is c.5% below the threshold of the 2018-21 target. Despite strong progress, the high level of property disposals and working capital generation already achieved, management remain focused on this key measure and the mid-point of the new range is £20m above the maximum level for the 2017-20 LTIP.

Underlying basic EPS growth

The definition of underlying basic EPS is set out in definitions on page 45. The maximum growth target is an increase of 10% p.a over a 2017/18 52 week equivalent base of 12.03p.

In setting the target in January 2018, the Committee took into account analyst estimates available at the time, which were for the first two years of the LTIP only. Underlying EPS performance in this range will require the business to deliver sales growth on growth over a number of years, and achieving the maximum 10% underlying EPS growth each year, would likely be a strong relative performance particularly when comparing to historic performance and competitor experience in 2017.

When setting the target, the Committee was mindful of the lessons learned in the recent past when some UK food retailers were focused on short-term profitability ahead of remaining competitive for customers, and became less relevant for customers over time. EPS growth cannot be disconnected from shopping trip improvements. The targets are designed to prioritise consistent and sustainable long-term growth.

Chairman and Non-Executive Director fees

Fees for the Chairman and NEDs remain unchanged from those payable in 2017/18 and as set out in the summary of the remuneration policy on page 43.

Directors' remuneration report performance measures definitions

Annual Bonus Performance Measures

Measure	Definition
Group financial	
Underlying profit before tax	As defined in the Glossary on page 127
Strategic scorecard	
Group like-for-like sales growth (exc. fuel)	As defined in the Glossary on page 127
Productivity improvement/ cost reduction	Cost savings from productivity and cost reduction delivered in the year
Other measures	
Personal objectives	Personal objectives are linked to delivery of the strategy

Long Term Incentive Plan (LTIP) Performance Measures

Measure	Definition
Total sales growth (exc. fuel)	The change in total sales (excluding fuel and VAT) over the performance period of the award Total sales (excluding fuel and VAT) is defined in the Glossary on page 127
Adjusted free cash flow	The cumulative adjusted free cash flow over the performance period of the award Adjusted free cash flow is defined as: • Cash generated from operations • Less: Interest and tax • Plus: Property disposal proceeds (excluding sale and leaseback) • Less: Capital expenditure • Plus: Onerous payments
Underlying basic earnings per share (EPS) growth	The percentage change in underlying basic earnings per share (EPS) per annum over the performance period of the award Underlying basic earnings per share is defined in the Glossary on page 127

Note for the 2018-21 LTIP, sales and EPS growth will use 2017/18 52 week equivalent numbers as a base as set out on page 44.

Pay and conditions in the wider group – investing in a colleague-led turnaround.

One of our ambitions for colleagues is 'a fair day's pay for a fair day's work'. The Board receive regular updates on progress against this ambition. We are delighted that colleague satisfaction with pay has increased over 26% over the last three years, reflecting our substantial investment in both pay and working conditions.

In 2016, the colleague hourly rate in stores was increased from £6.83 to £8.20. Last year we increased all store colleagues to £8.50 – the highest of the 'big 4' grocery retailers and will increase again this year, to an hourly rate of £8.70. Colleagues are sharing in the value they create, with colleague bonus levels continuing to increase, from an average payment for applicable colleagues of £164 in March 2016, £276 in March 2017 and £350 in March 2018.

Following feedback from our listening and responding channels, we launched two new benefit schemes this year. The first is a more affordable pension scheme, with lower colleague contribution rates. 27,000 colleagues not previously in a pension scheme are now enrolled in it, and with new joiners there are around 30,000 colleagues benefiting.

The second is a new website, which offers a range of discounts to colleagues such as discounted cinema tickets, meals out and savings at high street retailers. This has proved extremely popular, with average monthly savings of £17 per user – equivalent to another two hours pay.

Colleagues have the chance to participate in an annual Sharesave scheme, offering share options at the maximum 20% discounted option price.

As part of our Fresh Look programme, we have underlined our commitment to a colleague-led turnaround by refurbishing colleague areas, many of which had not been refreshed for some time.

In June 2016, we launched a Group-wide listening and responding channels for colleagues called 'Your Say'. Stores and sites each have a monthly meeting, regional quarterly meetings and a national meeting twice a year. As the Chair of the Remuneration Committee, Tony van Kralingen will attend the national 'Your Say' forum, to hear views from colleagues on a range of issues, not just remuneration. Improvements that have been made as a result of colleague feedback include upgrading the scanners at our check out tills, making price reduction labels easier to scan, upgrading all our hand held terminals in-store and replacing all the shop floor printers. Our colleagues are passionate about our business, and engage with energy on how we can help them to simplify and speed up their roles, to enable them to put customers first.

Directors' remuneration report continued

Annual report on remuneration

Audited information

Single total figure of remuneration

The table below sets out the single total figure of remuneration and breakdown for each Director for 2017/18 and the comparative figure for 2016/17.

	2017/18						2016/17					
	Salary/fees £000	Benefits[1] £000	Annual[2] bonus £000	LTIP[3] £000	Pension[4] benefits £000	Total £000	Salary/fees £000	Benefits £000	Annual bonus £000	LTIP[5] £000	Pension[4] benefits £000	Total £000
Executive Directors												
D Potts	850	27	1,678	3,042	213	5,810	850	31	1,700	–	213	2,794
T Strain	596	35	1,177	1,503	143	3,454	575	35	1,150	809	138	2,707
D Philips	–	–	–	–	–	–	–	–	–	366	–	366
Non-Executive Directors												
A Higginson	400	24	–	–	–	424	400	15	–	–	–	415
R Anand	102	–	–	–	–	102	92	–	–	–	–	92
P Vennells	89	–	–	–	–	89	76	–	–	–	–	76
T van Kralingen	35	–	–	–	–	35	–	–	–	–	–	–
N Davidson	102	–	–	–	–	102	92	–	–	–	–	92
B Richards	102	–	–	–	–	102	92	–	–	–	–	92
I Lee[6]	–	–	–	–	–	–	54	–	–	–	–	54

1 Taxable benefits for the Executive Directors include a car allowance (or other car benefit), transport costs and private health provision. The Chairman has use of a car and driver for Group business and receives private health provision. For 2017/18, the figure disclosed for the Chairman includes tax paid via PAYE settlement agreement. All Directors receive the Group's normal staff discount entitlement which is not taxable. Applicable Sharesave awards granted in given financial years are also included in this figure.
2 50% of the annual bonus is deferred in shares for a period of three years. There are no performance conditions attached to this deferred element.
3 Awards granted under the LTIP in April 2015 are scheduled to vest in April 2018. The performance conditions relating to the 2015-18 LTIP award ended on 4 February 2018 and the vest value of the 2015-18 LTIP award is therefore calculated on the closing share price as at 2 February 2018 (the last trading day before year end). The figures stated in the 2017/18 figures also include the value of dividends accrued on the 2015-18 LTIP award at the time of vesting. Further detail is in the table on page 48.
4 D Potts received a salary supplement equal to 25% of base salary. T Strain received a salary supplement of 24% of base salary. None of the Executive Directors have a prospective entitlement to a defined benefit pension by reason of qualifying service.
5 The value of the 2014-17 LTIP vest that was disclosed in the 2016/17 Directors' remuneration report was based on an indicative price at 27 January 2017. The value of the 2014-17 LTIP vest has been restated to reflect the actual June 2017 vest value.
6 I Lee retired from the Board on 31 August 2016.

Annual Bonus Plan

Annual bonus achieved 2017/18

Director	Maximum bonus opportunity (% of salary)	Actual bonus (% of salary)	Actual bonus (£000)	Bonus deferred into shares (% of award)	Bonus paid in 2017/18 (£000)
D Potts	200%	197.4%	1,678	50%	839
T Strain	200%	197.4%	1,177	50%	588

Group financial and strategic scorecard

Performance measure[1,2]	Weighting (as a % of total annual bonus opportunity)	Achieved as a % of maximum: Threshold	Target	Maximum	Actual achievement	Payout (as a % of total annual bonus opportunity)
Group financial		20% payout	60% payout	100% payout		
Underlying profit before tax	50%	£338m		£371m	£374m	50%
Strategic scorecard		20% payout	50% payout	100% payout		
Productivity improvement/cost reduction	10%	£170m		£200m	£195m	8.7%
Group like-for-like sales growth (exc. fuel)	20%	0%		2%	2.8%	20%
Other measures						
Personal objectives	20%					20%

1 Performance measures are defined on page 45.
2 Targets were set for 2017/18 taking into account it is a 53 week period, and are reported on that basis. For 2018/19 like-for-like sales targets will be off the 2017/18 52 week excluding fuel sales base (£13.3bn) and for underlying profit before tax purposes the growth will be with reference to the 2017/18 base adjusted for the £5m benefit relating to the 53rd week (£369m).

As shown in the table above, management have delivered another year of strong performance which is further explained on page 47.

Underlying profit before tax

Underlying profit before tax increased by 11%, delivering just above the £371m maximum. At the time the target setting process started (end of 2016), the grocery market was facing falling consumer confidence and growing inflationary/cost pressures. The growth target challenged management to balance competing demands of growing profit while investing in the offer to be more competitive for customers, and in customer service and colleague pay (in line with our six priorities). Competitor/market performance in the year illustrates how stretching this target has been, and the strength of the performance against this measure.

Productivity improvement/cost reduction

At the start of the year, management identified significant procurement savings, resulting in a high target for a second year running. Management have performed well against this stretching target, resulting in £195m (97.5%) of this element being achieved. The maximum was set slightly lower than the previous year, given the performance in accelerating benefits in 2016/17 (delivered £269m vs max of £190m). The maximum of £200m was a very stretching target as a percentage of the cost base.

Group like-for-like sales growth (excluding fuel)

Group like-for-like sales growth (excluding fuel) was 2.8%. When the targets were set, the Group had achieved five quarters of like-for-like sales growth, following 16 quarters of decline. Therefore, this year was the first time since 2011 that management were required to grow sales on top of prior year growth in order to achieve the target. A target range of 0-2% therefore represented significant stretch given prior year performance and the ongoing intensely competitive market.

For context, the previous year's range had been (2)% to 0%, so the 2017/18 target was 200 basis points more challenging.

Personal objectives

Stretching and measurable objectives are set by the Committee at the start of the financial year, taking into account our six priorities, and the ambitions for our four stakeholders: customers, colleagues, suppliers and shareholders.

	Objective	Achievement
D Potts	Deliver key actions against our six priorities	• Invested in being competitive through 'Price Crunch', 'Way Down' and Christmas shopping list • Local food makers roadshows resulted in new locally relevant ranges in stores • Number one for checkout wait times • Significant capital investment in Fruit & Veg
	Develop capability	• Leadership development programme delivered to c.1,000 leaders • Continued investment in store manager capability • Hired 83 new store managers into Morrisons
	Start to implement strategy for a broader, stronger business	• 'Nutmeg' womenswear launched • Home & Leisure complete range reset • Strategic acquisitions in manufacturing
	Start to realise potential of Wholesale and Popular and Useful services (as part of the £75m-£125m incremental profit opportunity)	• Wholesale supply agreements signed with McColl's and Sandpiper • Continued expansion with Rontec • All cafés refurbished and new menu • Roll out of barista bars in selected areas
T Strain	Take lead on identifying opportunities and building the 2018/19 cost reduction programme	• Strong plan identified to realise cost saving opportunities across automated ordering, in-store administration, procurement of goods not for resale, and distribution
	Drive work to develop and execute plans for non-core/non-strategic assets	• Proceeds from disposals of non-core assets were £108m in the year • Proceeds from the start of the programme to monetise non-core assets now £1bn
	Deliver cash flow objectives	• Net debt below the £1bn target • Strong free cash flow delivery
	Develop our Wholesale business	• Wholesale turnover target exceeded • Safeway brand revived with McColl's supply agreement • New wholesale supply agreements signed, providing foundations for future wholesale growth
	Continue to develop and execute broad-based strategy for profitable growth	• Three sites for new stores developed for opening in 2018/19 • Petrol forecourt offer expanded • Continued strong progress with Popular and Useful services
	Lead GSCOP compliance Executive Sub Committee	• Strong progress in improving processes

Directors' remuneration report continued

Annual report on remuneration

Audited information continued

Personal objectives performance summary

The Committee carefully assessed performance against objectives at the end of the financial year. In determining the final level of bonus payable, the Committee took into account both the performance against objectives and the performance of the wider business. As well as individual objectives being delivered in full, management continue to make significant progress against our six priorities, in particular being more competitive which is improving like-for-like sales and volumes, and thereby rebuilding profitability. The Committee therefore decided to award them each the full 20%, and their total bonus achieved is 197.4%.

50% of any bonus payable is deferred in shares under the DSBP which vest three years after the date of award. Dividend equivalents will accrue and be paid on the shares that vest. Deferred shares are normally forfeited if the individual leaves the Group before they vest.

LTIP awards

2015-18 LTIP awards

Awards granted under the LTIP in April 2015 are scheduled to vest in April 2018. The performance period relating to these awards ended on 4 February 2018. Details of the performance conditions and the extent to which they have been satisfied are set out below:

Measure[1,2]	Weighting	(25%) Threshold performance required	(100%) Maximum performance required	Actual outcome	Actual LTIP vesting (% of maximum)
Total sales (exc. fuel)[3]	20%	£12.7bn	£13.2bn	£13.5bn	20%
Adjusted free cash flow[4]	60%	£850m	£1,600m	£2,053m	60%
Underlying basic earnings per share (EPS)	20%	10p	15p	12.19p	16.3%

1 Performance measures are defined on page 45.
2 Vesting is on a straight-line basis for the cumulative free cash flow and total sales (excluding VAT and fuel) measures. Intermediate vesting applies for the underlying earnings per share measure: 10p (25%), 11p (60%), 12p (80%), 15p (100%) with straight-line vesting between each point.
3 Total sales (exc. fuel) exceeded the 2015-18 target by £336m, of which £248m was due to the impact of the 53rd week. The 2018-21 £2bn sales growth target will be off a 52 week base for 2017/18 (£13.3bn).
4 The 2015-18 LTIP awards were subject to certain 'guardrails' relating to the free cash flow measure. The Committee has minimum and maximum guardrails for maintenance capital expenditure and cumulative net proceeds from property sales over the performance period. When considering vesting against the free cash flow measure, the Committee can review and adjust as appropriate in the event of operation outside the agreed parameters. The 2015-18 vesting for free cash flow was within the agreed parameters and as such no adjustment was required.

Share awards granted in 2017/18

The table below sets out the share awards made to the Executive Directors during 2017/18 under the Group's LTIP:

	Grant date	Award type	Basis on which award made	Face value of award (£)[1]	Percentage of award vesting at threshold performance	Performance period end date	Performance conditions
D Potts	22 March 2017	Conditional award	300% of salary	2,550	25%	2 February 2020	see table below
T Strain	22 March 2017	Conditional award	300% of salary	1,789	25%	2 February 2020	see table below

1 The face value in the table above has been calculated by multiplying the maximum number of shares that could vest by the average share price used to determine the number of shares awarded. The average share price used was £2.373 and this was calculated over a period of five business days prior to the date of grant.

The table below sets out the performance conditions attached to the awards made during the year. These awards were granted in March 2017.

Measure[1,2]	Period over which the measure applies	Weighting (% of maximum award)	Threshold (25%)	Maximum (100%)
Total sales growth (exc. fuel)	Three year performance period (2017/18 – 2019/20)	40%	£400m	£750m
Adjusted free cash flow	Three year performance period (2017/18 – 2019/20)	40%	£600m	£800m
Underlying basic earnings per share (EPS) growth	Three year performance period (2017/18 – 2019/20)	20%	5%	10%

1 Performance measures are defined on page 45.
2 Vesting is on a straight-line basis between threshold and maximum.

For the sales target, as set out in the Directors' remuneration policy, the Committee will retain the discretion to adjust the targets in the event of material disposals or store closures during the performance period which were not taken into account in setting the target range.

The Committee has discretion to adjust these calculations for material exceptional events or actions (which may include strategic changes to capital expenditure approved by the Board and material acquisitions or disposals) which were not in the contemplation of the Committee at the time the targets were set and which might otherwise materially distort the outcome, in order to ensure that vesting of the LTIP is an accurate and fair reflection of performance. If the Committee exercises its discretion to amend the calculation, a full disclosure of the reason for the amendment and an explanation of the impact will be given in the relevant Annual Report on remuneration. There is a ROCE underpin which allows the Committee to adjust vesting options if ROCE is below weighted average cost of capital (WACC).

Payments to past Directors and loss of office payments

There were no payments made to past Directors of the Group or loss of office payments made during the year.

Statement of Directors' shareholdings (Executive and Non-Executive Directors)

The Group has share ownership guidelines for Executive Directors of 250% of salary. Shares held under the deferred share bonus plan (calculated on a post-tax basis) which are subject only to a continuing service requirement, will be included in assessing the level of shareholding. The shareholding guideline should be reached within five years of appointment to the Board. The Group has share ownership guidelines for Non-Executive Directors of 50% of base fees. This guideline should be reached within three years of appointment to the Board or three years after the date of adoption of the policy for incumbent Directors.

David Potts has met his shareholding requirement. Trevor Strain met the 200% shareholding guidance set at the time of his appointment but is yet to meet the updated 250% shareholding guideline, he is within the five year period permitted to build up his shareholding.

	Shareholding requirement (% salary)	Shareholding as at 2 February 2018 (% salary)[1,2]	Shares owned outright	Deferred shares not subject to performance	Share save options not subject to performance	LTIP shares subject to performance[3]	Total interests in shares
Executive Directors							
D Potts	250%	347%	1,002,881	631,885	7,411	3,385,918	5,028,095
T Strain	250%	218%	282,732	580,087	2,195	2,081,520	2,946,534

1 Includes shares held under the DSBP on an after tax basis.
2 For the purpose of calculating the shareholding as a percentage of salary, the three month average share price of £2.1934 up to 2 February 2018 (the last trading day of the financial year ended 4 February 2018) has been used. In previous years, shares purchased in the market were valued at the acquisition price. This has been changed to obtain a more representative shareholding calculation.
3 1,293,365 shares and 639,074 shares represent LTIP awards granted to D Potts and T Strain respectively in April 2015 which are due to vest in April 2018. Performance targets for these awards and associated outcomes are provided in the section headed '2015-18 LTIP awards' on page 48. 1,017,964 and 688,622 shares granted to D Potts and T Strain respectively represent LTIP awards made in April 2016 which are due to vest in April 2019. 60% of the award is linked to a cumulative free cash flow target. 25% of this element vests for achieving £620m over the performance period, and 100% vests for achieving £1,340m over the period. 20% of the award is linked to an underlying EPS target. 25% of this element will vest for achieving 6% growth per annum over the performance period. 100% of this element will vest for achieving 13% growth per annum over the performance period. 20% of the award is linked to total sales (excluding fuel and VAT) for the final year of the performance period (2018/19). 25% of this element vests for achieving £12.7bn in total sales (excluding fuel and VAT) in 2018/19. 100% of this element vests for achieving total sales (excluding fuel and VAT) of £13.2bn in 2018/19. 1,074,589 and 753,824 shares granted to D Potts and T Strain respectively represent LTIP awards made in March 2017 which are due to vest in March 2020. Performance targets for these awards are disclosed in the section headed 'Share awards granted in 2017/18' on page 48.

All Non-Executive Directors are still within the three year period allowed to build up their shareholding. Shareholdings as at 2 February 2018 (the last trading day of the financial year ended 4 February 2018) are set out in the table below.

	2 February 2018 Total (owned outright)
A Higginson	266,209
R Anand	22,500
N Davidson	12,800
K Havelock (appointed 1 February 2018)	–
C A van Kralingen	13,000
B Richards	13,721
P Vennells	12,745

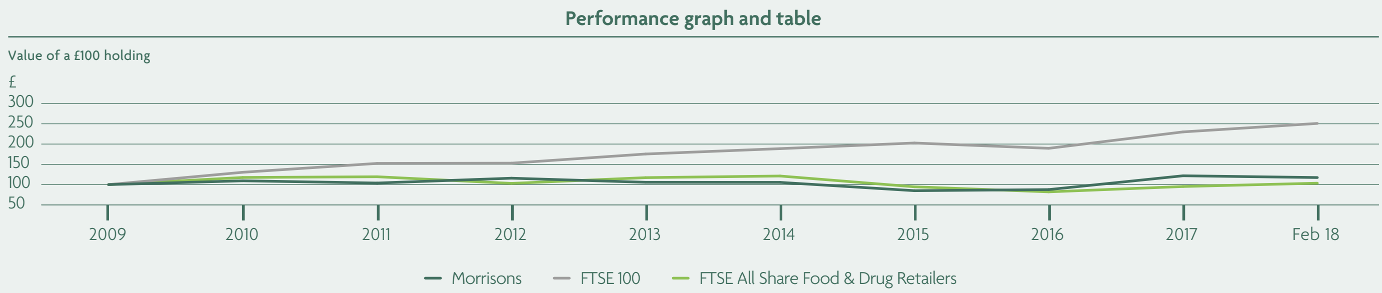
There have been no changes in the Directors' interests since the year end.

Directors' remuneration report continued

Annual report on remuneration

Unaudited information

Total shareholder return (TSR)



The graph above shows the Group's total shareholder return (TSR) compared with the TSR of the FTSE 100 and FTSE All Share Food & Drug Retailers indices over the nine year period to 2 February 2018 (last trading day before year end). These indices have been selected as being appropriate in giving a broad equity view and given that the Group is or has been constituent of these indices over the period.

TSR is a measure of the returns that a company has provided for its shareholders, reflecting share price movements and assuming reinvestment of dividends.

The table below sets out the total remuneration figure for the CEO over the previous nine years, valued using the methodology applied to the single total figure of remuneration.

	Chief Executive	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16[3]	2016/17	2017/18
Total remuneration (£000)	D Potts	–	–	–	–	–	–	2,252	2,794	5,810
	D Philips	–	3,328[2]	2,502	1,089	1,089	2,101	50	366	–
	M Bolland	1,159[1]	304	–	–	–	–	–	–	–
Annual bonus payment (% of maximum opportunity)	D Potts	–	–	–	–	–	–	73%	100%	98.7%
	D Philips	–	70%	90%	0%	0%	60%	–	–	–
	M Bolland	0%[1]	–	–	–	–	–	–	–	–
LTIP vesting level achieved (% of maximum opportunity)	D Potts	–	–	–	–	–	–	–	–	96.3%
	D Philips	–	–	–	0%	0%	0%	0%	50%	–
	M Bolland[4]	–	–	–	–	–	–	–	–	–

1 M Bolland was not treated as a good leaver and therefore did not receive a bonus in 2009/10.
2 Total remuneration includes value of unrestricted share award over 319,401 shares and restricted share award over 120,965 shares granted on recruitment.
3 D Potts was appointed on 16 March 2015 and D Philips stepped down from the Board on 16 February 2015.
4 M Bolland was not treated as a good leaver and therefore lost any eligibility to shares that may have otherwise vested following his departure.

Change in remuneration of CEO compared to Group employees

The table below sets out the change in total remuneration paid to the CEO from 2016/17 to 2017/18 and the average percentage change from 2016/17 to 2017/18 for employees of the Group as a whole.

	% increase in element between 2016/17 and 2017/18		
	Salary and fees	Taxable benefits	Annual bonus
D Potts	0%	(13)%	(1.3)%
All Group employees[1]	2.4%	0%	21%[2]

1 Reflects the change in average pay for all Group employees employed in both the financial year 2016/17 and the financial year 2017/18.
2 Reflects the increase in the average bonus payout for eligible employees.

Relative importance of spend on pay

The table below sets out the total spend on remuneration in the 2016/17 and 2017/18 financial years compared with distributions to shareholders.

	2017/18 £m	2016/17 £m	Difference £m
Total spend on remuneration for all Group employees	1,938	1,925	13
Profit distributed by way of dividends	129	118	11

The Committee and its advisers

During the year, the following individuals were members of the Remuneration Committee:

T van Kralingen (Chair since 1 September 2017)	1 September 2017	To date
R Anand	21 January 2016	To date
N Davidson	3 November 2015	To date
K Havelock	1 February 2018	To date
A Higginson	22 January 2015	To date
B Richards	2 September 2015	To date
P Vennells	21 January 2016	To date

The CEO, CFO, the Group People Director and other Human Resources (HR) representatives also attend meetings by invitation (other than where their own remuneration is being discussed). The Company Secretary acts as secretary to the Committee. Willis Towers Watson were appointed by the Committee in August 2016, following a competitive tender process, to provide independent external advice on market practice and Executive and Non-Executive remuneration. The Committee is satisfied that the advice provided by Willis Towers Watson is objective and independent. Fees are agreed by the Committee according to services provided. Total fees paid for assistance in relation to Remuneration Committee matters were £110,703 on a time and expense basis.

Statement of voting at the 2017 AGM on the remuneration policy

	Votes for	For as a % of votes cast	Votes against	Votes against as a % of votes cast	Abstentions	Total
Remuneration policy	1,639,088,405	92.35%	135,826,285	7.65%	575,379	1,775,490,069

Statement of voting at the 2017 AGM on the remuneration report

	Votes for	For as a % of votes cast	Votes against	Votes against as a % of votes cast	Abstentions	Total
Remuneration report	873,317,656	51.89%	809,799,691	48.11%	93,759,087	1,776,876,434

The Chair of the Remuneration Committee has met with shareholders to understand the reasons for the 52% vote on the 2016/17 Directors' remuneration report. This was primarily driven by perceived stretch in 2017-20 LTIP targets and there is therefore greater explanation and clarity about the target setting process and why the Committee believes the 2018-21 LTIP targets are appropriately stretching in the Implementation report which starts on page 44.

Tony van Kralingen
Remuneration Committee Chair
13 March 2018

Directors' report

Statutory disclosures

The following disclosures have been included elsewhere within the Annual Report and are incorporated into the Directors' report by reference.

Disclosures required pursuant to Listing Rule 9.8.4R can be found on the following pages:

Political donations

No political donations were made in the financial year, which is Group policy.

Going concern

The Directors' assessment of the Group and the Company's ability to continue as a going concern is based on cash flow forecasts for the Group and the committed borrowing and debt facilities of the Group. These forecasts include consideration of future trading performance, working capital requirements, retail market conditions and the wider economy.

The Group remains able to borrow cash at competitive rates. The Group has negotiated, and has available to it, committed, competitive facilities that will meet the Group's needs in the short and medium term.

Having assessed the principal risks as set out on pages 24 and 25 and the other matters discussed in connection with the viability statement on page 26, the Directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

Forward-looking statements

The Strategic report and Directors' report are prepared for the members of the Group and should not be relied upon by any other party or for any other purpose. Where the Strategic report and Directors' report include forward-looking statements, these are made by the Directors in good faith based on the information available to them at the time of their approval of the Annual Report.

Consequently, such statements should be treated with caution due to the inherent uncertainties, including both economic and business risk factors, underlying such forward-looking statements and information.

The liabilities of the Directors in connection with the Strategic report, the Directors' remuneration report and the Directors' report shall be subject to the limitations and restrictions provided by the Companies Act 2006.

Borrowing powers

The Articles of Association of the Group restrict the borrowings of the Group and its subsidiary undertakings to a maximum amount equal to twice the share capital and consolidated reserves.

Relating to beneficial owners of shares with 'information rights'

Beneficial owners of shares who have been nominated by the registered holder of those shares to receive information rights under section 146 of the Companies Act 2006 are required to direct all communications to the registered holder of their shares rather than to the Group's registrar, Link Asset Services, or to the Group directly.

Directors' and Officers' liability insurance

The Group maintains insurance cover for the protection of Directors and senior management from personal liabilities and costs which may arise in the course of fulfilling their duties. The Group also provides an indemnity to the Non-Executive Directors for such liabilities and costs to the fullest extent permitted by law.

Substantial shareholdings

As at 4 February and 13 March 2018, the following information has been received, in accordance with DTR 5, from holders of notifiable interest in the Group's issued share capital.

The information provided below was correct at the date of notification, however the date received may not have been within the current financial year. As notification is not required until the next notifiable threshold is crossed, it should be noted that these holdings are likely to have changed since the Group was last notified.

	As at 4 February 2018		As at 13 March 2018	
	Number of shares	% of share capital	Number of shares	% of share capital
Amerprise Financial Inc	177,970,287	7.62	177,970,287	7.62
Schroders PLC	155,916,196	6.68	155,916,196	6.68
Deutsche Bank AG	142,101,677	6.03	141,816,217	6.02
Silchester International Investors LLP	117,553,329	5.04	117,553,329	5.04
BlackRock Inc	117,232,444	5.02	117,232,44	5.02
Majedie Asset Management Limited	116,805,074	5.00	114,296,273	5.00
Brandes Investment Partners, LP	115,902,280	4.96	115,902,280	4.96
First Eagle Investment Management, LLC	114,296,273	4.89	114,296,273	4.89
Invesco Limited	111,082,524	4.75	111,082,524	4.75
Morgan Stanley	102,579,493	4.36	98,985,578	4.20
Zurich Financial Services	81,286,130	3.04	81,286,130	3.04

Additional shareholder information

Additional information for shareholders is required by the implementation of the EU Takeover Directive into UK law.

Pursuant to section 992 of the Companies Act 2006, the Group is required to disclose certain additional information. Such disclosures, which are not covered elsewhere in this report, include the following paragraphs. The disclosures set out below are in some cases a summary of the relevant provisions of the Group's Articles of Association and the relevant full provisions can be found in the Articles which are available for inspection at the Group's registered office.

Appointment and powers of Directors

Directors are appointed by ordinary resolution at a general meeting of ordinary shareholders. The Directors have the power to appoint a Director during the year, but any person so appointed must be put up for appointment at the next AGM.

Subject to its Articles of Association and relevant statutory law, and to such direction as may be given by the Group in general meeting by special resolution, the business of the Group shall be managed by the Directors, who may exercise all powers of the Group which are not required to be exercised by the Group in general meeting.

Articles of Association

The Group's Articles of Association may only be amended by a special resolution at a general meeting of shareholders.

Share capital

The authorised and called-up share capital of the Group, together with details of shares allotted and cancelled during the year, are shown in note 6.5 of the Group financial statements.

At the AGM of the Group held in June 2017, a special resolution was passed to renew the authority given at the AGM held in June 2016 for the purchase by the Group of up to 233,561,903 ordinary shares, representing approximately 10% of the issued ordinary share capital at that time.

During the period, 20,279,315 (2017: 381,043) ordinary shares were issued to employees exercising share options and 2,584,182 (2017: 2,733,049) out of the Group's trust shares.

Share capital and rights attaching to the Group's shares

Under the Group's Articles of Association, any share in the Group may be issued with such rights or restrictions, whether in regard to dividend, voting, return of capital or otherwise as the Group may from time-to-time by ordinary resolution determine (or, in the absence of any such determination, as the Directors may determine).

At a general meeting of the Group, every member has one vote on a show of hands and, on a poll, one vote for each share held. The notice of general meeting specifies deadlines for exercising voting rights either by proxy or present in person in relation to resolutions to be passed at a general meeting.

No member is, unless the Board decides otherwise, entitled to attend or vote either personally or by proxy at a general meeting, or to exercise any other right conferred by being a shareholder if they or any person with an interest in shares has been sent a notice under section 793 of the Companies Act 2006 (which confers upon public companies the power to require information with respect to interests in their voting shares) and they or any interested person failed to supply the Group with the information requested within 14 days after delivery of that notice. The Board may also decide that no dividend is payable in respect of those default shares and that no transfer of any default shares shall be registered. These restrictions end seven days after receipt by the Group of a notice of an approved transfer of the shares or all the information required by the relevant section 793 notice, whichever is the earlier.

The Directors may refuse to register any transfer of any share which is not a fully paid share, although such discretion may not be exercised in a way which the Financial Conduct Authority regards as preventing dealings in the shares of the relevant class or classes from taking place on an open or proper basis. The Directors may likewise refuse to register any transfer of a share in favour of more than four persons jointly. The Group is not aware of any other restrictions on the transfer of shares in the Group other than certain restrictions that may from time-to-time be imposed by laws and regulations (for example, insider trading laws). The Group is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities or voting rights.

Other disclosures

The Group is not party to any significant arrangements which take effect, alter or terminate upon a change of control of the Group following a takeover bid.

The Group does not have any employee share schemes where the shares to which the scheme relates have rights with regard to the control of the Group which are not exercisable by employees.

Equal opportunities for all

Integral to a high performing culture is the concept of equal opportunity and inclusion for all colleagues, which we promote through an environment free from discrimination, harassment and victimisation. We believe that everyone's efforts are worthwhile and offer all colleagues regardless of race, colour, nationality, ethnic origin, gender (including gender reassignment), marital or civil partnership status, disability, religion or belief, sexual orientation, age or trade union membership the opportunity to be their best, using their individual talents and abilities.

This includes applications for employment made by people with disabilities, which are given full and fair consideration. Respect underpins our behaviour towards all disabled candidates, as well as colleagues who have a disability or become disabled in any way during the course of their employment. A full assessment of the individual's needs is undertaken and we will make reasonable adjustments to the selection process, work environment or practices in order to help people with disabilities. With a heightened awareness of the impact of mental health on society we are a more mindful than ever that not all disabilities can be seen and therefore ensure the same respect and support is provided to those candidates or colleagues whose disabilities are not visible.

All candidates and colleagues are treated equally in respect of recruitment, promotion, training, pay and other employment policies and conditions. The decisions we make are based on relevant merits and abilities, with decisions made free from bias.

It is also a priority that we remain receptive to the needs of our customers and the wider communities by providing the same level of respect and taking an inclusive approach respect.

Health and safety policy

It is the Group's intention, so far as is reasonably practicable, to ensure the health, safety and welfare of all its employees, customers and visitors to its premises. In order to achieve this, a comprehensive health and safety manual is in place for each division of the Group and subsidiary companies within the Group. Each health and safety manual contains the policy and procedures for complying with the Health and Safety at Work Act 1974, including the provision, based on risk assessment, of safe working practices for all work activities across the Group. The Group's health and safety policy is approved by the Executive Committee.

Health and safety improvement plans are in place for each division which are monitored to ensure continuous improvement in performance and practice.

By order of the Board

Jonathan Burke
Company Secretary
13 March 2018

Directors' report continued

Statement of Directors' responsibilities in respect of the Annual Report and Financial Statements

The Directors are responsible for preparing the Annual Report and the Financial Statements in accordance with applicable law and regulation.

Company law requires the Directors to prepare financial statements for each financial period. Under that law the Directors have prepared the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and Group financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 Reduced Disclosure Framework, and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and Company and of the profit or loss of the Group and Company for that period. In preparing the financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable IFRSs as adopted by the European Union have been followed for the Group financial statements and United Kingdom Accounting Standards, comprising FRS 101, have been followed for the Company financial statements, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group and Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and Company and enable them to ensure that the financial statements and the Directors' remuneration report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

The Directors are also responsible for safeguarding the assets of the Group and Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the Group and Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors consider that the Annual Report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group and Company's position and performance, business model and strategy.

Each of the Directors, whose names and functions are listed in the Corporate governance report confirm that, to the best of their knowledge:

- the Company financial statements, which have been prepared in accordance with United Kingdom Generally Accepted Accounting Policies (United Kingdom Accounting Standards, comprising of FRS 101 'Reduced Disclosure Framework', and applicable law), give a true and fair view of the assets, liabilities, financial position and profit of the Company;
- the Group financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit of the Group; and
- the Annual Report includes a fair review of the development and performance of the business and the position of the Group and Company, together with a description of the principal risks and uncertainties that it faces.

In the case of each Director in office at the date the Directors' report is approved:

- so far as the Director is aware, there is no relevant audit information of which the Group and Company's auditors are unaware; and
- they have taken all the steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Group and Company's auditors are aware of that information.

Disclosure of information to auditors

The Directors who held office at the date of approval of this Directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Group's auditor is unaware; and each Director has taken all steps that he or she ought to have taken as a Director to make himself or herself aware of any relevant audit information and to establish that the Group's auditor is aware of that information.

Assessment of whether the Annual Report is fair, balanced and understandable

As required by the Code, the Directors confirm that they consider that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

When arriving at this position the Board was assisted by a number of processes including the following:

- the Annual Report is drafted by appropriate senior management with overall coordination by the Chief Financial Officer to ensure consistency across sections;
- an extensive verification process is undertaken to ensure factual accuracy; and
- comprehensive reviews of drafts of the report are undertaken by members of the Executive Committee and other senior management; and the final draft is reviewed by the Audit Committee prior to consideration by the Board.

Responsibility statement

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group and its subsidiaries included in the consolidation as a whole; and
- the Strategic report includes a fair review of the development of the business and the position of the Group and its subsidiaries included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

Jonathan Burke
Company Secretary
13 March 2018

Independent auditors' report

Independent auditors' report to the members of Wm Morrison Supermarkets PLC

Report on the audit of the financial statements

Opinion

In our opinion,

- Wm Morrison Supermarkets PLC's Group financial statements and Company financial statements (the 'financial statements') give a true and fair view of the state of the Group's and of the Company's affairs as at 4 February 2018 and of the Group's profit and cash flows for the 53 week period (the 'period') then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 'Reduced Disclosure Framework', and applicable law); and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Financial Statements (the 'Annual Report'), which comprise: the consolidated balance sheet and Company balance sheet as at 4 February 2018; the consolidated statement of comprehensive income; the consolidated cash flow statement; the consolidated statement of changes in equity; the Company statement of changes in equity for the 53 week period then ended; the general information; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Company.

Other than those disclosed in note 1.6 to the financial statements, we have provided no non-audit services to the Group or the Company in the period from 30 January 2017 to 4 February 2018.

Our audit approach

Overview

Materiality

- Overall Group materiality: £18.7m (2017: £16.9m), based on 5% of underlying profit before tax.
- Overall Company materiality: £16.8m (2017: £16.0m), based on the amount of component materiality allocated to the Company as part of the Group audit.

Audit scope

- We identified two reporting units, Wm Morrison Supermarkets PLC and Safeway Stores Limited, which in our view, required a full scope audit based on their size and risk. In addition, we determined that certain account balances of a further four reporting units were in the scope of our Group audit to address specific risk characteristics or to provide sufficient overall Group coverage of particular financial statement line items.
- The Group engagement team performed the audit procedures for each reporting unit in the scope of our Group audit, which accounted for 99% of total Group revenue and 84% of profit before tax. Our audit scope provided sufficient appropriate audit evidence as a basis for our opinion on the Group financial statements as a whole.

Areas of focus

- Impairment of property, plant and equipment (Group and Company).
- Onerous property contracts (Group and Company).
- Commercial income and manual promotional funding (Group and Company).
- Impairment of intangible assets (Group and Company).
- Stock valuation (Group and Company).
- Pension accounting (Group and Company).

Independent auditors' report continued

Independent auditors' report to the members of Wm Morrison Supermarkets PLC

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Group and the industry in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at Group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Group and Company financial statements, including, but not limited to, the Companies Act 2006, the Listing Rules, Pensions legislation and UK tax legislation. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, review of correspondence with, and reports to, the regulators, review of correspondence with legal advisers, enquiries of management and review of internal audit reports in so far as they related to the financial statements. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Impairment of property, plant and equipment Refer to page 69 (sources of estimation uncertainty), note 3.1 (accounting policies) and note 3.3 (property, plant and equipment). The Group has a large freehold store estate (£5,770m at 4 February 2018). Given the challenging trading conditions in the UK grocery retail market in recent years and the subsequent adverse impact on the market value of traditional supermarket freehold stores, the possibility of impairment of these assets and the related trading assets is an area of focus for management, as is the possibility that previously charged impairments may need reversing where store trading conditions have improved. We focused on this area because of the judgemental factors involved in testing for impairment and the significant carrying value of freehold property. Management considers each store to be a cash generating unit ('CGU') and has calculated the recoverable amount of each CGU as the higher of value in use and fair value less costs of disposal. **Value in use** Value in use is based on discounted future cash flow forecasts, requiring management to make judgements on certain key inputs including, for example, discount rates and long-term growth rates. **Fair value less costs of disposal** Fair value less costs of disposal is estimated by management based on their knowledge of individual stores, likely demand from grocers or other retailers in the event those stores were for sale and also informed by a valuation performed by a third party valuer. The key judgements made by the Directors in this fair value calculation relate to the estimated rental values and the yields of the stores. Management has calculated that an impairment charge of £118m is required as at 4 February 2018. A release of impairment charged in previous years of £126m has also been calculated following an improvement in the performance of certain stores.	**Value in use** We have obtained the Group's approved budget (upon which forecasts underlying the value in use calculations are based). Our audit procedures included an assessment of management's discounted cash flow models. We tested the mathematical accuracy of the calculations derived from each forecast model and assessed key inputs in the calculations, such as the discount rate of 9%, by reference to management's forecasts, industry reports and our valuation experts. We focused on these key assumptions because small changes can have a material impact on the value in use assessment and any resultant impairment charge. We found, based on our audit work, that the key assumptions used by management were supportable and appropriate in light of the current environment. **Fair value less costs of disposal** Management has determined its own view of estimated rental values and yields for each store used in their calculation of market values. Management derived these assumptions having considered available information such as industry data on market conditions, purchase offers recently received for properties and information from an independent third party valuer. We evaluated management's supporting information, and assessed this using our own internal experts, with a particular focus on the assumptions and methodology used, obtaining third party evidence and market data to corroborate the assumptions. We determined that the valuations performed by management were reasonable. **Disclosures** In addition, we evaluated the adequacy of the disclosures made in note 3.3 of the financial statements, including those regarding the key assumptions and sensitivities to changes in such assumptions by comparing the disclosures against the requirements of IAS 36 'Impairment of assets' and found them to be consistent.

Key audit matter	How our audit addressed the key audit matter
Onerous lease provisions and onerous property contracts Refer to page 69 (sources of estimation uncertainty), note 5.1 (accounting policies) and note 5.5 (provisions). **Onerous lease provisions** Accounting standards require management to assess the Group's leasehold properties to identify where the expected future benefits from a property are less than the future lease commitments which would indicate that an onerous lease provision is required. Under IAS 37 'Provisions, contingent liabilities and contingent assets' such a provision is made for the unavoidable costs of the contract, defined in the standard as the 'least net cost of exit'. We focused on this area because of the judgements required to be made by management in identifying those stores requiring an onerous lease provision and the assumptions used in the models, such as the discount rate and those used in developing the associated cash flow forecasts. We also note that management judgement is required to assess the level of provision for lease guarantees in respect of convenience stores previously disposed of. **Onerous property contracts** The Group recognises a provision in respect of committed onerous property contracts. For example, where management believes that no economic benefit would result from developing sites, a provision is made. There are judgements involved in determining the expected realisable value of these sites and associated contract exit costs, therefore this has been an area of focus during our audit.	**Onerous lease provisions** Having considered the possibility of impairment in the value of freehold properties (see above), we also tested management's calculations in respect of leasehold stores where the estimated future benefits are not expected to exceed the future lease commitments, resulting in an onerous lease. We obtained management's onerous lease model, which includes all leased stores, and tested the accuracy and completeness of key data by agreeing inputs such as individual store cash flows. This helps provide an insight into store profitability. We agreed lease expiry dates for a sample of stores to the original signed lease agreements, noting no issues. We obtained the Group's approved budget (upon which forecasts are based) and assessed the principles of the Group's discounted cash flow model, noting no exceptions. We tested the mathematical accuracy of the calculation derived from each forecast model and assessed key inputs in the calculations such as revenue growth and discount rate, by reference to management's forecasts, analyst reports and our own valuation experts, with no issues noted. We obtained management's calculation of the required provision for former convenience store leases which reverted back to the Group in a prior year. We assessed the principles of the model and tested key inputs such as lease commitment information and sub-let assumptions, with no issues noted. **Onerous property contracts** In respect of onerous property contracts, we obtained original contracts and management's calculations and considered the accuracy of these provisions by performing recalculations and testing key inputs such as estimates of contract exit costs, contractual payments due and by reviewing evidence of the status of any negotiations with landlords. We considered the completeness of these provisions by reviewing documentation in relation to these contracts. We found no issues in this area. **Disclosures** We read the disclosures within the Annual Report in respect of onerous lease provisions and onerous property contracts, and, based on our work, determined that they are consistent with accounting standards.

Independent auditors' report continued

Independent auditors' report to the members of Wm Morrison Supermarkets PLC

Key audit matter

Commercial income and manual promotional funding

Refer to page 69 (sources of estimation uncertainty), note 1.1 (accounting policies) and notes 1.6 (operating profit).

Commercial income

The Group has two categories of commercial income: marketing and advertising funding, and volume-based rebates on purchases.

Commercial income is recognised as a deduction from cost of sales and is earned over the period of the contractual agreements with individual suppliers, as disclosed in the Group's accounting policy on page 70. The total income recognised in the income statement in a year is based on the expected entitlement earned up to the balance sheet date under each supplier agreement. It requires management to apply judgement based on the contractual terms in place with each of its suppliers, together with estimates of amounts the Group is entitled to where transactions span the financial period end.

The relative level of judgement in each category of commercial income is considered below:

Commercial income – marketing and advertising funding

This income is varied with regards to the nature and timing of the activity to which it relates, and is recognised in accordance with written agreements with suppliers. This income is based on specific agreements, and its recognition requires limited judgement or estimation by management in determining the amount that the Group is entitled to. Our focus was on assessing whether a written agreement for the marketing and advertising funding existed, whether the relevant marketing or advertising had taken place and whether the income recognised was recorded in the appropriate period.

Commercial income – volume-based rebates

Volume-based rebates are driven by the Group achieving purchase volume targets set by individual suppliers for specific products over a predetermined period. There is therefore judgement involved in estimating the volume of purchases, particularly where rebate agreements span a financial period end. In order to narrow this judgement, management endeavours to structure agreements to coincide with the Group's financial period end, thereby reducing or eliminating the degree of estimation. In instances where the rebate agreement does not fully coincide with the period end, the key judgement that we focused on was the estimate of commercial income to be accrued at the period end.

Promotional funding

The Group separately recognises promotional funding on promotions that are partially funded by suppliers.

The majority of promotional funding is an automated deduction from cost of sales, triggered when a sale is recognised. The funding is recognised when the transaction occurs in accordance with the terms of supplier agreements. The amount receivable is wholly based on sales volumes achieved, multiplied by rates agreed with each supplier in advance. There are some elements of promotional funding which include a manual element to the invoicing.

We focused on the manual elements of promotional funding because of the significance of the amounts to the Group's gross profit, the significant number of transactions and agreements in place with suppliers covering a range of periods, the manual nature of the invoicing process and the industry-wide focus on this area of accounting.

How our audit addressed the key audit matter

Our audit work in respect of commercial income and the manual elements of promotional funding comprised a combination of controls testing, substantive testing of a sample of income and funding recognised during the period, testing of amounts recognised in the balance sheet and an assessment of the Group's disclosures in this area. Each element of our work is considered in more detail below.

Controls testing

Our controls work encompassed understanding, evaluating and testing management's key controls in respect of the recognition of both commercial income and manual promotional funding. These key controls included the monitoring of invoices raised and the accuracy of confirmations from suppliers. We found no significant deficiencies in these key controls, and our testing of management's key system controls contributed to our evidence in determining whether commercial income and manual promotional funding had been recorded appropriately and in the correct period.

Income statement testing

We tested a sample of commercial income and the manual elements of promotional funding to supporting documentation including supplier agreements. We requested confirmations directly from suppliers in respect of a sample of commercial income and the manual elements of promotional funding across a large number of suppliers. The confirmations received, and documentation reviewed, allowed us to evaluate whether commercial income or the manual elements of promotional funding had been appropriately recognised in the period. No exceptions arose from this work.

We also analysed commercial income and the manual elements of promotional funding recognised each month and compared it to the previous period to identify whether there were any unusual trends in the amounts or timing of commercial income and the manual elements of promotional funding recognised in each period. We used a data analytics approach to identify any unusual items in the commercial income and the manual elements of promotional funding populations. Where unusual items were identified these were agreed to supporting documentation without exception.

Balance sheet testing

We wrote to a sample of suppliers, and obtained independent evidence of the value and timing of commercial income and the manual elements of promotional funding to evaluate whether it had been recognised in the correct period. We also agreed a sample of accrued income to evidence of post-year end invoicing. We performed cut-off procedures and credit note testing to provide further evidence to support the timing of the recognition of both commercial income and the manual elements of promotional funding. Cut-off work involved testing a sample of commercial income and the manual elements of promotional funding recognised both pre and post the period end and evaluating by reference to documentation from suppliers that the timing of recognition was appropriate. We found no issues as a result of our audit procedures.

Our credit note testing focused on credit notes raised after the period end in order to identify any instances of commercial income or the manual elements of promotional funding being subsequently reversed. We did not identify any exceptions from this work. We tested the recoverability of invoiced commercial income and the manual elements of promotional funding (unsettled balances included within trade debtors in note 5.3 to the financial statements and where the Group does not have the right of offset against trade creditors). This testing was performed by assessing the ageing of both outstanding commercial income and the manual elements of promotional funding debtors together with understanding the details of any disputes, and obtained explanations from management to assess whether any provisions were appropriate. We also considered management's commercial income and promotional funding Key Performance Indicators in this analysis. No exceptions were noted.

Disclosures

We read the disclosures within the Annual Report in respect of commercial income and manual promotional funding and, based on our work, determined that they are consistent with accounting standards and the guidance on the reporting of complex supplier arrangements issued by the Financial Reporting Council.

Key audit matter	How our audit addressed the key audit matter
Impairment of intangible assets Refer to page 69 (sources of estimation uncertainty), note 3.1 (accounting policies) and note 3.2 (goodwill and intangible assets). The Group balance sheet includes intangible assets of £428m, of which the majority relates to software development costs incurred in connection with the Group's technology improvement programme, details of which are shown on pages 79 to 81 of the Annual Report. We focused on this area because judgement is required to assess whether the carrying value of the existing capitalised software or systems is impaired.	We obtained management's assessment as to whether the development of new software or systems superseded or impaired any of the existing assets on the balance sheet. We re-visited the expected costs budgeted by management within the cost benefit analysis and compared them to actual outcomes in the current period and we assessed the future expected benefits of the projects, with no issues being identified from our work. We also applied our own understanding of both new and existing projects and considered whether, in our view, any existing software was no longer in use or whether its life had been shortened by development activity. We found no such items. No material impairment of the intangible assets was identified from our work. **Disclosures** We read the disclosures within the Annual Report in respect of intangible assets, and, based on our work, determined that they are consistent with accounting standards.
Stock valuation Refer to page 69 (sources of estimation uncertainty), note 5.1 (accounting policies) and note 5.2 (stock). The stock valuation of £686m (2017: £614m) was focused on due to the nature of judgements made by management when assessing the level of provisions required. As disclosed in note 5.1, the stock valuation is reduced by commercial income and promotional funding (as the stock which this income and/or funding relates to, is yet to be sold). When the stock is sold, the commercial income and/or promotional funding is recognised in the income statement. The stock valuation is additionally reduced for provisions related to estimated losses due to shrinkage, obsolescence and other known specific risks. As stock is counted by the Group on a cyclical basis, rather than in full at the period end date, the shrinkage provision at 4 February 2018 contains a degree of estimation.	We attended stock counts and performed sample counts at a number of the Group's supermarkets and petrol forecourts throughout the period. In addition to performing sample test counts, we assessed the effectiveness of the count controls in operation, with no material issues identified from our work. We also evaluated the results of cycle counts performed by management and third parties through re-performance and inspection at a sample of distribution centres throughout the period to assess the level of count variances. We found no material variances or count control deficiencies across these sites. We tested the unearned commercial income and promotional funding deduction by verifying the inputs of the calculation and methodology of the provision, noting no issues. We tested management's shrinkage assumptions determined by the count procedures and the comparison of this to historical data. The historical data included the results of the recent counts at each location, and our procedures did not identify any significant unusual fluctuations in the data. The obsolescence provision is calculated by applying a judgemental percentage to the period end stock levels, with this judgement being informed by management's view of the current stock profile and expected stock life. We considered this provision by assessing the explanations provided by management on the current profile and expected stock life noting no issues. We have assessed the other specific provisions with reference to the risks identified by management and noted no issues. **Disclosures** We read the disclosures within the Annual Report in respect of stock, and, based on our work, determined that they are consistent with accounting standards.
Pension accounting Refer to page 69 (sources of estimation uncertainty) and note 8 (pensions). We have focused on the valuation of the Group's defined benefit pension schemes because of the level of judgement required in determining the year end valuation. In addition, the size of the gross assets (£4,857m) and liabilities (£4,263m) within the schemes are significant and material.	We obtained the IAS 19 valuation reports produced by the Group's actuaries. We used our own actuarial experts to assess the judgemental assumptions used within the reports to form the valuation of the pension schemes' liabilities, such as discount rate, inflation and mortality rates. We obtained the detailed reports underlying the valuation of the schemes' assets and agreed the valuations to third party confirmations. We assessed the membership data used in valuing the schemes' liabilities and tested any significant changes since the last valuation. We agreed a sample of contributions made by the Group to bank statements. We have no exceptions to report as a result of this testing. The net surplus position of the schemes at 4 February 2018 was £594m. We have reviewed management's assessment of the right to recognise the net surplus in two of the three schemes under the requirements of IFRIC 14, including inspecting updated legal advice, and are satisfied that it is appropriate to recognise the net asset on the balance sheet. The third scheme (RSP) is recognised as a net liability and therefore this aspect of IFRIC 14 is not applicable. **Disclosures** We read the disclosures within the Annual Report in respect of pensions, and, based on our work, determined that they are consistent with accounting standards.

Independent auditors' report continued

Independent auditors' report to the members of Wm Morrison Supermarkets PLC

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group and the Company, the accounting processes and controls, and the industry in which they operate.

The Group's accounting process is structured around a Group finance function at its head office in Bradford who are responsible for the Group's reporting units. For each reporting unit we determined whether we required an audit of their reported financial information ('full scope'), or whether certain account balances of reporting units were required to be in the scope of our Group audit to address specific risk characteristics or to provide sufficient overall Group coverage of particular financial statement line items.

A full scope audit was required for Wm Morrison Supermarkets PLC and Safeway Stores Limited determined as financially significant because they individually contribute more than 15% of the Group's profit before tax. We also considered that certain account balances of a further four reporting units were in the scope of our Group audit to address specific risk characteristics or to provide sufficient overall Group coverage of particular financial statement line items. All of the audit procedures have been performed by the Group audit engagement team.

In aggregate, our audit procedures accounted for 99% of Group revenues and 84% of profit before tax. In addition, the Group audit team performed analytical review procedures over a number of smaller reporting units. This included an analysis of year-on-year movements, at a level of disaggregation to enable a focus on higher risk balances and unusual movements. Those not subject to analytical review procedures were individually, and in aggregate, immaterial. This gave us the evidence we needed for our opinion on the financial statements as a whole.

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Company financial statements
Overall materiality	£18.7m (2017: £16.9m).	£16.8m (2017: £16.0m).
How we determined it	5% of underlying profit before tax.	The amount of component materiality allocated to the Company as part of the Group audit.
Rationale for benchmark applied	Consistent with last year, we applied this benchmark because, in our view, this is the most relevant metric against which the performance of the Group is most commonly measured. Underlying profit is defined by management as profit before impairment, onerous contracts and other items that do not relate to the Group's principal activities on an ongoing basis, profit/loss arising on disposal and exit of properties and sale of investments and IAS 19 pension interest, at a normalised tax rate, as reconciled in note 1.4 of the Group financial statements.	In our view, users focus on the consolidated results of the Group rather than the individual results of the Company, therefore we determined our materiality in the overall context of the Group.

For the two reporting units in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The materiality allocated to the two components was £16.8m.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £0.9m (Group audit) (2017: £0.8m) and £0.8m (Company audit) (2017: £0.8m) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Going concern

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the Directors' statement in the financial statements about whether the Directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the Directors' identification of any material uncertainties to the Group's and the Company's ability to continue as a going concern over a period of at least 12 months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Company's ability to continue as a going concern.
We are required to report if the Directors' statement relating to Going Concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.	We have nothing to report.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic report and Directors' report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006, (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic report and Directors' report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic report and Directors' report for the period ended 4 February 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic report and Directors' report. (CA06)

The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

We have nothing material to add or draw attention to regarding:

- The Directors' confirmation on page 23 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The Directors' explanation on page 26 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the Directors' statement that they have carried out a robust assessment of the principal risks facing the Group and statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the 'Code'); and considering whether the statements are consistent with the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit. (Listing Rules)

Other Code Provisions

We have nothing to report in respect of our responsibility to report when:

- The statement given by the Directors, on page 54, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Company obtained in the course of performing our audit.
- The section of the Annual Report on pages 34 to 37 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.
- The Directors' statement relating to the Company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' remuneration

In our opinion, the part of the Directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006. (CA06)

Independent auditors' report continued

Independent auditors' report to the members of Wm Morrison Supermarkets PLC

Responsibilities for the financial statements and the audit

Responsibilities of the Directors for the financial statements

As explained more fully in the Statement of Directors' responsibilities set out on page 54, the Directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Use of this report

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- the Company financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the members on 5 June 2014 to audit the financial statements for the year ended 1 February 2015 and subsequent financial periods. The period of total uninterrupted engagement is four years, covering the years ended 1 February 2015 to 4 February 2018.

Andrew Paynter (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
Leeds
13 March 2018

Consolidated statement of comprehensive income

53 weeks ended 4 February 2018

	Note	2018 £m	2017 £m
Revenue	1.2	17,262	16,317
Cost of sales		(16,629)	(15,713)
Gross profit		633	604
Other operating income		78	76
Profit/loss on disposal and exit of properties and sale of investments	1.4	19	32
Administrative expenses		(272)	(244)
Operating profit	1.6	458	468
Finance costs	6.2	(94)	(160)
Underlying finance costs	6.2	(78)	(104)
Adjustments for:			
Costs associated with the repayment of borrowings	1.4, 6.2	(16)	(56)
Finance income	6.2	14	15
Share of profit of joint venture (net of tax)	4.2	2	2
Profit before taxation		380	325
Analysed as:			
Underlying profit before taxation		374	337
Adjustments for:			
Impairment and provision for onerous contracts	1.4	6	6
Profit/loss on disposal and exit of properties	1.4	19	19
Profit arising on disposal of investment	1.4, 4.3	–	13
Costs associated with the repayment of borrowings	1.4, 6.2	(16)	(56)
Pension scheme set-up credit	1.4, 8.6	13	–
Net pension income	1.4, 6.2	9	8
Other exceptional costs	1.4	(25)	(2)
		380	325
Taxation	2.2	(69)	(20)
Profit for the period attributable to the owners of the Company		311	305
Other comprehensive income/(expense)			
Items that will not be reclassified to profit or loss:			
Remeasurement of defined benefit pension schemes	8.2	323	86
Tax on defined benefit pension schemes	2.3	(55)	(17)
		268	69
Items that may be reclassified subsequently to profit or loss:			
Cash flow hedging movement		(18)	30
Items reclassified from hedging reserve in relation to repayment of borrowings	1.4	(2)	6
Tax on items that may be reclassified subsequently to profit or loss	2.3	(2)	1
Exchange differences on translation of foreign operations		(1)	(1)
		(23)	36
Other comprehensive income for the period, net of tax		245	105
Total comprehensive income for the period attributable to the owners of the Company		556	410
Earnings per share (pence)			
– basic	1.5	13.30	13.11
– diluted	1.5	13.03	12.95

Consolidated balance sheet

4 February 2018

	Note	2018 £m	2017 £m
Assets			
Non-current assets			
Goodwill and intangible assets	3.2	428	445
Property, plant and equipment	3.3	7,243	7,227
Investment property	3.5	33	33
Pension asset	8.2	612	293
Investment in joint venture	4.2	53	56
Investments	4.3	–	–
Derivative financial assets	7.3	16	16
		8,385	8,070
Current assets			
Stock	5.2	686	614
Debtors	5.3	250	214
Derivative financial assets	7.3	15	22
Cash and cash equivalents	6.4	327	326
		1,278	1,176
Assets classified as held-for-sale	3.4	4	–
		1,282	1,176
Liabilities			
Current liabilities			
Creditors	5.4	(2,981)	(2,837)
Short-term borrowings	6.3	(72)	–
Derivative financial liabilities	7.3	(13)	(3)
Current tax liabilities		(15)	(24)
		(3,081)	(2,864)
Non-current liabilities			
Borrowings	6.3	(1,245)	(1,550)
Derivative financial liabilities	7.3	(1)	(5)
Pension liability	8.2	(18)	(21)
Deferred tax liabilities	2.3	(478)	(417)
Provisions	5.5	(299)	(326)
		(2,041)	(2,319)
Net assets		4,545	4,063
Shareholders' equity			
Share capital	6.5	236	234
Share premium	6.5	159	128
Capital redemption reserve	6.6	39	39
Merger reserve	6.6	2,578	2,578
Retained earnings and other reserves	6.6	1,533	1,084
Total equity attributable to the owners of the Company		4,545	4,063

The notes on pages 70 to 105 form part of these financial statements.

The financial statements on pages 63 to 105 were approved by the Board of Directors on 13 March 2018 and were signed on its behalf by:

Trevor Strain
Chief Financial Officer

Consolidated cash flow statement

53 weeks ended 4 February 2018

	Note	2018 £m	2017 £m
Cash flows from operating activities			
Cash generated from operations	5.6	884	1,113
Interest paid		(66)	(100)
Taxation paid		(74)	(35)
Net cash inflow from operating activities		744	978
Cash flows from investing activities			
Interest received		4	6
Dividends received from joint venture	10.1	8	8
Proceeds from the sale of property, plant and equipment		108	79
Proceeds from the sale of investments	4.3	–	44
Purchase of property, plant and equipment, investment property and assets classified as held-for-sale		(429)	(374)
Purchase of intangible assets		(71)	(45)
Net cash outflow from investing activities		(380)	(282)
Cash flows from financing activities			
Purchase of own shares for trust	6.5	(4)	(5)
Settlement of employee tax liability for share awards	6.5	(7)	–
Proceeds from exercise of employee share options	6.5	33	–
Proceeds on settlement of derivative financial instruments		6	37
Repayment of borrowings		(245)	(729)
Costs incurred on repayment of borrowings		(17)	(42)
Dividends paid	1.8	(129)	(118)
Net cash outflow from financing activities		(363)	(857)
Net increase/(decrease) in cash and cash equivalents		1	(161)
Cash and cash equivalents at start of period		326	487
Cash and cash equivalents at end of period	6.4	327	326

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

	Note	2018 £m	2017 £m
Net increase/(decrease) in cash and cash equivalents		1	(161)
Cash outflow from decrease in debt		239	692
Non-cash movements		(19)	21
Opening net debt		(1,194)	(1,746)
Closing net debt	6.4	(973)	(1,194)

Consolidated statement of changes in equity

53 weeks ended 4 February 2018

		Attributable to the owners of the Company						
	Note	Share capital £m	Share premium £m	Capital redemption reserve £m	Merger reserve £m	Hedging reserve £m	Retained earnings £m	Total equity £m
Current period								
At 30 January 2017		234	128	39	2,578	18	1,066	4,063
Profit for the period		–	–	–	–	–	311	311
Other comprehensive (expense)/income:								
Cash flow hedging movement		–	–	–	–	(18)	–	(18)
Items reclassified from hedging reserve in relation to repayment of borrowings	1.4	–	–	–	–	(2)	–	(2)
Exchange differences on translation of foreign operations		–	–	–	–	–	(1)	(1)
Remeasurement of defined benefit pension schemes	8.2	–	–	–	–	–	323	323
Tax in relation to components of other comprehensive income	2.3	–	–	–	–	4	(61)	(57)
Total comprehensive (expense)/income for the period		–	–	–	–	(16)	572	556
Purchase of trust shares	6.5	–	–	–	–	–	(4)	(4)
Employee share option schemes:								
Share-based payments charge	1.7	–	–	–	–	–	33	33
Settlement of employee tax liability for share awards	6.5	–	–	–	–	–	(7)	(7)
Share options exercised	6.5	2	31	–	–	–	–	33
Dividends	1.8	–	–	–	–	–	(129)	(129)
Total transactions with owners		2	31	–	–	–	(107)	(74)
At 4 February 2018		236	159	39	2,578	2	1,531	4,545

		Attributable to the owners of the Company						
	Note	Share capital £m	Share premium £m	Capital redemption reserve £m	Merger reserve £m	Hedging reserve £m	Retained earnings £m	Total equity £m
Prior period								
At 1 February 2016		234	127	39	2,578	(10)	788	3,756
Profit for the period		–	–	–	–	–	305	305
Other comprehensive income/(expense):								
Cash flow hedging movement		–	–	–	–	30	–	30
Items reclassified from hedging reserve in relation to repayment of borrowings		–	–	–	–	6	–	6
Exchange differences on translation of foreign operations		–	–	–	–	–	(1)	(1)
Remeasurement of defined benefit pension schemes	8.2	–	–	–	–	–	86	86
Tax in relation to components of other comprehensive income	2.3	–	–	–	–	(8)	(8)	(16)
Total comprehensive income for the period		–	–	–	–	28	382	410
Purchase of trust shares	6.5	–	–	–	–	–	(5)	(5)
Employee share option schemes:								
Share-based payments	1.7	–	–	–	–	–	20	20
Proceeds and settlements of employee share award	6.5	–	1	–	–	–	(1)	–
Dividends	1.8	–	–	–	–	–	(118)	(118)
Total transactions with owners		–	1	–	–	–	(104)	(103)
At 29 January 2017		234	128	39	2,578	18	1,066	4,063

General information

Company 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 statements have been prepared for the 53 weeks ended 4 February 2018 (2017: 52 weeks ended 29 January 2017) in accordance with International Financial Reporting Standards (IFRS) and International Financial Reporting Standards Interpretation Committee (IFRS IC) interpretations as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. IFRS and IFRS IC interpretations are issued by the International Accounting Standards Board (the IASB) and must be adopted into European Union law, referred to as endorsement, before they become mandatory under the IAS Regulation.

The financial statements have been prepared on a going concern basis.

The financial statements are presented in pounds sterling, rounded to the nearest million, except in some instances, where it is deemed relevant to disclose the amounts up to two decimal places. They are drawn up on the historical cost basis of accounting, except as disclosed in the accounting policies set out within these financial statements.

The Group's accounting policies have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

Accounting reference date

The accounting period of the Group ends on the Sunday falling between 29 January and 4 February each year.

New IFRS and amendments to IAS and interpretations

The following amendments to standards are mandatory for the first time for the financial period ended 4 February 2018:

Amendments to IAS 7 'Statement of Cash Flows'

The amendment to IAS 7 requires additional disclosures about changes in an entity's financing liabilities arising from both cash flow and non-cash flow items. The amendment applies to changes in financial assets as well as liabilities if the cash flows from those financial assets are included in cash flows from financing activities in the cash flow statement. The Group has applied the amendment to the disclosures in the financial statements (see note 6.4). There is no material impact on the Group as a result of applying this amendment.

Other than the amendment to IAS 7 noted above, there have been no significant changes to accounting under IFRS which have affected the Group's reported results for the period. The Group has considered the following amendments to published standards that are effective for the first time for the 53 weeks ended 4 February 2018 and concluded that they are either not relevant to the Group or they do not have a significant impact on the Group's financial statements. These amendments are:

- Amendments to IAS 12 'Income taxes' on recognition of deferred tax assets for unrealised losses; and
- Annual improvements 2014-2016.

There are a number of standards and interpretations issued by the IASB that are effective for financial statements after this reporting period. These are detailed below:

IFRS 9 'Financial Instruments'

IFRS 9 'Financial Instruments' was published in July 2014 and will be effective for the Group from the period beginning 5 February 2018. The standard replaces IAS 39 'Recognition and Measurement' and is applicable to financial assets and financial liabilities.

The main changes the new standard introduces are:

- new requirements for the classification and measurement of financial assets and financial liabilities;
- a new model for recognising impairments of financial assets; and
- changes to hedge accounting by aligning hedge accounting more closely to an entity's risk management objectives.

The Group will apply the modified retrospective approach for transition, including no requirement to restate comparative amounts. Any differences in carrying values will be recognised as an adjustment to the opening balance sheet at 5 February 2018.

The Group has assessed in detail the impact of the three areas of the new standard on the consolidated financial statements. The Group does not expect any material changes in relation to accounting policies, classification and measurement of financial assets and liabilities, nor for hedge accounting as detailed in note 7.1 of the financial statements. IFRS 9 also introduces a forward looking approach to impairment of financial assets which results in earlier recognition of credit losses. The Group has assessed the impact of IFRS 9 in this area, with reference to all financial assets including trade receivables, and concluded that the impact will be immaterial.

IFRS 15 'Revenue from Contracts with Customers'

IFRS 15 'Revenue from Contracts with Customers' was published in May 2014 and will be effective for the Group from the period beginning 5 February 2018. The standard replaces IAS 18 'Revenue', IAS 11 'Construction contracts' and related interpretations. The standard introduces a five-step approach to the timing and recognition of revenue based on performance obligations in customer contracts. Under IFRS 15, revenue should only be recognised when a customer obtains control of goods or services and has the ability to direct the use and obtain the benefits from the goods or services. It applies to all contracts with customers, except those in the scope of other standards.

The Group will apply the modified retrospective approach for transition set out in the standard. The cumulative effect of initial application will be recognised as an adjustment to the opening balance sheet at 5 February 2018, without restating comparative amounts.

The Group has performed a detailed impact assessment, identifying all current sources of revenue and analysing accounting requirements for each under IFRS 15. The Group has concluded that the adoption of IFRS 15 will not have a material impact on the consolidated financial statements as the vast majority of transactions (volume and value) are for sale of goods in stores or online where the transfer of control is clear (either at the till or on delivery of goods). The impact assessment also covered areas which require further specific consideration such as customer loyalty schemes, rights of return and wholesale supply arrangements and concluded that there is no material impact on the current accounting policies for revenue recognition applied by the Group, which are disclosed in note 1.1 of the financial statements.

General information continued

New IFRS and amendments to IAS and interpretations continued

IFRIC 22 'Foreign Currency Transactions and Advance Consideration'

IFRIC 22 'Foreign Currency Transactions and Advance Consideration' was issued in December 2016 and will be effective for the Group from the period beginning 5 February 2018. The interpretation clarifies the date to be used in determining the initial exchange rate for transactions, relating to advance payments or receipts in a foreign currency, to be the date the related non-monetary asset or liability is first recognised. The Group will apply the interpretation prospectively to assets, expenses and income recognised on or after 5 February 2018, including where related non-monetary assets and liabilities from advance consideration have been recognised before this date.

The Group has performed an impact assessment and believes that the interpretation will not have a material impact on the consolidated financial statements as sales and purchases involving advanced consideration in foreign currencies are negligible.

IFRS 16 'Leases'

IFRS 16 'Leases' was published in January 2016 and will be effective for the Group from the period beginning 4 February 2019, replacing IAS 17 'Leases'. The main principle of the standard is to eliminate the dual accounting model for lessees under IAS 17, which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases, and to provide a single model for lessee accounting. IFRS 16 requires lessees to recognise right-of-use assets and lease liabilities for leases. Accounting requirements for lessors as disclosed in note 3.1 will be substantially unchanged from IAS 17.

The standard represents a significant change in the accounting and reporting of leases for lessees and it will impact the income statement and balance sheet as well as statutory and alternative performance measures used by the Group.

The impact on the financial statements on transition to IFRS 16, where the Group is the lessee, will depend on the approach taken by the Group. The new standard allows for two different transition approaches, fully retrospective and modified retrospective. Both approaches will impact the income statement, balance sheet and disclosure when adopted including the opening balance sheet at 4 February 2019, although the amounts will differ dependent on the approach taken.

The Group is currently in the process of assessing the impact of the new standard, deciding on the transition approach and identifying process, systems and information required when adopted. The initial phase of work, which is still in progress, has involved assessing and modelling the impact of the new standard for a sample of leases and beginning to consider assumptions and assessing data requirements.

The Group has not yet concluded on a transition approach and as such it is not possible to fully quantify the impact of IFRS 16 at this stage.

Amendment to IAS 19 'Employee Benefits'

An amendment to IAS 19 'Employee Benefits' was published in February 2018 and will be effective for the Group from the period beginning 4 February 2019. The amendment applies prospectively in connection with accounting for plan amendments, curtailments and settlements. The amendment requires entities to use updated assumptions to determine current service cost and net interest for the remainder of the period after a plan amendment, curtailment or settlement.

The Group is in the process of assessing the impact of the amendment. However, at this stage it is not yet practicable to fully quantify the effect of this amendment on these consolidated financial statements.

IFRIC 23 'Uncertainty over income tax treatments'

IFRIC 23 'Uncertainty over income tax treatments' was issued in June 2017 and will be effective for the Group from the period beginning 4 February 2019. The interpretation covers how the Group accounts for taxation, where there is some uncertainty over whether treatments in the tax return will be accepted by HMRC or the relevant overseas jurisdictions. Each uncertain treatment (or combination of treatments) is considered for whether it will be accepted, and if probable taxable profits/losses, tax bases, unused tax losses, unused tax credits and tax rates are accounted for consistently with the tax return. Otherwise the Group accounts for each treatment using whichever of the two allowed measurement methods is expected to best predict the final outcome – the single most likely outcome or a probability weighted-average value of a range of possible outcomes.

The new standard allows for two different transition approaches, fully retrospective and modified retrospective. The Group has not yet concluded on a transition method and as such it is not possible to fully quantify the impact of IFRIC 23 at this stage, though it is not expected to be material as the Group has taken a comparable approach to the interpretation in previous periods.

Basis of consolidation

Subsidiaries (including partnerships) are all entities over which the Group has control. The Group controls an entity when it has power over that entity, is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date the control ceases. The financial statements of subsidiaries used in the consolidation are prepared for the same reporting period as the Company and are based on consistent accounting policies. Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions are eliminated on consolidation.

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.

Critical accounting judgements

The critical judgement made in the process of applying the Group's accounting policies are detailed below:

Items excluded from underlying earnings

The Directors consider that the underlying earnings measure provides useful information for shareholders on underlying trends and performance. These measures are consistent with how business performance is measured internally by the Board and the Executive Committee.

Underlying profit and underlying earnings per share measures are not recognised measures under EU-adopted IFRS and may not be directly comparable with adjusted measures used by other companies. The classification of items excluded from underlying earnings requires judgement after considering the nature and intentions of a transaction. The Group's definition of items excluded from underlying earnings, together with further details of adjustments made during the period, are provided in note 1.4.

Sources of estimation uncertainty

The areas of estimation uncertainty that have a significant risk of resulting in material adjustment to carrying amounts of assets and liabilities are detailed below. These estimates and assumptions are continually evaluated and are based on historical experience and other factors that the Directors believe to be reasonable.

Impairment of property, plant and equipment and intangible assets and onerous property commitments

Property, plant and equipment and intangible assets are reviewed annually for impairment or where changes in circumstances indicate impairment (or impairment reversal). The recoverable amount is estimated when the impairment review is conducted. Further detail is provided in notes 3.1, 3.2 and 3.3.

Where property contracts for which expected future cash flows are less than the future contract commitments, an onerous contract provision is recognised. Judgement is required in applying estimates to assess the level of provision required. Further detail is provided in notes 5.1 and 5.5.

Commercial income

Commercial income is accounted for as a deduction from the cost of purchase, and it is recognised in accordance with signed supplier agreements, with most income subject to little or no subjectivity or judgement. However, a certain level of estimation or judgement is required in assessing future sales or purchase volumes and whether performance obligations are achieved. The Group's recognition policy for commercial income along with areas of estimation is included in note 1.1.

Stock

Certain estimates are required to assess the net realisable value of stock, along with provisions for obsolete and slow moving stock, where estimation is required. The Group's accounting policy for stock is provided in note 5.1.

Pensions

Accounting for defined benefit pension schemes requires the application of a number of assumptions which have an impact on the valuation of the schemes' assets and liabilities. The significant assumptions include discount rate, inflation, rate of salary increases and longevity. Details of these assumptions are provided in note 8.

Alternative Performance Measures

The Directors measure the performance of the Group based on a range of financial measures, including measures not recognised by EU-adopted IFRS. These Alternative Performance Measures may not be directly comparable with other companies' Alternative Performance Measures and the Directors do not intend these to be a substitute for, or superior to, IFRS measures. For definitions of the Alternative Performance Measures used, see the Glossary on page 127.

Notes to the Group financial statements

53 weeks ended 4 February 2018

1 Performance in the period

1.1 Accounting policies

Revenue recognition

Sale of goods in-store and online, and fuel

Revenue from the sale of goods in-store and online comprises cash from customers and excludes VAT. It is stated net of returns, colleague discounts, coupons, vouchers, 'More' points earned in-store and online, and the free element of multi-save transactions. Sale of fuel is recognised net of VAT and 'More' points earned on fuel. Revenue is recognised when transactions are completed in-store, or, in the case of Food Online, when goods are accepted by the customer on delivery.

Other sales

Other sales includes income from concessions and commissions based on the terms of the contract, and wholesale sales made direct to third party customers recognised on despatch of goods. Revenue collected on behalf of others is not recognised as revenue, other than the related commission. Sales are recorded net of VAT and intra-group transactions.

'More' points

The fair value of 'More' points is determined to be the value to the customer of the points issued, adjusted for factors such as the expected redemption rate. The Group continues to assess the appropriateness of the expected redemption rates against actual redemptions.

The fair value is treated as a deduction from revenue at the time the points are issued, and is deferred until the rewards are redeemed by the customer in a future sale.

Cost of sales

Cost of sales consists of all costs of the goods being sold to the point of sale, net of promotional funding and commercial income, and includes property, manufacturing, warehouse and transportation costs. Store depreciation, store overheads and store-based employee costs are also allocated to cost of sales.

Promotional funding

Promotional funding refers to investment in the customer offer by suppliers by way of promotion. The calculation of funding is mechanical and system generated based on a funding level agreed in advance with the supplier. Funding is recognised as units are sold and invoiced in accordance with the specific supplier agreement. Funding is recorded effectively as a direct adjustment to the cost price of the product in the period. Funding is invoiced and collected through the year, shortly after the promotions have ended.

Commercial income

Commercial income is recognised as a deduction from cost of sales, based on the expected entitlement that has been earned up to the balance sheet date for each relevant supplier contract. The Group only recognises commercial income where there is documented evidence of an agreement with an individual supplier and when associated performance conditions are met.

The types of commercial income recognised by the Group, and the recognition policies are:

Type of commercial income	Description	Recognition
Marketing and advertising funding	Examples include income in respect of in-store marketing and point of sale, as well as funding for advertising.	Income is recognised over the period as set out in the specific supplier agreement. Income is invoiced once the performance conditions in the supplier agreement have been achieved.
Volume-based rebates	Income earned by achieving volume or spend targets set by the supplier for specific products over specific periods.	Income is recognised through the year based on forecasts for expected sales or purchase volumes, informed by current performance, trends and the terms of the supplier agreement. Income is invoiced throughout the year in accordance with the specific supplier terms. In order to minimise any risk arising from estimation, supplier confirmations are also obtained to agree the final value to be recognised at year end, prior to it being invoiced.

Uncollected commercial income at the balance sheet date is classified within the financial statements as follows:

- Creditors: A large proportion of the Group's trading terms state that income due from suppliers is netted against amounts owing to that supplier. Any outstanding invoiced commercial income relating to these suppliers at the balance sheet date are included within trade payables. Any amounts received in advance of income being recognised are included in accruals and deferred income.
- Debtors: Where the trading terms described above do not exist, the Group classifies outstanding commercial income within trade debtors. Where commercial income is earned and not invoiced to the supplier at the balance sheet date, this is classified within accrued commercial income.
- Stock: The carrying value of stock is adjusted to reflect unearned elements of commercial income when it relates to stock which has not yet been sold. This income is subsequently recognised in cost of sales when the product has been sold.

In order to provide users of the financial statements with greater understanding in this area, additional income statement and balance sheet disclosure is provided in notes 1.6, 5.2, 5.3 and 5.4 to the financial statements.

1 Performance in the period continued

1.1 Accounting policies continued

Other operating income
Other operating income primarily consists of income not directly related to in-store and online grocery retailing and mainly comprises rental income from investment properties and income generated from the recycling of packaging.

Profit/loss on disposal and exit of properties
Profit/loss from the disposal and exit of properties includes gains and losses on disposal of property assets and other costs incurred by the Group following a decision to dispose, close or no longer purchase properties. Where the Group disposes of a property, this disposal transaction is accounted for upon unconditional exchange of contracts. Gains and losses are determined by comparing sale proceeds with the asset's carrying amount and are presented net of costs associated with disposal.

1.2 Revenue

	2018 £m	2017 £m
Sale of goods in-store and online	13,246	12,747
Other sales	290	219
Total sales excluding fuel	13,536	12,966
Fuel	3,726	3,351
Total revenue	17,262	16,317

1.3 Segmental reporting

The Group's principal activity is that of retailing, derived from the UK.

The Group is required to determine and present its operating segments based on the way in which financial information is organised and reported to the chief operating decision-maker (CODM). The CODM has been identified as the Executive Committee as this makes the key operating decisions of the Group and is responsible for allocating resources and assessing performance.

Key internal reports received by the CODM, primarily the management accounts, focus on the performance of the Group as a whole. The operations of all elements of the business are driven by the retail sales environment and hence have fundamentally the same economic characteristics. All operational decisions made are focused on the performance and growth of the retail outlets and the ability of the business to meet the supply demands of the stores.

The Group has considered the overriding core principles of IFRS 8 'Operating segments' as well as its internal reporting framework, management and operating structure. In particular, the Group considered its retail outlets, the fuel sale operation, the manufacturing entities and online operations. The Directors' conclusion is that the Group has one operating segment, that of retailing.

Reconciliations of reportable segment revenues, profit or loss, assets and liabilities and other material items
Performance is measured by the CODM based on underlying profit before tax as reported in the management accounts. Management believes that this underlying profit measure is the most relevant in evaluating the results of the Group. This information and the reconciliation to the statutory position can be found in note 1.4. In addition, the management accounts present a Group balance sheet containing assets and liabilities.

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

1 Performance in the period continued

1.4 Underlying profit

The definition of underlying profit is defined in the Glossary on page 127.

The Directors consider that the underlying profit and underlying adjusted earnings per share measures referred to in the results provide useful information for shareholders on underlying trends and performance. The adjustments are made to reported profit/loss to: (a) remove impairment, provision for onerous contracts, or other items that do not relate to the Group's principal activities on an ongoing basis; (b) remove profit/loss arising on disposal and exit of properties and sale of investments; (c) remove the impact of pension volatility; and (d) apply a normalised tax rate of 23.8% (2017: 25.0%).

	2018 £m	2017 £m
Profit after tax	311	305
Add back: tax charge for the period[1]	69	20
Profit before tax	380	325
Adjustments for:		
Impairment and provision for onerous contracts[1]	(6)	(6)
Profit/loss arising on disposal and exit of properties[1]	(19)	(19)
Profit arising on disposal of investment (note 4.3)[1]	–	(13)
Costs associated with the repayment of borrowings[1]	16	56
Pension scheme set-up credit (note 8.6)[1]	(13)	–
Net pension income (note 8.2)[1]	(9)	(8)
Other exceptional costs[1]	25	2
Underlying profit before tax	374	337
Normalised tax charge at 23.8% (2017: 25.0.%)[1,2]	(89)	(84)
Underlying profit after tax	285	253
Underlying earnings per share (pence)		
– basic (note 1.5.2)	12.19	10.86
– diluted (note 1.5.2)	11.94	10.73

1 Adjustments marked[1] decrease post-tax underlying earnings by £26m (2017: decrease of £52m), as shown in the reconciliation of earnings disclosed in note 1.5.2.
2 Normalised tax is defined in the Glossary, see page 128 for details.

Following the Group's annual impairment and onerous contract review a net credit of £6m has been recognised. This included a net impairment reversal of £7m (£126m impairment reversal offset by £119m impairment charge). The £119m impairment charge includes £118m in relation to property, plant and equipment and £1m in relation to intangible assets (see notes 3.2 and 3.3). The £126m impairment reversal relates entirely to property, plant and equipment. A net £1m credit has been recognised in relation to provisions for onerous contracts (£22m charge offset by £23m release) (see note 5.5). In addition, amounts provided for onerous commitments has increased by a net £2m. Impairment and provision for onerous contracts in 2016/17 totalled a net credit of £6m. This included a net impairment reversal of £44m (£191m impairment reversal offset by £147m impairment charge) and charge of £38m relating to provisions for onerous contracts.

Profits/losses arising on disposal and exit of properties amounted to £19m (2017: £19m) and includes £14m (2017: £nil) relating to the disposal of the customer fulfilment centre (CFC) at Dordon in June 2017. For further detail, see note 3.3. In the 52 weeks ended 29 January 2017, a profit of £13m was recognised on the disposal of the Group's investment in Fresh Direct Inc (see note 4.3).

Costs associated with the early repayment of borrowing facilities and other refinancing activities total £16m (2017: £56m). This includes £17m relating to financing charges on redemption of financial instruments (primarily premiums) and £1m of fees written off on the repayment of bonds, offset by £2m relating to gains which had previously been recognised in reserves which have been reclassified to the income statement on termination of hedging arrangements.

The pension scheme set-up credit of £13m relates to back dated contributions in respect of the Group's new defined contribution scheme which was established in the year and is the auto enrolment scheme for the Group. The credit represents the difference between the expected back dated contributions and the cost based on actual participation rates.

Other exceptional costs include restructuring costs of £21m (2017: £nil) primarily relating to the restructuring of store management teams, and legal costs incurred in relation to cases in respect of historic events.

1 Performance in the period continued

1.4 Underlying profit continued

The adjustments above are classified within the consolidated statement of comprehensive income on the following lines:

- impairment and provision for onerous contracts has been included within administrative expenses;
- profit/loss arising on disposal and exit of properties and profit arising on disposal of investments are classified within profit/loss arising on disposal and exit of properties and sale of investments;
- pension scheme set-up credit is classified within administrative expenses;
- costs associated with the repayment of borrowings are classified within finance costs;
- net pension income is included within finance income; and
- other exceptional costs have been recognised in administrative expenses.

1.5 Earnings per share

Basic earnings per share (EPS) is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period excluding shares held in trust. For diluted EPS, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all potentially dilutive ordinary shares.

The Company has two (2017: two) classes of instrument that are potentially dilutive: those share options granted to employees where the exercise price together with the future IFRS 2 charge of the option 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 plans (LTIP).

1.5.1 Basic and diluted EPS (unadjusted)

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

			2018			2017
	Earnings £m	Weighted average number of shares millions	EPS Pence	Earnings £m	Weighted average number of shares millions	EPS Pence
Unadjusted EPS						
Basic EPS						
Profit attributable to ordinary shareholders	311.1	2,338.6	13.30	305.0	2,327.1	13.11
Effect of dilutive instruments						
Share options and LTIPs	–	49.3	(0.27)	–	27.9	(0.16)
Diluted EPS	311.1	2,387.9	13.03	305.0	2,355.0	12.95

1.5.2 Underlying EPS

Basic EPS is adjusted to more accurately show underlying business performance. The reconciliation of the earnings used in the calculations of underlying earnings per share is set out below:

			2018			2017
	Earnings £m	Weighted average number of shares millions	EPS Pence	Earnings £m	Weighted average number of shares millions	EPS Pence
Underlying EPS						
Basic EPS						
Profit attributable to ordinary shareholders	311.1	2,338.6	13.30	305.0	2,327.1	13.11
Adjustments to determine underlying profit (note 1.4)	(26.1)	–	(1.11)	(52.2)	–	(2.25)
	285.0	2,338.6	12.19	252.8	2,327.1	10.86
Effect of dilutive instruments						
Share options and LTIPs	–	49.3	(0.25)	–	27.9	(0.13)
Diluted EPS	285.0	2,387.9	11.94	252.8	2,355.0	10.73

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

1 Performance in the period continued

1.6 Operating profit

	2018 £m	2017 £m
The following items have been included in arriving at operating profit:		
Employee costs (note 1.7)	1,938	1,925
Depreciation and impairment:		
– Property, plant and equipment (note 3.3)	333	305
– Investment property (note 3.5)	1	1
– Net impairment reversal (note 1.4 and 3.3)	(8)	(44)
Amortisation and impairment:		
– Intangible assets (note 3.2)	84	93
– Net impairment (note 1.4 and 3.2)	1	–
Operating lease rentals:		
– Land and buildings	93	93
– Other	17	16
– Sublease receipts	(3)	(6)
Value of stock expensed	13,365	12,519

Commercial income

The amounts recognised as a deduction from cost of sales for the two types of commercial income are detailed as follows:

	2018 £m	2017 £m
Commercial income		
Marketing and advertising funding	34	52
Volume-based rebates	192	257
Total commercial income	226	309

Auditor remuneration

During the period PricewaterhouseCoopers LLP, the Group's auditor, provided the following services:

	2018 £m	2017 £m
Audit services		
Fees payable to the Group's auditor for the audit of the Group and the Company financial statements	0.5	0.5
Other services		
Fees payable to the Group's auditor and its associates for other services:		
– the audit of the Group's subsidiaries pursuant to legislation	0.2	0.2
– other services	0.2	0.2
	0.9	0.9

The Board has a policy on the engagement of the external auditor to supply non-audit services, which is available in the Corporate governance compliance statement set out in the investor relations section of the Group's website at www.morrisons-corporate.com

1 Performance in the period continued

1.7 Employees and Directors

	2018 £m	2017 £m
Employee benefit expense for the Group during the period		
Wages and salaries	1,682	1,708
Social security costs	131	119
Share-based payments	33	20
Other pension costs	92	78
	1,938	1,925

	2018 No.	2017 No.
Average monthly number of people, including Directors		
Stores	89,558	96,612
Manufacturing	8,212	8,207
Distribution	5,565	5,467
Centre	2,152	2,079
	105,487	112,365

Directors' remuneration

A detailed analysis of Directors' remuneration, including salaries, bonuses and long term incentives, and the highest paid Director, is provided in the Single total figure of remuneration table in the audited section of the Directors' remuneration report, which forms part of these financial statements (page 46). There are no Executive Directors (2017: none) who have retirement benefits accruing under any of the Group's defined benefit pension schemes.

Senior management remuneration

The table below shows the remuneration of senior managers. It excludes employees already included in the Directors' remuneration report. Senior managers are considered to be key management personnel in accordance with the requirements of IAS 24 'Related party disclosures', and in the context of gender disclosures required by the Companies Act 2006.

	2018 £m	2017 £m
Senior managers		
Wages and salaries	20	25
Social security costs	4	4
Share-based payments	11	8
Other pension costs	1	2
	36	39

1.8 Dividends

Amounts recognised as distributed to equity holders in the period:

	2018 £m	2017 £m
Interim dividend for the period ended 4 February 2018 of 1.66p (2017: 1.58p)	39	37
Final dividend for the period ended 29 January 2017 of 3.85p (2017: 3.50p)	90	81
	129	118

The Directors propose a final ordinary dividend in respect of the financial period ended 4 February 2018 of 4.43p per share which will absorb an estimated £104m of shareholders' funds. The Directors also propose a special dividend of 4.00p per share which will absorb an estimated £94m of shareholders' funds. Subject to approval at the AGM, these dividends will be paid on 28 June 2018 to shareholders who are on the register of members on 25 May 2018.

The dividends paid and proposed during the year are from cumulative realised distributable reserves of the Company.

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

2 Taxation

The Group takes a compliance-focused approach to its tax affairs, and has a transparent relationship with the UK and overseas tax authorities and interacts with HMRC on a regular basis. The Group's tax policy provides a governance framework with all related risks and stakeholder interests taken into consideration. The tax policy is approved by the Board, with updates on tax compliance and governance matters being provided to the Audit Committee.

The Group's approach to tax is to ensure compliance with the relevant laws of the territories in which the Group operates. The majority of the Group's stores and sales are in the UK so the majority of the Group's taxes are paid in the UK.

The Group operates a small number of branches and subsidiary companies outside of the UK based in the following overseas jurisdictions:

- The Netherlands: The Group has operations in the Netherlands as part of its produce supply chain. Local corporation taxes of £2m were paid during 2018 (2017: £1.3m);
- Hong Kong: Offices in Hong Kong were established in 2011 and source many of the Group's non-food products. Local corporation taxes of £0.4m were paid during 2018 (2017: £0.3m); and
- Isle of Man, Jersey and Guernsey: The Group's insurance company is based in the Isle of Man for regulatory reasons. Companies based in Jersey and Guernsey hold UK property assets as a result of historic acquisitions. All profits arising in these companies are subject to UK tax.

2.1 Accounting policies

Current tax

The current income tax charge is calculated on the basis of the tax laws in effect during the period and any adjustments to tax payable in respect of previous periods. Taxable profit differs from the reported profit for the period as it is adjusted both for items that will never be taxable or deductible, and temporary differences. Current tax is charged to profit or loss for the period, except when it relates to items charged or credited directly in other comprehensive income or equity, in which case the current tax is reflected in other comprehensive income or equity as appropriate.

Deferred tax

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 are 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 to profit for the period except when it relates to items charged or credited directly to other comprehensive income or equity, in which case the deferred tax is reflected in other comprehensive income or equity as appropriate.

Deferred tax assets are recognised to the extent that it is probable that the asset can be utilised. Deferred tax assets are reviewed at each reporting date as judgement is required to estimate the probability of recovery. Deferred tax assets and liabilities are offset where amounts will be settled on a net basis as there is a legally enforceable right to offset.

Uncertain tax positions

The Group uses in-house tax specialists, professional advisers and relevant previous experience to assess tax risks, and considers IFRIC 23 'Accounting for Uncertainties in Income Taxes', which provides guidance on the determination of taxable profit and tax bases, when making its assessment.

The Group recognises a tax provision when it is considered probable that there will be a future outflow of funds to a tax authority. Provisions are measured based on the single most likely outcome for each item unless there is a range of possible outcomes for a particular item where a weighted average measurement is more appropriate. Provisions are included in current liabilities.

2 Taxation continued

2.2 Taxation

2.2.1 Analysis of charge in the period

	2018 £m	2017 £m
Current tax		
– UK corporation tax	69	57
– overseas tax	4	2
– adjustments in respect of prior periods	(8)	(11)
	65	48
Deferred tax		
– origination and reversal of timing differences	(2)	(10)
– adjustments in respect of prior periods	6	3
– impact of change in tax rate	–	(21)
	4	(28)
Tax charge for the period	69	20

2.2.2 Tax on items charged in other comprehensive income and equity

	2018 £m	2017 £m
Remeasurements arising in the pension scheme	55	17
Cash flow hedges	(4)	8
Share-based payments	6	(9)
Total tax on items included in other comprehensive income and equity (note 2.3)	57	16

2.2.3 Tax reconciliation

The reconciliation below shows how the tax charge of £69m (2017: £20m) has arisen on profit before taxation of £380m (2017: £325m).

The tax for the period is lower (2017: lower) than the standard rate of corporation tax in the UK of 19.16% (2017: 20.0%). The differences are explained below:

	2018 £m	2017 £m
Profit before taxation	380	325
Profit before taxation at 19.16% (2017: 20.0%)	73	65
Effects of:		
Recurring items:		
– Expenses not deductible for tax purposes	(6)	1
– Disallowed depreciation on UK properties	20	20
– Deferred tax on Safeway acquisition assets	(4)	(10)
– Adjustments in respect of prior periods	(2)	(8)
Non-recurring items:		
– Profit on property transactions	(8)	(6)
– Tax impact of impairment and related items	(4)	(21)
– Effect of change in tax rate	–	(21)
Tax charge for the period	69	20

Factors affecting current and future tax charges

The effective tax rate for the year was 18.2% (2017: 6.2%). The normalised tax rate for the year (excluding the impact of property transactions, business disposals and tax rate changes) was 23.8% (2017: 25.0%).

The normalised tax rate was 4.64% above the UK statutory tax rate of 19.16%. The main factor increasing the normalised tax rate is disallowed depreciation on UK properties which reflects the Group's strategy to maintain a majority freehold estate.

Legislation to reduce the standard rate of corporation tax to 17% from 1 April 2020 was included in the Finance Bill 2016 and was enacted in the prior period. Accordingly, deferred tax has been provided at 19% or 17% depending upon when the temporary difference is expected to reverse (2017: 19% or 17%).

There have been no indications of any further changes to the rate of corporation tax after 1 April 2020.

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

2 Taxation continued

2.3 Deferred tax

	2018 £m	2017 £m
Net deferred tax liability	478	417

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

The movements in deferred tax liabilities during the period are shown below:

	Property, plant and equipment £m	Pensions £m	Other short-term temporary differences £m	Total £m
Current period				
At 30 January 2017	361	46	10	**417**
Charged to profit for the period	3	–	1	**4**
Charged to other comprehensive income and equity	–	55	2	**57**
At 4 February 2018	364	101	13	**478**
Prior period				
At 1 February 2016	392	33	4	**429**
(Credited)/charged to profit for the period	(31)	(4)	7	**(28)**
Charged/(credited) to other comprehensive income and equity	–	17	(1)	**16**
At 29 January 2017	361	46	10	**417**

The analysis of net deferred tax liabilities are as follows:

	2018 £m	2017 £m
Net deferred tax liabilities to be settled after more than 12 months	480	420
Net deferred tax assets to be settled within 12 months	(2)	(3)
	478	417

3 Operating assets

3.1 Accounting policies

Intangible assets

Goodwill

Goodwill arising on a business combination is not amortised but is reviewed for impairment on an annual basis or more frequently if there are indicators that it may be impaired. Goodwill is allocated to cash generating units that will benefit from the synergies of the business combination for the purpose of impairment testing.

Software development costs

Costs that are directly attributable to the creation of identifiable software, which meet the development asset recognition criteria as laid out in IAS 38 'Intangible assets', are recognised as intangible assets.

Direct costs include consultancy costs, the employment costs of internal software developers, and borrowing costs. All other software development and maintenance costs are recognised as an expense as incurred. Software development assets are held at historic cost less accumulated amortisation and impairment, and are amortised over their estimated useful lives (three to ten years) on a straight-line basis. Amortisation is charged in cost of sales.

Licences

Separately acquired pharmaceutical licences and software licences are recognised at historic cost less accumulated amortisation and impairment. Those acquired in a business combination are recognised at fair value at the acquisition date. Pharmaceutical licences and software licences are amortised over their useful lives (three to ten years) on a straight-line basis or over the life of the licence if shorter. Amortisation is charged in cost of sales.

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Costs include directly attributable costs such as borrowing costs and employment costs of those people directly working on the construction and installation of property, plant and equipment.

Depreciation rates

Depreciation rates used to write off cost less residual value on a straight-line basis are:

Freehold land	0%
Freehold buildings	2.5%
Leasehold land	Over the lease period
Leasehold buildings	Over the shorter of lease period and 2.5%
Plant, equipment, fixtures and vehicles	10% to 33%
Assets under construction	0%

Depreciation expense is primarily charged in cost of sales with an immaterial amount in administration expenses.

Investment property

Property held to earn rental income is classified as investment property and is held at cost less accumulated depreciation and impairment. The depreciation policy is consistent with that described for property above.

Non-current assets classified as held-for-sale

Non-current assets are classified as held-for-sale if their carrying amount is to be recovered principally through a sale transaction, rather than continuing use within the Group, and the sale is considered highly probable. The sale is expected to complete within one year from the date of classification and the assets are available for sale in their current condition. Non-current assets held-for-sale are stated at the lower of carrying amount and fair value less costs of disposal and are not depreciated.

Lessor accounting – operating leases

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

Finance leases

Assets funded through finance leases are capitalised as property, plant and equipment and depreciated over their useful economic life or lease term, whichever is shorter. The amount capitalised is the lower of the fair value and the present value, calculated using the interest rate implicit in the lease, of the future minimum lease payments. The obligations to pay future rentals are included within liabilities. Rental payments are apportioned between the finance charge and the outstanding obligation so as to produce a constant rate of finance charge on the remaining balance.

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

3 Operating assets continued

3.1 Accounting policies continued

Impairment of non-financial assets

Intangible assets with indefinite lives, such as goodwill, and those in construction that are not yet being amortised, are tested for impairment annually. Group policy is to test non-financial assets annually for impairment or if events or changes in circumstances indicate that the carrying amount may not be recoverable.

Testing is performed at the level of a cash generating unit (CGU) in order to compare the CGU's recoverable amount against its carrying value. An impaired CGU is written down to its recoverable amount, which is the higher of value in use or its fair value less costs to dispose. 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.

The Group considers that each of its stores is a CGU, which together form a grocery group of CGUs supported by corporate assets such as head office and vertically integrated suppliers.

Impairment losses are reversed if there is evidence of an increase in the recoverable amount of a previously impaired asset, 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. Impairment losses relating to goodwill are not reversed. Any reversal of impairment losses is excluded from underlying earnings.

3.2 Goodwill and intangible assets

Current period	Goodwill £m	Software development costs £m	Licences £m	Total £m
Cost				
At 30 January 2017	10	647	31	688
Additions	–	60	8	68
Reclassifications	–	7	(7)	–
Disposals	–	(3)	–	(3)
Fully written down assets	–	(26)	(3)	(29)
At 4 February 2018	10	685	29	724
Accumulated amortisation and impairment				
At 30 January 2017	–	229	14	243
Amortisation charge for the period	–	78	6	84
Impairment	–	1	–	1
Reclassifications	–	2	(2)	–
Disposals	–	(3)	–	(3)
Fully written down assets	–	(26)	(3)	(29)
At 4 February 2018	–	281	15	296
Net book amount at 4 February 2018	10	404	14	428

Included within software development costs are assets under construction of £20m (2017: £3m).

The Group has performed its annual assessment of its amortisation policies and asset lives and deemed them to be appropriate. No changes have been made to asset lives during the year.

As in previous years, fully amortised assets are retained in the Group's fixed asset register. In order to provide greater understanding of the Group's annual amortisation charge, assets which have become fully amortised in the year have been removed from both cost and accumulated amortisation.

Following the annual impairment review conducted by the Group, an impairment charge of £1m (2017: £nil) has been recognised in relation to intangible assets. This has been included as an adjustment to underlying earnings (see note 1.4).

Goodwill

The goodwill arose on the acquisition of Flower World Limited (£3m) and Farmers Boy (Deeside) Limited (£7m).

Impairment testing of goodwill

Goodwill of £10m is allocated to the grocery group of CGUs. This group of CGUs has been tested for impairment via the value in use calculation described in note 3.3. The pre-tax discount rate used is 9.0% (2017: 9.0%) and the growth rate applied to the period after five years is 2.0% (2017: 2.0%).

3 Operating assets continued

3.2 Goodwill and intangible assets continued

Software development costs

The cumulative interest capitalised included within software development costs is £41m (2017: £41m). The cost of internal labour capitalised during the year is not material for separate disclosure.

Prior period	Goodwill £m	Software development costs £m	Licences £m	Total £m
Cost				
At 1 February 2016	10	647	31	688
Additions	–	41	14	55
Fully written down assets	–	(41)	(14)	(55)
At 29 January 2017	10	647	31	688
Accumulated amortisation and impairment				
At 1 February 2016	–	187	18	205
Amortisation charge for the period	–	83	10	93
Fully written down assets	–	(41)	(14)	(55)
At 29 January 2017	–	229	14	243
Net book amount at 29 January 2017	10	418	17	445

3.3 Property, plant and equipment

Current period	Freehold land £m	Freehold buildings £m	Leasehold land and buildings £m	Plant, equipment, fixtures and vehicles £m	Total £m
Cost					
At 30 January 2017	3,948	4,251	944	1,409	**10,552**
Additions	–	23	1	403	**427**
Interest capitalised	–	1	–	–	**1**
Reclassifications	2	5	(7)	–	**–**
Disposals	(52)	(67)	(2)	(8)	**(129)**
Fully written down assets	–	(24)	(4)	(68)	**(96)**
At 4 February 2018	3,898	4,189	932	1,736	**10,755**
Accumulated depreciation and impairment					
At 30 January 2017	601	1,690	469	565	**3,325**
Depreciation charge for the period	–	100	17	216	**333**
Impairment	49	25	24	20	**118**
Impairment reversal	(51)	(44)	(21)	(10)	**(126)**
Reclassifications	–	4	(4)	–	**–**
Disposals	(23)	(10)	(2)	(7)	**(42)**
Fully written down assets	–	(24)	(4)	(68)	**(96)**
At 4 February 2018	576	1,741	479	716	**3,512**
Net book amount at 4 February 2018	3,322	2,448	453	1,020	**7,243**
Assets under construction included above	5	16	–	3	**24**

The Group has performed its annual assessment of its depreciation policies and asset lives and deemed them to be appropriate. No changes have been made to asset lives during the year.

As in previous years, fully depreciated assets are retained in the Group's fixed asset register. In order to provide greater understanding of the Group's annual depreciation charge, assets which have been fully depreciated in the year have been removed from both cost and accumulated depreciation.

During June 2017, the Group sold the land and buildings of its customer fulfilment centre (CFC) at Dordon to a third party for cash consideration of £92m. The disposal is included within the disposals during the 53 weeks ended 4 February 2018. The disposal resulted in a profit of £14m. This profit has been included in profit/loss on disposal and exit of properties as an adjustment to underlying earnings (see note 1.4).

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

3 Operating assets continued

3.3 Property, plant and equipment continued

Included within the table on page 81 are leasehold land and buildings held under finance lease with a cost of £293m (2017: £294m) and accumulated depreciation of £75m (2017: £72m).

The cost of financing property developments prior to their opening date has been included in the cost of the asset. The cumulative amount of interest capitalised in the total cost above amounts to £199m (2017: £198m).

Impairment

The Group considers that each store is a separate cash generating unit (CGU) and therefore considers every store for an indication of impairment annually. The Group calculates each store's recoverable amount and compares this amount to its book value. The recoverable amount is determined as the higher of 'value in use' and 'fair value less costs of disposal'. If the recoverable amount is less than the book value, an impairment charge is recognised based on the following methodology:

'Value in use' is calculated by projecting individual store pre-tax cash flows over the remaining useful life of the store, based on forecasting assumptions. The methodology used for calculating future cash flows is to:

- use the actual cash flows for each store in the current year;
- allocate a proportion of the Group's central costs to each store on an appropriate basis;
- project each store's cash flows over the next five years by applying forecast sales and cost growth assumptions;
- project cash flows beyond year five for the remaining useful life of each store by applying a long-term growth rate; and
- discount the cash flows using a pre-tax rate of 9.0% (2017: 9.0%). The discount rate takes into account the Group's weighted average cost of capital.

'Fair value less costs of disposal' is estimated by the Directors based on their knowledge of individual stores and the markets they serve and likely demand from grocers or other retailers. The Directors also obtain valuations by store prepared by independent valuers and consider these in carrying out their estimate of fair value less cost of disposal for the purposes of testing for impairment. In determining their valuation, the independent valuers assume an expected rent and yield for each store based on the quality of the asset, local catchment and the store being occupied by a supermarket tenant with a similar covenant to Morrisons.

In order to reflect specific local market conditions, in particular the continued low demand from major grocery retailers for supermarket space, the Directors consider it appropriate for the purpose of testing for impairment to revise downwards the rent and yield assumptions in the independent valuation to reflect the following factors on a store by store basis:

- whether a major grocery operator might buy the store, taking into consideration whether they are already located near the store, and whether the store size is appropriate for their business model, and then if not;
- assessing whether a smaller store operator might buy the store, in which case the value has been updated to reflect the Directors' assessment of the yield which would be achievable if such an operator acquired the store, and then if not; and
- assessing whether a non-food operator might buy the store, in which case the value has been updated to reflect the Directors' assessment of the yield which would be achievable if such an operator acquired the store.

Having applied the above methodology and assumptions, the Group has recognised a net impairment reversal of £8m (£126m impairment reversal offset by £118m impairment charge) during the year in respect of property, plant and equipment (2017: £44m; £191m impairment reversal offset by £147m impairment charge). This movement reflects fluctuations from store level trading performance and local market conditions.

At 4 February 2018, the key assumption to which the value in use calculation is most sensitive to is the discount rate. Specific sensitivity analysis with regard to this assumption shows that an increase of 1% in the discount rate would result in an additional impairment charge of £96m.

3 Operating assets continued

3.3 Property, plant and equipment continued

Prior period	Freehold land £m	Freehold buildings £m	Leasehold land and buildings £m	Plant, equipment, fixtures and vehicles £m	Total £m
Cost					
At 1 February 2016	3,978	4,290	978	1,306	10,552
Additions	2	10	9	346	367
Interest capitalised	–	1	–	–	1
Reclassifications	3	11	(14)	–	–
Transfers from investment properties	–	(4)	–	–	(4)
Transfers to assets held-for-sale	(35)	(30)	–	(4)	(69)
Disposals	–	(9)	(24)	(76)	(109)
Fully written down assets	–	(18)	(5)	(163)	(186)
At 29 January 2017	3,948	4,251	944	1,409	10,552
Accumulated depreciation					
At 1 February 2016	657	1,645	510	579	3,391
Depreciation charge for the period	–	99	16	190	305
Impairment	55	38	18	36	147
Impairment reversal	(92)	(53)	(39)	(7)	(191)
Reclassifications	–	9	(9)	–	–
Transfers to assets held-for-sale	(19)	(26)	–	(4)	(49)
Disposals	–	(4)	(22)	(66)	(92)
Fully written down assets	–	(18)	(5)	(163)	(186)
At 29 January 2017	601	1,690	469	565	3,325
Net book amount at 29 January 2017	3,347	2,561	475	844	7,227
Assets under construction included above	4	–	–	2	6

3.4 Assets classified as held-for-sale

	2018 £m	2017 £m
At start of period	–	–
Additions	–	19
Transfers from property, plant and equipment at net book value	–	20
Transfers from investment property at net book value	4	7
Disposals	–	(46)
At end of period	4	–

No assets were transferred from property, plant and equipment to assets classified as held-for-sale in the 53 weeks ended 4 February 2018 (2017: assets transferred with a cost of £69m and accumulated depreciation of £49m). Assets transferred from investment property had a cost of £5m (2017: £10m) and accumulated depreciation of £1m (2017: £3m).

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

3 Operating assets continued

3.5 Investment property

	2018 £m	2017 £m
Cost		
At start of period	53	59
Additions	5	–
Transfers from property, plant and equipment	–	4
Transfers to assets classified as held-for-sale	(5)	(10)
At end of period	53	53
Accumulated depreciation and impairment		
At start of period	20	22
Charge for the period	1	1
Transfers to assets classified as held-for-sale	(1)	(3)
At end of period	20	20
Net book amount at end of period	33	33

Included in other operating income is £8m (2017: £7m) of rental income generated from investment properties. At the end of the period the fair value of investment properties was £52m (2017: £51m). Investment properties are valued by independent surveyors on a vacant possession basis using observable inputs (fair value hierarchy level 2).

3.6 Operating leases – lessor

The Group has non-cancellable agreements with tenants with varying terms, escalation clauses and renewal rights. The future minimum lease income is as follows:

	2018 £m	2017 £m
Within one year	11	16
More than one year and less than five years	29	55
After five years	20	27
	60	98

3.7 Capital commitments

	2018 £m	2017 £m
Contracts placed for future capital expenditure not provided in the financial statements (property, plant and equipment and intangible assets)	38	28

4 Interests in other entities

4.1 Accounting policies

Joint ventures

The Group applies IFRS 11 'Joint Arrangements' to all joint arrangements. Under IFRS 11 investments in joint arrangements are classified as either joint operations or joint ventures depending on the contractual rights and obligations of each investor. The Group has assessed the nature of its joint arrangements and determined them to be joint ventures. Joint ventures are accounted for under the equity method and are initially recognised at cost.

The consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of the equity accounted investees, from the date that joint control commences until the date that joint control ceases.

Investments

Investments comprise investments in equity instruments held for long-term investment. They are measured at fair value through other comprehensive income, where the fair value can be measured reliably. Where the fair value of the instruments cannot be measured reliably, for example, when there is variability in the range of estimates, the investments are recognised at cost less accumulated impairment losses. When the Group disposes of an investment, the fair value of the consideration received less the carrying value of the investment at the date of disposal is recognised in profit or loss, along with any amounts previously recognised in other comprehensive income in respect of the investment.

Business combinations

The acquisition method is used to account for business combinations. Consideration is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group, including the fair value of any contingent consideration arrangement. Acquisition related costs are expensed as incurred. Identifiable assets acquired, and liabilities and contingent liabilities assumed, are measured initially at their fair values at the acquisition date. On an acquisition by acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets.

Goodwill is the excess of consideration transferred, plus any non-controlling interest and the fair value of any previous equity interest in the acquiree, over the fair value of the identifiable net assets acquired. In the event that this excess is negative the difference is recognised directly in profit for the period.

Disposal of subsidiaries

When the Group ceases to have control over a subsidiary, any retained interest in the entity is remeasured to its fair value at the date when control is lost, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities.
This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

4 Interests in other entities continued

4.2 Investment in joint ventures

The Group and Ocado Group plc are sole investors in a company (MHE JV Co), which owns the plant and equipment at the Dordon Customer Fulfilment Centre. The Group has a 51.5% interest in MHE JV Co (2017: 50%). Decisions regarding MHE JV Co require the unanimous consent of both parties. The Directors have considered the impact of IFRS 11 and determined that the Group continues to jointly control MHE JV Co.

MHE JV Co	2018 £m	2017 £m
Non-current assets	86	96
Current assets	20	22
Current liabilities	(3)	(6)
Net assets	103	112
Group's share of net assets	53	56
Profit	4	4
Group's share of profit	2	2

4.3 Investments

	2018 £m	2017 £m
At start of period	–	31
Fair value adjustments	–	14
Disposals	–	(45)
At end of period	–	–

In the 52 weeks ended 29 January 2017, the Group disposed of its 10% stake in Fresh Direct Inc, a US internet grocer, for cash consideration of £45m, net of £1m of transaction costs. In line with IAS 39 'Financial Instruments: Recognition and Measurement', the asset was remeasured to fair value before the sale completed, resulting in a £14m increase in the book value of the investment. On disposal the £14m revaluation gain was recognised in the income statement net of £1m of transaction costs. This profit is one-off in nature and was excluded from reported underlying earnings for the 52 weeks ended 29 January 2017 (see note 1.4). Following the transaction the undrawn loan facility provided to Fresh Direct Inc ceased.

4.4 Business combinations

In the 53 weeks ended 4 February 2018 and in the 52 weeks ended 29 January 2017 there were no business combinations.

4.5 Disposals of businesses

In the 53 weeks ended 4 February 2018 and in the 52 weeks ended 29 January 2017 there were no disposals of businesses.

5 Working capital and provisions

5.1 Accounting policies

Stock

Stock represents goods for resale and is measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs necessary to make the sale. Cost is calculated on a weighted average basis and comprises purchase price, and other directly attributable costs, including import duties and other non-recoverable taxes, reduced by promotional funding and commercial income and a provision for estimated losses relating to shrinkage and obsolescence. Losses relating to shrinkage in stores are based on historical losses verified by physical stock counts conducted by an independent third party. Provision is made for obsolete and slow moving items.

Trade and other debtors

Trade and other debtors are initially recognised at fair value, which is generally equal to face value, and subsequently held at amortised cost. Provision is made when there is objective evidence that the Group will not be able to recover balances in full, with the charge being included in administrative expenses.

Cash and cash equivalents

Cash and cash equivalents for cash flow purposes includes cash-in-hand, cash-at-bank and bank overdrafts. In the balance sheet, bank overdrafts that do not have right of offset are presented within current liabilities.

Cash and cash equivalents includes debit and credit card payments made by customers which clear the bank shortly after the sale takes place.

Cash held by the Group's captive insurer, Farock Insurance Company Limited, is not available for use by the rest of the Group as it is restricted for use against the specific liability of the captive. As the funds are available on demand, they meet the definition of cash in IAS 7 'Cash flow statements'.

Trade and other creditors

Trade and other creditors are initially recognised at fair value, which is generally equal to face value of the invoices received, and subsequently held at amortised cost. Trade creditors are presented net of commercial income due when the Group's trading terms state that income from suppliers will be netted against amounts owing to that supplier.

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, and where it can be reliably measured. For petrol filling station decommissioning costs this is when the filling station is first constructed and for dilapidations on leased buildings, when the lease is entered into. Provisions for onerous leases and other onerous contracts are recognised when the Group believes that the unavoidable costs of meeting the obligations exceed the economic benefits expected to be received under the contract. The amounts provided are based on the Group's best estimate of the least net cost of exit. Where material, these estimated outflows are discounted to net present value using a pre-tax rate that reflects current market assumptions. The unwinding of this discount is recognised as a financing cost in the income statement.

5.2 Stock

	2018 £m	2017 £m
Finished goods	686	614

Unearned elements of commercial income are deducted from finished goods as the stock has not been sold.

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

5 Working capital and provisions continued

5.3 Debtors

	2018 £m	2017 £m
Trade debtors:		
– Commercial income trade debtors	3	4
– Accrued commercial income	29	38
– Other trade debtors	123	101
Less: provision for impairment of trade debtors	(6)	(6)
	149	137
Prepayments and accrued income	91	68
Other debtors	10	9
	250	214

The ageing analysis of trade debtors is as follows:

	2018 £m	2017 £m
Neither past due nor impaired	149	137
Past due but not impaired:		
Not more than three months	–	–
Greater than three months	–	–
Impaired debt	6	6
	155	143

As at 4 February 2018 and 29 January 2017, trade debtors that were neither past due nor impaired related to a number of debtors for whom there is no recent history of default. The other classes of debtors do not contain impaired assets.

As at 11 March 2018, £2m of the £3m commercial income trade debtor balance had been settled and £16m of the £29m accrued commercial income balance had been invoiced and settled.

5.4 Creditors

	2018 £m	2017 £m
Trade creditors	2,298	2,160
Less: commercial income due, offset against amounts owed	(28)	(34)
	2,270	2,126
Other taxes and social security payable	93	68
Other creditors	147	198
Accruals and deferred income	471	445
	2,981	2,837

Included within accruals and deferred income is £4m (2017: £3m) in respect of deferred commercial income.

As at 11 March 2018, £20m of the £28m commercial income due above had been offset against payments made.

5 Working capital and provisions continued

5.5 Provisions

	Onerous leases and onerous contracts £m	Other property provisions £m	Total £m
At 30 January 2017	306	20	**326**
Charged to profit for the period	22	–	**22**
Utilised/released during the period	(62)	–	**(62)**
Unwinding of discount	13	–	**13**
At 4 February 2018	279	20	**299**

Part of the onerous leases relate to sublet and vacant properties, with commitments ranging from one to 55 years. The provision is revised regularly in response to market conditions. During the year, £22m has been charged to onerous lease and onerous contracts provisions due to changes in circumstances or performance relating to certain contracts, which has been offset by a £23m release in relation to others, as detailed in note 1.4. The utilisation of provisions relates to the ongoing utilisation of onerous contracts and the assignment of onerous leases.

Other property provisions include a petrol filling station decommissioning reserve for the cost of decommissioning petrol tanks, and provisions for dilapidations on leased buildings, for the cost of restoring assets to their original condition.

5.6 Cash generated from operations

	2018 £m	2017 £m
Profit for the period	**311**	305
Net finance costs	**80**	145
Taxation charge	**69**	20
Share of profit of joint venture (net of tax)	**(2)**	(2)
Operating profit	**458**	468
Adjustments for:		
Depreciation and amortisation	**418**	399
Impairment	**119**	147
Impairment reversal	**(126)**	(191)
Profit/loss arising on disposal and exit of properties and sale of investments	**(19)**	(32)
Adjustment for non-cash element of pension charges	**10**	7
Share-based payments charge	**33**	20
Other non-cash charges	**–**	2
(Increase)/decrease in stock[1]	**(72)**	2
Increase in debtors[1]	**(50)**	(19)
Increase in creditors[1]	**153**	306
(Decrease)/increase in provisions[1]	**(40)**	4
Cash generated from operations	**884**	1,113

Total working capital outflow (the sum of items marked[1] in the table) is £9m in the year (29 January 2017: £293m inflow). This includes £1m (29 January 2017: £38m) as a result of the current year charges in respect of onerous contracts and accruals of onerous commitments, net of £42m (29 January 2017: £94m) of onerous payments and other non-operating payments of £3m (29 January 2017: £11m). When adjusted to exclude these items, the working capital inflow is £35m (29 January 2017: £360m).

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

6 Capital and borrowings

6.1 Accounting policies

Borrowings

Interest-bearing 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 profit for the period over the period of the borrowings on an effective interest rate basis.

Borrowing costs

All borrowing costs are recognised in the Group's profit for the period 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 commences when both expenditure on the asset and borrowing costs are being incurred, and necessary activities to prepare the asset for use are in progress. In the case of new stores, this is generally once planning permission has been obtained. Capitalisation ceases when the asset is ready for use. Interest is capitalised at the effective rate incurred on borrowings before taxation of 5% (2017: 5%). Capitalised interest is included within interest paid in cash flow from operating activities.

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. Property leases are analysed into separate components for land and buildings and tested to establish whether the components are operating leases or finance leases. Rental payments on operating leases in which the Group is lessee are taken to profit for the period on a straight-line basis over the life of the lease.

Sale and leaseback of properties

The accounting treatment of the sale and leaseback depends upon the substance of the transaction (by applying the lease classification principles described above). For sale and operating leasebacks, the assets are sold at fair value, and accordingly the profit or loss from the sale is recognised immediately in the Statement of comprehensive income. When forming the conclusion of operating lease classification, consideration is given to the key lease classification indicators of IAS 17. The leases are typically for a 25 year period. On making this assessment the Directors reviewed the remaining useful lives for these particular properties and concluded they are significantly longer than the period of the lease. As disclosed on page 81 a review of the useful economic lives of each of the property, plant and equipment categories has been performed in the year with no changes made. Other key indicators considered in reaching an operating lease classification were the present value of the minimum lease payments and the ownership clauses in the contracts upon expiry of the lease.

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.

Own shares held

The Group has employee trusts for the granting of Group shares to executives and members of the employee share plans. Shares in the Group held by the employee share trusts are 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.

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).

6 Capital and borrowings continued

6.2 Finance costs and income

	2018 £m	2017 £m
Interest payable on short-term loans and bank overdrafts	(2)	(3)
Interest payable on bonds	(63)	(86)
Interest capitalised	1	1
Total interest payable	(64)	(88)
Provisions: unwinding of discount (note 5.5)	(13)	(13)
Other finance costs	(1)	(3)
Underlying finance costs[1]	(78)	(104)
Costs associated with the repayment of borrowings (note 1.4)	(16)	(56)
Finance costs	(94)	(160)
Bank interest received	5	6
Amortisation of bonds	–	1
Underlying finance income[1]	5	7
Net pension income (note 1.4 and 8.2)	9	8
Finance income	14	15
Net finance cost	(80)	(145)

1 Underlying net finance costs marked [1] amount to £73m (2017: £97m).

6.3 Borrowings

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

	2018 £m	2017 £m
Current		
£71m sterling bonds 6.12% December 2018 (2017: £135m)	72	–

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

	2018 £m	2017 £m
Non-current		
£71m sterling bonds 6.12% December 2018 (2017: £135m)	–	136
£365m sterling bonds 4.625% December 2023 (2017: £365m)	363	363
£318m sterling bonds 3.50% July 2026 (2017: £384m)	342	411
£300m sterling bonds 4.75% July 2029 (2017: £300m)	293	292
€280m euro bond 2.25% June 2020 (2017: €411m)	247	348
Total non-current borrowings	1,245	1,550

The December 2018 sterling bond has been reclassified as current as it is due for repayment within one year of the balance sheet date.

The movements in the nominal value of the other bonds are due to partial early repayment during the 53 weeks ended 4 February 2018. During the year, the Group continued to reduce its level of debt, through the partial early settlement of the 2018 and 2026 sterling bonds, and the 2020 euro bond.

Borrowing facilities

The Group has a syndicated committed revolving credit facility of £1.35bn with a maturity date of September 2021. The revolving credit facility incurs commitment fees and drawdowns bear interest at floating interest rates at a spread above LIBOR. There were no borrowings under the revolving credit facility at the balance sheet date. Therefore the Group had £1.35bn of undrawn committed borrowing facilities available (2017: £1.35bn).

In the event of default of covenants the principal amounts of borrowings and any interest accrued become repayable on demand.

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

6 Capital and borrowings continued

6.3 Borrowings continued

Maturity of borrowings

The table below summarises the maturity profile of the Group's borrowings based on contractual, undiscounted payments, which include interest payments. As a result, amounts shown below do not agree to the amounts disclosed on the balance sheet for borrowings. Creditors (note 5.4) are excluded from this analysis.

	2018 £m	2017 £m
Less than one year	123	61
One to two years	48	195
Two to three years	293	52
Three to four years	42	400
Four to five years	42	45
More than five years	1,130	1,248

Fair values

The fair value of the sterling and euro denominated bonds is measured using closing market prices (level 1). The fair values of borrowings included in level 2 are based on the net present value of the anticipated future cash flows associated with these instruments using rates currently available for debts on similar terms, credit risk and equivalent maturity dates.

These compare to carrying values as follows:

	2018		2017	
	Amortised cost £m	Fair value £m	Amortised cost £m	Fair value £m
Total bonds: non-current and current	1,317	1,429	1,550	1,676

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

6.4 Analysis of net debt

	Note	2018 £m	2017 £m
Cross-currency contracts and interest rate swaps[1]		12	6
Fuel and energy price contracts		4	10
Non-current financial assets	7.3	16	16
Foreign exchange forward contracts		1	11
Fuel and energy price contracts		14	11
Current financial assets	7.3	15	22
Bonds[1]	6.3	(72)	–
Foreign exchange forward contracts	7.3	(13)	(2)
Fuel and energy price contracts	7.3	–	(1)
Current financial liabilities		(85)	(3)
Bonds[1]	6.3	(1,245)	(1,550)
Fuel and energy price contracts	7.3	(1)	(5)
Non-current financial liabilities		(1,246)	(1,555)
Cash and cash equivalents		327	326
Net debt		(973)	(1,194)

Total net liabilities from financing activities (the sum of items marked [1] in the table) is £1,305m in the 53 weeks ended 4 February 2018 (2017: £1,544m).

Cash and cash equivalents include restricted balances of £7m (2017: £9m) which is held by Farock Insurance Company Limited, a subsidiary of Wm Morrison Supermarkets PLC.

6 Capital and borrowings continued

6.5 Called-up share capital

	Number of shares millions	Share capital £m	Share premium £m	Total £m
At 30 January 2017	2,335.6	234	128	362
Share options exercised	20.3	2	31	33
At 4 February 2018	2,355.9	236	159	395

The total authorised number of ordinary shares is 4,000 million shares (2017: 4,000 million shares) with a par value of 10p per share (2017: 10p per share). All issued shares are fully paid. The Group did not acquire any of its own shares for cancellation in the 53 weeks ended 4 February 2018 or the 52 weeks ended 29 January 2017.

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

Trust shares
Included in retained earnings is a deduction of £14m (2017: £14m) in respect of own shares held at the balance sheet date. This represents the cost of 7,661,470 (2017: 8,458,487) of the Group's ordinary shares (nominal value of £0.8m (2017: £0.8m)). These shares are held in a trust and were acquired by the business to meet obligations under the Group's employee share plans using funds provided by the Group. The market value of the shares at 4 February 2018 was £17m (2017: £20m). The trust has waived its right to dividends. These shares are not treasury shares as defined by the London Stock Exchange.

During the period the Group acquired 1,787,165 (2017: 2,790,045) of its own shares to hold in trust for consideration of £4m (2017: £5m), and utilised 2,584,182 (2017: 2,733,049) trust shares to satisfy awards under the Group's employee share plans.

Proceeds from exercise of employee share options
The Group issued 20,279,315 (2017: 381,043) new shares to satisfy options exercised by employees during the period. Proceeds received on exercise of these shares amounted to £33m (2017: £0.6m) and these have been recognised as an addition to share capital and share premium in the period.

Settlement of employee tax liability for share awards
During the 53 weeks ended 4 February 2018 the Group has settled 2,584,182 of share options out of trust shares which have vested during the period net of tax. The Group paid the £7m tax liability in cash (2017: £nil) due on the vesting of these share options on behalf of the employees rather than selling shares on the employees' behalf to settle the tax due.

6.6 Reserves

	2018 £m	2017 £m
Capital redemption reserve	39	39
Merger reserve	2,578	2,578
Hedging reserve	2	18
Retained earnings	1,531	1,066
Total	4,150	3,701

Capital redemption reserve
The capital redemption reserve relates to 389,631,561 of the Company's own shares which it purchased on the open market for cancellation between 31 March 2008 and 8 March 2013 at a total cost of £1,081m.

Merger reserve
The merger reserve represents the reserve in the Company's balance sheet arising on the acquisition in 2004 of Safeway Limited.

Hedging reserve
This represents the gains and losses arising on derivatives used for cash flow hedging.

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

6 Capital and borrowings continued

6.7 Capital management

The Group defines the capital that it manages as the Group's total equity and net debt balances, as well as its lease commitments.

The Group's capital management objectives are to safeguard its viability taking into consideration the risks that it faces whilst maintaining an investment grade credit rating and having adequate liquidity headroom. The Group manages its capital structure by managing the balance of debt and shares outstanding. It does this by seeking an effective balance between debt and equity. During the 53 weeks ended 4 February 2018, net debt has reduced by £221m. Throughout the year, the Group has comfortably complied with the gearing and fixed charge cover covenants attaching to its revolving credit facility.

6.8 Operating leases – lessee

The Group has outstanding commitments for future minimum lease payments under non-cancellable operating leases. The leases have varying terms, escalation clauses and renewal rights, and fall due as follows:

	2018		2017	
	Property £m	Vehicles, plant and equipment £m	Property £m	Vehicles, plant and equipment £m
Within one year	114	13	121	14
More than one year and less than five years	435	22	466	34
After five years	1,666	–	1,851	–
	2,215	35	2,438	48

The movement in the property lease commitments within one year is summarised below:

	£m
At 30 January 2017	121
Net impact of disposal programme	(7)
New lease commitments	1
Other	(1)
At 4 February 2018	114

7 Financial risk and hedging

7.1 Accounting policies

Derivative financial instruments and hedge accounting

Derivatives are transacted to mitigate financial risks that arise as a result of the Group's operating activities and funding arrangements. At the inception of a hedge, the Group documents the relationship between the hedging instrument and the hedged item, the risk management objective and strategy for undertaking the hedge.

The Group assesses whether the hedging instrument is highly effective in offsetting changes in fair values or cash flows of the hedged item at inception and it also assesses whether the hedge has been and will continue to be effective on an ongoing basis.

All derivatives are initially recognised at fair value and are also measured at fair value at each reporting date. Derivatives with positive fair values are recognised as assets and those with negative fair values as liabilities. They are also categorised as current or non-current according to the maturity of each derivative. All gains or losses arising due to changes in the fair value of derivatives are recognised in profit or loss except when the derivative qualifies for cash flow hedge accounting.

Cash flow hedges

The Group designates derivatives into a cash flow hedge where they have been transacted to hedge a highly probable forecast transaction or a particular risk associated with an asset or liability. The effective portion of the change in the fair value of the derivatives, that are designated into cash flow hedge relationships, are recognised in other comprehensive income. Cumulative gains or losses on derivatives are reclassified from other comprehensive income into profit or loss in the period when the transaction occurs. Any ineffective portion of the gain or loss on the derivative is immediately recognised in profit or loss.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs at which point the net cumulative gain or loss recognised in equity is transferred to profit or loss in the period.

Fair value hedge

The Group designates derivatives into a fair value hedge relationship when they hedge the Group's exposure to changes in the fair value of a recognised asset or liability, or a firm commitment. The change in fair value of the hedged asset or liability that is attributable to the hedged risk is recognised in profit or loss for the period as well as the gain or loss from changes in the fair value of the derivative.

7.2 Financial risk management

The Group has a centralised treasury function which manages funding, liquidity and other financial risk in accordance with the Board approved Treasury Policy. The objective of the policy and controls that are established is to mitigate the risk of an adverse impact on the performance of the Group as a result of its exposure to financial risks arising from the Group's operations and its sources of finance. It is the Group's policy not to engage in speculative trading of financial instruments.

The Board retains ultimate responsibility for treasury activity and is involved in key decision making. A Treasury Committee is established to provide governance and oversight to treasury activity within delegated authority limits and formally reports to the Audit Committee.

Foreign currency risk

The majority of purchases made by the Group are denominated in sterling, however some trade purchases are made in other currencies, primarily the euro and US dollar. The Group's objective is to reduce short-term profit volatility from exchange rate fluctuations. Group policy specifies the minimum percentage of committed and highly probable exposures that must be hedged.

Cross-currency interest rate swaps are used to mitigate the Group's currency exposure arising from payments of interest and principal in relation to foreign currency funding.

At the reporting date, the sensitivity to a reasonable possible change (+/-10%) in the US dollar and euro exchange rates would equate to a £9m post-tax profit or loss exposure in relation to the euro and £2m in relation to the US dollar, for the unhedged forecast foreign currency exposures over the next 12 months. A movement of the pound sterling by +/-10% against the euro and US dollar exchange rates would impact other comprehensive income by £27m for the hedged amount.

Liquidity risk

The Group policy is to maintain an appropriate maturity profile across its borrowings and a sufficient level of committed headroom to meet obligations. The Group finances its operations using a diversified range of funding providers including banks and bondholders.

A central cash forecast is maintained by the treasury function who monitor the availability of liquidity to meet business requirements and any unexpected variances. The treasury function seek to centralise surplus cash balances to minimise the level of gross debt. Short-term cash balances, together with undrawn committed facilities, enable the Group to manage its day-to-day liquidity risk. Any short-term surplus is invested in accordance with Treasury Policy.

The Treasury Committee compares the committed liquidity available to the Group against the forecast requirements including policy headroom. This policy includes a planning assumption that supply chain finance facilities are not available.

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

7 Financial risk and hedging continued

7.2 Financial risk management continued

Interest rate risk

The Group seeks to protect itself against adverse movements in interest rates by maintaining at least 60% of its total borrowings at fixed interest rates. As at the balance sheet date, 100% (2017: 100%) of the Group's borrowings are at fixed rate.

Whilst still applying the policy described above, from time-to-time the Group enters into fixed-to-floating interest rate swaps to achieve the appropriate proportion of fixed versus floating rate borrowings.

Credit risk

As a retailer, the majority of the Group's revenue is received in cash at the point of sale and therefore credit risk is not considered significant to the Group. Some credit risk does arise from cash and cash equivalents, deposits with banking groups and exposures from other sources of income such as commercial income, third party wholesale customers and tenants of investment properties.

The Group has established appropriate credit verification procedures in respect of financial institutions. Limits on the total exposure to any counterparty or Group of connected counterparties are established within Treasury Policy, taking into account credit ratings. Compliance with limits is regularly monitored.

There are no significant concentrations of credit risk within the Group.

Commodity price risk

The Group manages the risks associated with the purchase of electricity, gas and diesel consumed by its activities (excluding fuel purchased for resale to customers) by entering into hedging contracts to fix prices for expected consumption.

The Group has adopted a capital at risk model for hedging its fuel and power consumption. The Treasury Committee reviews the Group's exposure to commodity prices and ensures it remains within policy limits.

A change of +/-10% in the market value of the commodity price at the balance sheet date would affect other comprehensive income by £13m (2017: £18m).

7.3 Derivative financial assets and liabilities

Derivative financial assets	2018 £m	2017 £m
Current		
Foreign exchange forward contracts	1	11
Fuel and energy price contracts	14	11
	15	22
Non-current		
Cross-currency contracts and interest rate swaps	12	6
Fuel and energy price contracts	4	10
	16	16

All derivatives are categorised as level 2 instruments. Level 2 fair values for simple, over-the-counter derivatives are calculated by using benchmarked, observable market interest rates to discount future cash flows.

Derivative financial liabilities	2018 £m	2017 £m
Current		
Foreign exchange forward contracts	13	2
Fuel and energy price contracts	–	1
	13	3
Non-current		
Fuel and energy price contracts	1	5
	1	5

7 Financial risk and hedging continued

7.3 Derivative financial assets and liabilities continued

The amounts disclosed in the table below are the contractual undiscounted derivative cash flows and therefore differ to those in the balance sheet.

Maturity analysis of derivatives	2018 < 1 year £m	2018 1-5 years £m	2017 < 1 year £m	2017 1-5 years £m
Derivatives settled on a gross basis				
Cross-currency swaps – cash flow hedges				
– Outflow	(7)	(254)	(10)	(381)
– Inflow	6	250	8	376
Forward contracts – cash flow hedges				
– Outflow	(350)	–	(246)	–
– Inflow	339	–	251	–
Derivatives settled on a net basis				
Energy price contracts – cash flow hedges				
– Inflow	14	3	8	7

Cash flow hedges

At 4 February 2018 and at 29 January 2017, the Group held cross-currency swaps designated as cash flow hedges. The notional principal amount of the outstanding cross-currency swaps at 4 February 2018 was €282m (2017: €413m).

The fuel and energy price contracts and foreign currency derivatives shown in note 7.3 are designated as cash flow hedges.

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

8 Pensions

8.1 Accounting policies

A defined contribution scheme is a pension scheme under which the Group pays fixed contributions into a separate entity and provides no guarantee as to the quantum of retirement benefits that those contributions will ultimately purchase. A defined benefit scheme is one that is not a defined contribution scheme.

8.1.1 Defined benefit schemes

Pension scheme assets are valued at fair market value as required by IAS 19. Pension scheme obligations are an estimate of the amount required to pay the benefits that employees have earned in exchange for current and past service, assessed and discounted to present value using the assumptions shown in note 8.4.1. The net pension liability or asset recognised in the Consolidated balance sheet is the net of the schemes' assets and obligations, which are calculated separately for each scheme.

Current service cost is treated as an operating cost in the Consolidated statement of comprehensive income and Consolidated cash flow statement and is part of underlying earnings. Net interest income/expense is calculated by applying the discount rate on liabilities to the net pension liability or asset (adjusted for cash flows over the accounting period) and is recognised in finance costs or income and excluded from underlying earnings.

Expenses incurred in respect of the management of scheme assets are included in other comprehensive income as a reduction in the return on scheme assets. Other scheme expenses are recognised in profit or loss as an operating expense.

Remeasurements comprise of actuarial gains and losses on the obligations and the return on scheme assets (excluding interest). They are recognised immediately in other comprehensive income. Amounts shown within note 8 are before any adjustments for deferred taxation.

8.1.2 Defined contribution schemes

The cost of defined contribution schemes is recognised in the income statement as incurred. The Group has no further payment obligations once the contributions have been paid.

8.2 Defined benefit schemes: summary and description

The Group operates a number of defined benefit retirement schemes (together 'the Schemes') providing benefits based on a benefit formula that depends on factors including the employee's age and number of years of service. The Morrison and Safeway Schemes provide pension benefits based on either the employee's compensation package and/or career average revalued earnings (CARE) (the 'CARE Schemes'). The CARE Schemes are not open to new members and were closed to future accrual in July 2015. The Retirement Saver Plan ('RSP') is a cash balance scheme, which provides a lump sum benefit based upon a defined proportion of an employee's annual earnings in each year, which is revalued each year in line with inflation subject to a cap.

The position of each scheme at 4 February 2018 is as follows:

	2018 £m	2017 £m
CARE Schemes	612	293
RSP	(18)	(21)
Net pension asset	594	272

The disclosures below show the details of the schemes combined:

Balance sheet:	2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Fair value of scheme assets	4,542	315	4,455	219
Present value of obligations	(3,930)	(333)	(4,162)	(240)
Net pension asset/(liability)	612	(18)	293	(21)

Consolidated statement of comprehensive income	2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Current service cost – recognised in cost of sales	–	60	–	42
Current service cost – recognised in administrative expenses	–	31	–	29
Administrative costs paid by the Schemes – recognised in administrative expenses	3	1	3	1
Settlement and curtailment gain	(10)	–	(1)	–
Net interest on net pension asset – finance income	(9)	–	(6)	(2)
Total expense (credited)/charged to income statement	(16)	92	(4)	70
Statement of other comprehensive income:				
Remeasurements in other comprehensive income (credit)/charge	(295)	(28)	(101)	15

8 Pensions continued

8.2 Defined benefit schemes: summary and description continued

The Schemes are registered schemes under the provisions of Schedule 36 of the Finance Act 2004 and the assets are held in legally separate, trustee-administered funds. The Board of each scheme is required by law to act in the best interests of the scheme participants within the context of administering the scheme in accordance with the purpose for which the trust was created, and is responsible for setting the investment, funding and governance policies of the fund. A representative of the Group attends Trustee Investment Committee meetings in order to provide the Group's view on investment strategy, but the ultimate power lies with the Trustees. The Deed and Rules of the Morrison Scheme gives the Trustees the power to set contributions, while in the Safeway Scheme and the RSP this power is given to the Group, subject to regulatory override.

Settlement and curtailment gains in the 53 weeks ended 4 February 2018 include £8m relating to the settlement of retirement benefits resulting from actions taken to further de-risk the Group's pension schemes.

8.3 Scheme assets

Assets of the Schemes generate returns and ultimately cash that is used to satisfy the Schemes' obligations. They are not necessarily intended to be realised in the short term. The Trustees of each Scheme invest in different categories of asset and with different allocations amongst those categories, according to the investment principles of that Scheme.

Currently, the investment strategy of the CARE Schemes is to maintain a balance of growth assets (equities and diversified growth funds), income assets (comprising credit investments, corporate bonds and absolute return bonds) and protection assets (comprising a liability driven investment (LDI) portfolio and the Safeway Scheme buy-in policy), with a weighting towards protection assets. There are no direct investments in the parent Company's own shares or property occupied by any member of the Group.

Fair value of Scheme assets:

	2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Equities (quoted)	562	130	770	107
Corporate bonds (quoted)	375	–	382	–
Absolute return bonds (quoted)	–	–	382	–
Diversified growth funds (quoted)	573	82	489	50
Credit funds (unquoted)	468	–	417	–
Liability driven investments (unquoted)	2,189	102	1,998	61
Annuity policies (unquoted)	336	–	–	–
Cash (quoted)	39	1	17	1
Total	4,542	315	4,455	219

Liability driven investments (LDI)

Part of the investment objective of the Schemes is to minimise fluctuations in the Schemes' funding levels due to changes in the value of the liabilities. This is primarily achieved through the use of 'liability driven investments' (LDI), whose main goal is to align movements in the value of assets with movements in the Schemes' liabilities arising from changes in market conditions. The Schemes have hedging that broadly covers interest rate movements and inflation movements, as measured on the Trustees' funding assumptions which use a discount rate derived from gilt yields.

LDI primarily involves the use of government bonds (including re-purchase agreements). Derivatives such as interest rate and inflation swaps are also used. There are no annuities or longevity swaps.

The value of the LDI assets is determined based on the latest market bid price for the underlying investments, which are traded daily on liquid markets.

Annuity policies

During the 53 weeks ended 4 February 2018, the Safeway Scheme entered into a buy-in policy that provides insurance for a proportion of the pensioner population. The policy pays an income to the scheme that is exactly equal to the benefits paid to the insured population. This has removed all investment, interest rate, inflation and longevity risks in respect of these members.

The value of the annuity is determined using the disclosed assumptions used for valuing the benefits of the Schemes and is equal to the accounting liabilities of the insured pensioner population.

Diversified growth funds

The Schemes employ diversified growth funds in order to reduce their exposure to equity markets. These funds typically invest in a range of public and private market assets, including equities, bonds, commodities, property and other assets.

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

8 Pensions continued

8.3 Scheme assets continued

Credit funds

The Schemes invest in credit funds in order to improve returns available from their bond assets. These funds typically lend directly to corporations on a senior secured basis, rather than purchasing debt issued in the public markets.

The credit funds invest in a portfolio of different debt instruments and their value is equal to the value of the component assets. For high yield debt, the value is based on the latest available market price. For senior debt and private credit, where no such market price exists, the value is taken either at par value or by determining a fair enterprise value using a variety of techniques. For real-estate related investments, the value is derived from market comparables or third party valuations.

Absolute return bonds

The Schemes employ absolute return bond managers to target a moderate investment return whilst aiming to preserve capital in most market environments. These funds typically invest in a range of fixed income instruments and derivatives, across different countries and currencies, actively managing their exposure according to their market views and opportunities available.

The movement in the fair value of the Schemes' assets over the period was as follows:

	2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Fair value of scheme assets at start of period	4,455	219	3,812	138
Interest income	125	7	138	7
Return on scheme assets excluding interest	159	25	612	20
Employer contributions	8	67	10	56
Employee contributions	–	3	–	3
Settlement and curtailment paid	(37)	–	–	–
Benefits paid	(165)	(5)	(114)	(4)
Administrative expenses	(3)	(1)	(3)	(1)
Fair value of scheme assets at end of period	4,542	315	4,455	219

Scottish Limited Partnership

The Group has previously entered into a pension funding partnership structure. In January 2013, Wm Morrison Supermarkets PLC made a contribution to the CARE Schemes of £90m. On the same day, the CARE Schemes invested £90m in the Wm Morrison Property Partnership ('SLP') as a limited partner. The SLP holds properties which have been leased back to the Group in return for rental income payments. The Group retains control over these properties, including the flexibility to substitute alternative properties.

As partners in the SLP, the CARE Schemes are entitled to receive a fixed distribution of £6.6m p.a. from the profits of the SLP for 20 years from 2013, subject to certain conditions. The distributions shared with the Schemes are reflected in the Group financial statements as employer pension contributions.

In July 2015, the SLP was amended to enhance the security provided to the Schemes by including additional properties. The terms of these additional properties are such that the CARE Schemes have no entitlement to receive a distribution.

The CARE Schemes' interests in the SLP reduce the respective deficits on a funding basis, although the agreements do not affect the position directly on an IAS 19 accounting basis because the investments held by the CARE Schemes do not qualify as scheme assets for IAS 19 purposes.

8 Pensions continued

8.4 Present value of obligations

The movement in the defined benefit obligation over the period was as follows:

	2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Defined benefit obligation at start of period	(4,162)	(240)	(3,634)	(130)
Current service cost	–	(91)	–	(71)
Interest expense	(116)	(7)	(132)	(5)
Actuarial gain – demographic assumptions	–	–	94	–
Actuarial gain/(loss) – financial assumptions	136	4	(852)	(40)
Actuarial (loss)/gain – experience	–	(1)	247	5
Settlement and curtailment gain	47	–	1	–
Employee contributions	–	(3)	–	(3)
Benefits paid	165	5	114	4
Defined benefit obligation at end of period	(3,930)	(333)	(4,162)	(240)

The durations of the defined benefit obligations at the end of the 2018 reporting period are: RSP 20 years; Morrison CARE 26 years; Safeway CARE 24 years. The weighted average duration of all three Schemes is 24 years.

8.4.1 Significant actuarial assumptions

The following are the principal actuarial assumptions at the reporting date (expressed as weighted averages):

Financial assumptions	2018 CARE	2018 RSP	2017 CARE	2017 RSP
Discount rate applied to scheme liabilities (% p.a.)	2.8%	2.7%	2.9%	2.8%
Inflation assumption (RPI) (% p.a.)	3.3%	3.3%	3.5%	3.5%

Life expectancies	2018 CARE	2018 RSP	2017 CARE	2017 RSP
Longevity in years from age 65 for current pensioners				
Male	22.4	n/a	22.3	n/a
Female	23.9	n/a	23.8	n/a
Longevity in years from age 65 for current members aged 45				
Male	24.6	n/a	24.5	n/a
Female	26.3	n/a	26.2	n/a

During the year, the Group has updated the methodology for deriving the discount rate assumption used in valuing the pension scheme liabilities. The Group believes that this revised approach better reflects expected yields on high quality corporate bonds over the duration of the Group's pension schemes, as required by IAS 19. The previous methodology estimated the discount rate with reference to both corporate bond and gilt yields. The new method uses high quality corporate bond yields where available. At very long durations, where there are no high quality corporate bonds, the yield curve is extrapolated based on available corporate bond yields of mid to long duration. This change reduced the value placed on the IAS 19 pensions liabilities of the Group by £242m and improved the pre-tax balance sheet position by £234m.

Assumptions regarding future mortality experience are set based on actuarial advice and in accordance with published statistics. Following analysis completed as part of the 2016 actuarial valuations, the 2017 year end mortality tables used have been updated to the S2PMA/S2PFA-Heavy tables (males/females) based on year of birth with a scaling factor of 110%/100% applied to the mortality rates in the Morrison/Safeway Scheme respectively, with CMI 2015 projections and a long-term rate of improvement of 1.5% p.a.

Related actuarial assumptions (expressed as weighted averages)

	2018 CARE	2018 RSP	2017 CARE	2017 RSP
Rate of increases in salaries (% p.a.)	–	2.2%	–	2.4%
Rate of increase of pensions in payment: RPI inflation capped at either 2.5% p.a. or 5% p.a. (% p.a.)	2.1%/3.1%	–	2.2%/3.3%	–
Pre-retirement revaluation for active members (% p.a.)	–	1.8%	–	1.9%
Rate of increase of pensions in deferment: CPI inflation capped at either 2.5% p.a. or 5% p.a. (% p.a.)	–/2.2%	2.2%/–	–/2.4%	2.4%/–
CPI inflation (% p.a.)	2.2%	2.2%	2.4%	2.4%

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

8 Pensions continued

8.4 Present value of obligations continued

8.4.2 Sensitivity analysis on significant actuarial assumptions

The following table summarises the impact on the defined benefit obligation at the end of the reporting period if each of the significant actuarial assumptions listed above were changed, in isolation, assuming no other changes in market conditions at the accounting date. In practice any movement in assumptions could be accompanied by a partially offsetting change in asset values, and the corresponding overall impact on the net asset/(liability) is therefore likely to be lower than the amounts below in a number of scenarios. Extrapolation of the sensitivities shown may not be appropriate.

		2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Discount rate applied to Scheme obligations	+/– 0.1% p.a.	–/+95	–/+7	–/+105	–/+5
Inflation assumption (RPI and associated assumptions)	+/– 0.1% p.a.	+/–85	+/–3	+/–95	+/–3
Longevity	+/– one year	+170	–	+180	–

8.5 Funding

The Morrison Scheme is entirely funded by the parent Company and the Safeway Scheme is funded by Safeway Limited and its subsidiaries. The parent Company and its subsidiaries participate in the RSP. There is no contractual agreement or stated policy for charging the net defined benefit cost between the parent Company and its subsidiaries. The contribution of each participating subsidiary to the RSP is currently calculated in proportion to the number of employees that are members of the RSP.

The latest full actuarial valuations were carried out as at 1 April 2016 for the Safeway Scheme and 5 April 2016 for the Morrison Scheme and the RSP. The valuations indicated that, on the agreed funding basis, the Safeway, Morrison and RSP Schemes had surpluses of £100m, £1m and £10m respectively. As a result of these funding positions there are currently no deficit contributions payable. As such there is no 'minimum funding requirement' in force.

The results of the 2016 actuarial valuations for the CARE Schemes have been used and updated for IAS 19 'Employee benefits' purposes for the period to 4 February 2018 by a qualified independent actuary. For the RSP an actuarial valuation for the purposes of IAS 19, based on member data as at 31 December 2017, has been completed and updated to 4 February 2018 by a qualified independent actuary. The Schemes expose the Group to inflation risk, interest rate risk and market investment risk. In addition, the CARE Schemes expose the Group to longevity risk.

At 4 February 2018, schemes in surplus have been disclosed within the assets on the balance sheet. The Group has taken legal advice with regard to the recognition of a pension surplus and also recognition of a minimum funding requirement under IFRIC 14 'IAS 19 – The limit on a defined benefit asset, minimum funding requirement and their interaction'. This advice concluded that recognition of a surplus is appropriate on the basis that the Group has an unconditional right to a refund of a surplus. In respect of the RSP this is on the basis that paragraph 11(a) of IFRIC 14 applies, enabling a refund of surplus during the life of the RSP. In respect of the Morrison Scheme, it is on the basis that paragraph 11(b) or 11(c) of IFRIC 14 applies enabling a refund of surplus assuming the gradual settlement of the scheme liabilities over time until all members have left the scheme or the full settlement of the Scheme's liabilities in a single event (i.e. as a scheme wind up). In respect of the Safeway Scheme, a refund is available on the basis that paragraph 11(b) of IFRIC 14 applies. Amendments to the current version of IFRIC 14 are currently being considered. The legal advice received by the Group has considered the proposed new wording to paragraph 12(A) of IFRIC 14 concerning whether other parties have a unilateral power to use a scheme's surplus to settle in full the scheme's liabilities and has concluded that the above accounting treatment should not be affected by the current exposure draft of the revised wording to IFRIC 14.

The current best estimate of Group contributions to be paid to the defined benefit schemes for the accounting period commencing 5 February 2018 is £73m (2017: £79m). This estimate includes amounts payable from the SLP and salary sacrificed contributions from employees.

8.6 Defined contribution scheme

As previously announced, the Group opened a new defined contribution pension scheme called the Morrisons Personal Retirement Scheme ('MPRS') for employees during the 53 weeks ended 4 February 2018. The MPRS has become the Auto Enrolment scheme for the Group and as such the Group was liable for backdated contributions for eligible employees to 1 October 2012. This was paid in January 2018. The pension scheme set-up credit of £13m recognised as an adjustment to underlying earnings (see note 1.4), relates to the cost of back dated contributions in respect of this new defined contribution scheme. The credit represents the difference between the expected back dated contributions previously accrued for and the cost based on actual participation rates.

As the MPRS is a defined contribution scheme, the Group is not subject to the same investment, interest rate, inflation or longevity risks as it is for the defined benefit schemes. The benefits that employees receive are dependent on the contributions paid, investment returns and the form of benefit chosen at retirement. During the 53 weeks ended 4 February 2018, the Group paid contributions of £4m to the MPRS, and expects to contribute £23m for the following period.

9 Share-based payments

9.1 Accounting policy

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.

The fair value of share options is measured by use of the Black-Scholes 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 charge in the period for share-based payments was £33m (2017: £20m).

9.2 Share save schemes

The Share save scheme began in 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 £350 each month for a period of three years. Options are offered at a discount 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 subject only to service conditions. The schemes that launched in May 2011 and subsequently are under the new scheme rules approved by the shareholders in June 2010.

The fair value of options granted, and the inputs used to determine it are as follows:

Grant date	17 May 2017	16 May 2016	19 May 2015	20 May 2014
Share price at grant date	£2.44	£1.91	£1.81	£2.10
Fair value of options granted	£16.5m	£5.1m	£4.8m	£11.6m
Exercise price	£1.84	£1.70	£1.64	£1.64
Dividend yield	2.08%	2.62%	5.15%	6.21%
Annual risk free interest rate	0.30%	0.87%	1.06%	1.00%
Expected volatility[1]	28.1%	26.8%	22.7%	18.3%

1 The volatility measured at the standard deviation of expected share price returns is based on statistical analysis on weekly share prices over the past 3.37 years prior to the date of grant.

The requirement that the employee has to save in order to purchase shares under the Share save 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 Black-Scholes option pricing model. The discount is determined by estimating the probability that the employee will stop saving based on expected future trends in the share price and employee behaviour.

	2018		2017	
	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	1.66	46,765	1.72	48,827
Granted	1.84	24,257	1.70	13,478
Exercised	1.64	(20,279)	1.69	(381)
Forfeited	1.73	(6,067)	1.89	(15,159)
Outstanding at end of period	1.75	44,676	1.66	46,765
Exercisable at end of period	1.64	21	2.25	52

	2018			2017		
	Weighted average share price at date of exercise £	Weighted average option price at date of exercise £	Number of shares thousands	Weighted average share price at date of exercise £	Weighted average option price at date of exercise £	Number of shares thousands
Share options exercised in the financial period	2.40	1.64	20,279	2.14	1.69	381

	2018	2017
Share options outstanding at the end of the period		
Range of exercise prices	£1.64 to £1.84	£1.64 to £2.25
Weighted average remaining contractual life	1.61 years	1.1 years

Notes to the Group financial statements continued

53 weeks ended 4 February 2018

9 Share-based payments continued

9.3 Long term incentive plans

In May 2007, a discretionary LTIP for the benefit of certain employees was introduced. The awards have no exercise price and accrue the value of dividends over the vesting period with the exception of senior employees within the schemes granted in 2016.

LTIP grants issued between 2013 and 2016 had associated performance conditions for Executive Committee members, whilst other senior employees eligible for LTIPs had to satisfy a service condition only. The LTIP schemes granted since 2016 have service and performance conditions for all employees. The performance conditions associated with all awards are measured through adjusted free cash flow, sales and earnings per share performance.

Awards normally vest three years after the original grant date, provided the relevant service and performance criteria have been met.

The fair value of awards granted and the inputs used to determined it are as follows:

Grant date	24 Oct 2017	22 March 2017	25 Oct 2016	13 May 2016	06 Apr 2016	01 Oct 2015	23 Apr 2015	16 Oct 2014	20 Jun 2014	22 Apr 2014
Option fair value at grant date	£2.34	£2.37	£2.28	£1.90	£2.00	£1.74	£1.97	£1.57	£1.91	£2.02
Fair value of share awards	£2.0m	£29.4m	£9.2m	£1.9m	£73.6m	£1.8m	£5.3m	£0.9m	£3.0m	£16.7m

	2018 Share awards thousands	2017 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	46,482	20,279
Granted	13,253	42,258
Exercised	(4,415)	(2,459)
Forfeited	(7,353)	(13,596)
Outstanding at end of period	47,967	46,482
Exercisable at end of period	–	–

The weighted average remaining contractual life of the share awards is 1.45 years (2017: 1.96 years).

9.4 One-off share awards

As part of the package for certain senior management, restricted share awards may be granted. These are primarily designed to replace the value of share scheme awards forfeited from the previous employer. Vesting of these awards is subject only to service conditions.

The fair value of awards granted and the inputs used to determined it are as follows:

Grant date	10 July 2015
Share price at grant date	£1.72
Assumed leavers	–
Fair value of share awards granted	£0.1m

	2018 Share awards thousands	2017 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	62	62
Granted	–	–
Exercised	(16)	–
Forfeited	–	–
Outstanding at end of period	46	62

The weighted average remaining contractual life of the share awards is 0.39 years (2017: 1.09 years).

9 Share-based payments continued

9.5 Deferred share bonus plan

Certain members of senior management participate in the deferred share bonus plan under which 50% of any bonus payable is deferred in shares for three years from the date the deferred share award is made. Dividend equivalents accrue over the vesting period, to be paid when the shares vest. Vesting of these share awards is subject only to service conditions.

The fair value of awards granted and the inputs used to determine it:

Grant date	2017/18 scheme	2016/17 scheme
Share price at grant date	£2.35	£2.02
Assumed leavers	–	–
Exercise price	£nil	£nil
Fair value of share awards granted	£2.9m	£2.0m

	2018 Share awards thousands	2017 Share awards thousands
Movement in outstanding share awards		
Outstanding at start of period	1,360	413
Granted	1,247	947
Exercised	(116)	–
Lapsed	–	–
Outstanding at end of period	2,491	1,360

The weighted average remaining contractual life of the share awards is 1.52 years (2017: 1.76 years).

10 Other

10.1 Related party transactions

The Group's related party transactions in the period include the remuneration of the senior managers (see note 1.7), and the Directors' emoluments and pension entitlements, share awards and share options as disclosed in the audited section of the Directors' remuneration report, which forms part of these financial statements.

During the year, the Group received a dividend of £8m (2017: £8m) from MHE JVCo. The Group has a 51.5% interest in MHE JVCo (see note 4.2).

10.2 Guarantees and contingent liabilities

Following the disposal of the land and building of its customer fulfilment centre (CFC) at Dordon to a third party (see note 3.3) the Group continues to guarantee the lease in respect of this site. If the lessee were to default, their lease obligations could revert back to the Group under the terms of the guarantee and become a liability of the Group. Should the lessee default, the additional future commitment is estimated at up to £32m.

The Group has an ongoing legal case brought by a number of current and former colleagues relating to employee data theft in the 52 weeks ended 1 February 2015. In December 2017, the High Court concluded that the Group was liable for the actions of the former employee who conducted the data theft. The Group has since launched an appeal to this judgement and the High Court has confirmed that there will be no hearings on the level of compensation until the appeal has been concluded. It is the Directors' view that at this stage of the process the Group can not reliably assess the outcome of the case nor reasonably estimate the quantum of any loss and as such no provision has been recognised in these consolidated financial statements.

10.3 Post balance sheet events

Following IAS 10 'Events after the Balance Sheet Date', the Group continues to disclose events that it considers material and non-disclosure of which can influence the economic decisions of users of the financial statements.

On 19 February 2018, the Group acquired Chippindale Foods Limited, a leading supplier of free range eggs, for a consideration of £6m. The Directors consider this event as a non-adjusting post balance sheet event.

Wm Morrison Supermarkets PLC – Company balance sheet

4 February 2018

	Note	2018 £m	2017 £m
Fixed assets			
Intangible assets	11.6	411	428
Property, plant and equipment	11.7	2,197	2,134
Investment property	11.8	10	10
Investments	11.9	–	3,439
Investment in joint venture		67	64
		2,685	6,075
Current assets			
Stock		422	388
Debtors	11.10	5,901	3,077
Pension asset due after more than one year	11.16	230	120
Derivative financial assets due within one year	11.13	15	22
Derivative financial assets due after more than one year	11.13	16	16
Cash and cash equivalents		229	235
		6,813	3,858
Creditors – amounts falling due within one year	11.11	(3,090)	(3,501)
Derivative financial liabilities due within one year	11.13	(13)	(3)
Net current assets		3,710	354
Total assets less current liabilities		6,395	6,429
Creditors – amounts falling due after more than one year	11.12	(1,375)	(1,593)
Derivative financial liabilities due after more than one year	11.13	(1)	(5)
Pension liabilities due after more than one year	11.16	(18)	(21)
Deferred tax liabilities	11.14	(143)	(130)
Provisions for liabilities	11.15	(250)	(271)
Net assets		4,608	4,409
Shareholders' equity			
Share capital	11.17	236	234
Share premium	11.17	159	128
Capital redemption reserve	11.18	39	39
Merger reserve	11.18	1,604	2,578
Retained earnings and other reserves[1]	11.18	2,570	1,430
Total shareholders' funds		4,608	4,409

1 Included within Retained earnings and other reserves is profit after tax of £186m (52 weeks ended 31 January 2016: £78m).

The accounting policies on pages 108 to 110 and the notes on pages 111 to 121 form part of these financial statements.

The financial statements on pages 106 to 121 were approved by the Board of Directors and authorised for issue on 13 March 2018. They were signed on its behalf by:

Trevor Strain
Chief Financial Officer

Wm Morrison Supermarkets PLC – Company statement of changes in equity

53 weeks ended 4 February 2018

	Note	Share capital £m	Share premium £m	Capital redemption reserve £m	Merger reserve £m	Hedging reserve £m	Retained earnings £m	Total shareholders' funds £m
		Attributable to the owners of the Company						
Current period								
At 30 January 2017		234	128	39	2,578	11	1,419	4,409
Profit for the period		–	–	–	–	–	186	186
Other comprehensive (expense)/income:								
Cash flow hedging movement		–	–	–	–	(11)	–	(11)
Items reclassified from hedging reserve in relation to repayment of borrowings		–	–	–	–	(2)	–	(2)
Remeasurement of defined benefit pension schemes	11.16	–	–	–	–	–	127	127
Tax in relation to components of other comprehensive income	11.14	–	–	–	–	4	(31)	(27)
Total comprehensive (expense)/income for the period		–	–	–	–	(9)	282	273
Purchase of trust shares	6.5	–	–	–	–	–	(4)	(4)
Employee share option schemes:								
Share-based payments charge	11.5	–	–	–	–	–	33	33
Settlement of employee tax liability for share awards	6.5	–	–	–	–	–	(7)	(7)
Share options exercised	6.5	2	31	–	–	–	–	33
Dividends	1.8	–	–	–	–	–	(129)	(129)
Realisation of merger reserve	11.18	–	–	–	(974)	–	974	–
Total transactions with owners		2	31	–	(974)	–	867	(74)
At 4 February 2018		236	159	39	1,604	2	2,568	4,608

	Note	Share capital £m	Share premium £m	Capital redemption reserve £m	Merger reserve £m	Hedging reserve £m	Retained earnings £m	Total shareholders' funds £m
		Attributable to the owners of the Company						
Prior period								
At 1 February 2016		234	127	39	2,578	(10)	1,403	4,371
Profit for the period		–	–	–	–	–	78	78
Other comprehensive income/(expense):								
Cash flow hedging movement		–	–	–	–	22	–	22
Items reclassified from hedging reserve in relation to repayment of borrowings		–	–	–	–	6	–	6
Remeasurement of defined benefit pension schemes	11.16	–	–	–	–	–	42	42
Tax in relation to components of other comprehensive income	11.14	–	–	–	–	(7)	–	(7)
Total comprehensive income for the period		–	–	–	–	21	120	141
Purchase of trust shares	6.5	–	–	–	–	–	(5)	(5)
Employee share option schemes:								
Share-based payments charge	11.5	–	–	–	–	–	20	20
Proceeds and settlements of employee share awards	6.5	–	1	–	–	–	(1)	–
Dividends	1.8	–	–	–	–	–	(118)	(118)
Total transactions with owners		–	1	–	–	–	(104)	(103)
At 29 January 2017		234	128	39	2,578	11	1,419	4,409

The accounting policies on pages 108 to 110 and the notes on pages 111 to 121 form part of these financial statements.

Wm Morrison Supermarkets PLC – Company accounting policies

53 weeks ended 4 February 2018

11 Company financial statements

11.1 General information

The principal activity of Wm Morrison Supermarkets PLC (the 'Company') is the operation of retail supermarket stores under the Morrisons brand and associated activities. The Company is incorporated and domiciled in the United Kingdom. The address of its registered office is Hilmore House, Gain Lane, Bradford, BD3 7DL, United Kingdom.

11.2 Basis of preparation

The financial statements have been prepared for the 53 weeks ended 4 February 2018 (2017: 52 weeks ended 29 January 2017). These separate financial statements of the Company have been prepared in accordance with Financial Reporting Standard 101 'Reduced Disclosure Framework' (FRS 101) and the Companies Act 2006 ('the Act'). FRS 101 sets out a reduced disclosure framework for a 'qualifying entity' as defined in the standard which addresses the financial reporting requirements and disclosure exemptions in the individual financial statements of qualifying entities that otherwise apply the recognition, measurement and disclosure requirements of EU-adopted IFRS.

The Company is a qualifying entity for the purposes of FRS 101 as it is a member of a group which prepares publicly available consolidated financial statements and it is included in the consolidation for that group.

The disclosure exemptions adopted by the Company in preparation of these financial statements in accordance with FRS 101 are as follows:

a) IFRS 2 'Share-based payment' (paragraphs 45(b) and 46 to 52) – details of the number and weighted-average exercise prices of share options, and how the fair value of goods or services received was determined;

b) IFRS 7 'Financial Instruments: Disclosures';

c) IFRS 13 'Fair value measurement' (paragraphs 91 to 99) – disclosure of valuation techniques and inputs used for fair value measurement of assets and liabilities;

d) IAS 1 'Presentation of financial statements' (paragraph 38) – comparative information requirements in respect of:

   (i) paragraph 79(a)(iv) of IAS 1;

   (ii) paragraph 73(e) of IAS 16 'Property, plant and equipment';

   (iii) paragraph 118(e) of IAS 38 'Intangible assets' – reconciliations between the carrying amount at the beginning and end of the period; and

   (iv) paragraph 76 and 79(d) of IAS 40 'Investment property';

e) The following paragraphs of IAS 1 'Presentation of financial statements':

   (i) 10(d), (statement of cash flows);

   (ii) 111 (cash flow statement information); and

   (iii) 134-136 (capital management disclosures);

f) IAS 7 'Statement of cash flows';

g) IAS 8 'Accounting policies, changes in accounting estimates and errors' (paragraph 30 and 31) – requirement for the disclosure of information when an entity has not applied a new IFRS that has been issued but is not yet effective;

h) The following requirements of IAS 24 'Related party disclosures':

   (i) paragraph 17 – key management compensation; and

   (ii) the requirements to disclose related party transactions entered into with two or more wholly owned members of a group.

11 Company financial statements continued

11.2 Basis of preparation continued

In addition to the FRS 101 exemptions above, the Company has taken advantage of the exemption available under section 408 of the Act and not presented a profit and loss account for the Company.

The financial statements have been prepared on a going concern basis under the historical cost convention except as disclosed in the Summary of accounting policies in note 11.3. The Company's accounting policies have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

The preparation of financial statements in conformity with FRS 101 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are the same for the Company as they are for the Group. For further details, see page 69 in the Group financial statements.

Accounting reference date
The accounting period of the Company ends on the Sunday falling between 29 January and 4 February each year.

11.3 Summary of accounting policies

The accounting policies listed below are the same for the Company as for the Group. As such, for further detail see the following notes:

a) Revenue recognition (1.1);

b) Cost of sales (1.1);

c) Promotional funding and commercial income (1.1);

d) Other operating income (1.1);

e) Taxation (2.1);

f) Intangible assets (3.1);

g) Property, plant and equipment (3.1);

h) Investment property (3.1);

i) Impairment of non-financial assets (3.1);

j) Lessor accounting – operating leases (3.1);

k) Finance leases (3.1);

l) Stock (5.1);

m) Trade and other debtors (5.1);

n) Cash and cash equivalents (5.1);

o) Trade and other creditors (5.1);

p) Provisions (5.1);

q) Borrowings and borrowing costs (6.1);

r) Leases (6.1);

s) Sale and leaseback (6.1);

t) Share capital (6.1);

u) Derivative financial instruments and hedge accounting (7.1);

v) Pensions (8.1); and

w) Share-based payments (9.1).

Wm Morrison Supermarkets PLC – Company accounting policies continued

53 weeks ended 4 February 2018

11 Company financial statements continued

11.3 Summary of accounting policies continued

The following accounting policies are those policies which are specific, and which deal with items considered material, in relation to the Company's financial statements.

Investments

Investments in subsidiary undertakings and joint ventures are stated at cost less provision for impairment.

All other equity instruments are held for long-term investment and are measured at fair value, where the fair value can be measured reliably. Gains or losses arising from changes in the fair value are presented in the profit and loss account within finance income or expenses in the period they arise.

Where the fair value of the instruments cannot be measured reliably, for example, when there is variability in the range of estimates, the investments are recognised at cost less accumulated impairment losses.

Impairment losses or reversals of previous impairment losses are presented in the profit and loss account in the period they arise.

Contingent liabilities

Contingent liabilities are possible obligations whose existence will be confirmed only on the occurrence or non-occurrence of uncertain future events outside the Company's control, or present obligations that are not recognised because it is not probable that an outflow of economic benefits will be required to settle the obligation or the amount cannot be measured reliably. The Company does not recognise contingent liabilities but does disclose any such balances (see note 11.21). The disclosure includes an estimate of their potential financial effect and any uncertainties relating to the amount or timing of any outflow, unless the possibility of settlement is remote.

Financial guarantees

Where the Company enters into financial contracts to guarantee the indebtedness of other companies within its Group, the Company considers these to be insurance arrangements, and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

Notes to the Company financial statements

53 weeks ended 4 February 2018

11 Company financial statements continued

11.4 Operating profit

The employee benefit expense for the Company is £1,009m (2017: £977m). The average monthly number of people, including Directors, employed by the Company is 52,284 (2017: 55,556).

The Company's auditor, PricewaterhouseCoopers LLP charged £0.5m (2017: £0.5m) for audit services in the year, £nil (2017: £nil) for services related to taxation and £0.2m (2017: £0.2m) for other services.

11.5 Share-based payments

The Company 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 Company'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.

The fair value of share options is measured by use of the Black-Scholes 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 charge in the period for share-based payments was £33m (2017: £20m).

Further details of the Company's share schemes are disclosed in note 9, including:

a) a description of the type of share-based payment arrangements that existed during the reporting period, including general terms and conditions, maximum terms of options granted, and the method of entitlement;

b) weighted average share price information in respect of options exercised during the reporting period; and

c) the range of exercise prices and weighted average remaining contractual life of share options outstanding at the end of the reporting period.

11.6 Intangible assets

	Software development costs £m	Licences £m	Total £m
Cost			
At 30 January 2017	639	29	668
Additions	60	7	67
Reclassifications	7	(7)	–
Disposals	(3)	–	(3)
Fully written down assets	(26)	(3)	(29)
At 4 February 2018	677	26	703
Accumulated amortisation and impairment			
At 30 January 2017	227	13	240
Amortisation charge for the period	77	6	83
Impairment	1	–	1
Reclassifications	2	(2)	–
Disposals	(3)	–	(3)
Fully written down assets	(26)	(3)	(29)
At 4 February 2018	278	14	292
Net book amount at 4 February 2018	399	12	411

Included within software development costs are assets under construction of £20m (2017: £3m).

The Company has performed its annual assessment of its amortisation policies and asset lives and deemed them to be appropriate. No changes have been made to asset lives during the year.

As in previous years, fully amortised assets have been retained in the Company's fixed asset register. In order to provide greater understanding of the Company's annual amortisation charge, assets which have become fully amortised in the year have been removed from both cost and accumulated amortisation.

Following the annual impairment review, an impairment charge of £1m (2017: £nil) has been recognised in relation to intangible assets.

The cost of financing asset developments prior to them being ready for use has been included in the cost of the project. The cumulative amount of interest capitalised in the total cost above amounts to £41m (2017: £41m). Interest is capitalised at the effective interest rate of 5% (2017: 5%) incurred on borrowings.

Notes to the Company financial statements continued

53 weeks ended 4 February 2018

11 Company financial statements continued

11.7 Property, plant and equipment

	Freehold land £m	Freehold buildings £m	Leasehold land and buildings £m	Plant, equipment, fixtures and vehicles £m	Total £m
Cost					
At 30 January 2017	839	1,468	640	802	**3,749**
Additions	1	11	–	183	**195**
Reclassifications	1	3	(4)	–	**–**
Disposals	(2)	(8)	–	(2)	**(12)**
Fully written down assets	–	–	–	(80)	**(80)**
At 4 February 2018	839	1,474	636	903	**3,852**
Accumulated depreciation and impairment					
At 30 January 2017	172	670	361	412	**1,615**
Depreciation charge for the period	–	34	8	103	**145**
Impairment	10	9	16	10	**45**
Impairment reversal	(8)	(18)	(25)	(11)	**(62)**
Reclassifications	–	3	(3)	–	**–**
Disposals	–	(7)	–	(1)	**(8)**
Fully written down assets	–	–	–	(80)	**(80)**
At 4 February 2018	174	691	357	433	**1,655**
Net book amount at 4 February 2018	665	783	279	470	**2,197**

The Company has performed its annual assessment of its depreciation policies and asset lives and deemed them to be appropriate. No changes have been made to asset lives during the year.

As in previous years, fully depreciated assets have been retained in the Company's fixed asset register. In order to provide greater understanding of the Company's annual depreciation charge, assets which have become fully depreciated in the year have been removed from both cost and accumulated depreciation.

Included in the table above is a cost of £839m (2017: £839m) relating to non-depreciable land and £15m (2017: £2m) of assets under construction.

The cost of assets held under finance leases at 4 February 2018 is £334m (2017: £354m), with related accumulated depreciation of £162m (2017: £158m).

The cost of financing asset developments prior to them being ready for use has been included in the cost of the project. The cumulative amount of interest capitalised in the total cost above amounts to £73m (2017: £73m). Interest is capitalised at the effective interest rate of 5% (2017: 5%) incurred on borrowings.

The Company considers that each store is a separate cash generating unit ('CGU') and therefore considers every store for an indication of impairment annually. The Company calculates each store's recoverable amount and compares this amount to its book value. The recoverable amount is determined as the higher of 'value in use' and 'fair value less costs of disposal'. If the recoverable amount is less than the book value, an impairment charge is recognised. The methodology applied by the Company is the same methodology as applied by the Group, see note 3.3 for further details.

Having applied the methodology and assumptions, the Company has recognised a net impairment reversal of £17m (£62m impairment reversal of set by £45m impairment charge) during the year in respect of property, plant and equipment (2017: net impairment charge of £29m; £88m impairment charge offset by £59m impairment reversal). This movement reflects fluctuations from store level trading performance and local market conditions.

At 4 February 2018, the key assumption to which the value in use calculation is most sensitive to is the discount rate. Specific sensitivity analysis with regard to this assumption shows that an increase of 1% in the discount rate would result in an additional impairment charge of £23m.

11 Company financial statements continued

11.8 Investment property

	Total £m
Cost	
At 4 February 2018 and 29 January 2017	20
Accumulated depreciation and impairment	
At 4 February 2018 and 29 January 2017	10
Net book amount at 4 February 2018 and 29 January 2017	10

Included in other operating income is £3m (2017: £3m) of rental income generated from investment properties. At the end of the period the fair value of investment properties was £17m (2017: £18m). Investment properties are valued by independent surveyors on a vacant possession basis using observable inputs (fair value hierarchy level 2).

11.9 Investments

	Total £m
Cost	
At 30 January 2017	3,440
Disposals	(3,440)
At 4 February 2018	–
Provision for impairment	
At 30 January 2017	1
Disposals	(1)
At 4 February 2018	–
Net book amount at 4 February 2018	–
Net book amount at 29 January 2017	3,439

The disposals above relate to an internal restructuring exercise undertaken by the Group during the 53 weeks ended 4 February 2018. As part of this exercise, the Company sold certain investments it held in its subsidiaries to Wm Morrison Supermarkets Holdings Limited, a fellow group subsidiary, for consideration of £3,439m.

The Directors believe that the carrying value of these investments is supported by their underlying net assets. As at 4 February 2018, the Company continues to hold investments in related undertakings which in aggregate are less than £1m. A list of all of the Company's other related undertakings at the balance sheet date is shown on pages 122 to 123.

11.10 Debtors – amounts falling due within one year

	2018 £m	2017 £m
Trade debtors	136	119
Amounts owed by Group undertakings	5,387	2,640
Current tax asset	110	82
Prepayments and accrued income	268	236
	5,901	3,077

Prepayments includes £176m (2017: £165m) relating to amounts falling due after more than one year. Amounts owed by Group undertakings are unsecured and repayable on demand.

Notes to the Company financial statements continued

53 weeks ended 4 February 2018

11 Company financial statements continued

11.11 Creditors – amounts falling due within one year

	2018 £m	2017 £m
Trade creditors	2,088	1,991
Amounts owed to Group undertakings	420	941
Other taxation and social security	75	56
Other creditors	115	79
Accruals and deferred income	392	434
	3,090	3,501

Amounts owed to Group undertakings within one year are unsecured and repayable on demand.

11.12 Creditors – amounts falling due after more than one year

	2018 £m	2017 £m
£365m sterling bonds 4.625% December 2023 (2017: £365m)	363	363
£318m sterling bonds 3.50% July 2026 (2017: £384m)	342	411
£300m sterling bonds 4.75% July 2029 (2017: £300m)	293	292
€280m euro bond 2.25% June 2020 (2017: €411m)	247	348
Amounts owed to Group undertakings	130	179
	1,375	1,593

The movements in the nominal value of the bonds are due to partial early repayment during the 53 weeks ended 4 February 2018. During the year, the Company continued to reduce its level of debt, through the partial early settlement of the 2026 sterling bonds, and the 2020 euro bond.

Borrowings are denominated in sterling and euros, and bear fixed interest rates. All borrowings are unsecured.

The Group has a syndicated committed revolving credit facility of £1.35bn with a maturity date of September 2021. The revolving credit facility incurs commitment fees and drawdowns bear interest at floating interest rates at a spread above LIBOR. There were no borrowings under the revolving credit facility at the balance sheet date. Therefore the Group had £1.35bn of undrawn committed borrowing facilities available (2017: £1.35bn). In the event of default of covenants on the bank facility, the principal amounts and any interest accrued are repayable on demand.

Amounts owed to Group undertakings are unsecured and are non-interest-bearing.

Finance leases

Net obligations under finance leases of £130m (2017: £179m) are payable in two to five years, and are included in amounts owed to Group undertakings in the table above.

11 Company financial statements continued

11.13 Derivative financial assets and liabilities

	2018 £m	2017 £m
Assets due within one year		
Foreign exchange forward contracts	1	11
Fuel and energy price contracts	14	11
	15	22
Assets due after more than one year		
Cross-currency contracts and interest rate swaps	12	6
Fuel and energy price contracts	4	10
	16	16
Liabilities due within one year		
Foreign exchange forward contracts	13	2
Fuel and energy price contracts	–	1
	13	3
Liabilities due after more than one year		
Fuel and energy price contracts	1	5
	1	5

Further details of the derivative financial instruments are provided in note 7, including:

a) significant assumptions underlying the valuation; and

b) fair value and the amounts recognised in profit and loss.

11.14 Deferred tax liabilities

	2018 £m	2017 £m
Deferred tax liability	160	148
Deferred tax asset	(17)	(18)
Net deferred tax liability	143	130

IAS 12 ‘Income taxes’ permits the offsetting of balances within the same tax jurisdiction. All of the deferred tax assets are available for offset against deferred tax liabilities. The movements in deferred tax liabilities/(assets) during the period are shown below:

	Property, plant and equipment £m	Pensions £m	Other short-term temporary differences £m	Total £m
Current period				
At 30 January 2017	131	17	(18)	130
(Credited) to profit for the period	(7)	(5)	(2)	(14)
Charged to other comprehensive income and equity	–	24	3	27
At 4 February 2018	124	36	(17)	143
Prior period				
At 1 February 2016	137	12	(17)	132
(Credited)/charged to profit for the period	(6)	(4)	1	(9)
Charged/(credited) to other comprehensive income and equity	–	9	(2)	7
At 29 January 2017	131	17	(18)	130

Notes to the Company financial statements continued

53 weeks ended 4 February 2018

11 Company financial statements continued

11.15 Provision for liabilities

	Onerous leases and onerous contracts £m	Other property provisions £m	Total £m
At 30 January 2017	264	7	271
Charged to profit for the period	22	–	22
Utilised/released during the period	(54)	–	(54)
Unwinding of discount	11	–	11
At 4 February 2018	243	7	250

Part of the onerous leases relate to sublet and vacant properties, with commitments ranging from one to 55 years. The provision is revised regularly in response to market conditions. During the year, £22m has been charged to onerous lease and onerous contracts provisions due to changes in circumstances or performance relating to certain contracts which has been offset by a £23m release in relation to others, as detailed in note 1.4.

The utilisation of provisions relates to the ongoing utilisation of onerous contracts and the assignment of onerous leases. Other property provisions include a petrol filling station decommissioning reserve for the cost of decommissioning petrol tanks, and provisions for dilapidations on leased buildings, for the cost of restoring assets to their original condition.

11.16 Pensions

11.16.1 Defined benefit schemes: summary and description

The Company operates two defined benefit retirement schemes (together 'the Schemes') providing benefits based on a benefit formula that depends on factors including the employee's age and number of years of service. The Morrison Scheme provides pension benefits based on either the employee's compensation package or career average revalued earnings (CARE) (the 'CARE Scheme'). The CARE Scheme is no longer open to new members and was closed to future accrual in July 2015. The RSP is a cash balance scheme, which provides a lump sum benefit based upon a defined proportion of an employee's annual earnings, which is revalued each year in line with inflation subject to a cap.

The position of each scheme at the balance sheet date is as follows:

	2018 £m	2017 £m
CARE Scheme	230	120
RSP	(18)	(21)
Net pension asset	212	99

Balance sheet:	2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Fair value of scheme assets	1,249	315	1,222	219
Present value of obligations	(1,019)	(333)	(1,102)	(240)
Net pension asset/(liability)	230	(18)	120	(21)

Statement of comprehensive income	2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Current service cost – recognised in cost of sales	–	60	–	42
Current service cost – recognised in administrative expenses	–	31	–	29
Administrative costs paid by Schemes – recognised in administrative expenses	1	1	2	1
Settlement and curtailment gain	(9)	–	–	–
Net interest on net pension asset – finance income	(3)	–	(2)	(2)
Total expense charged to income statement	(11)	92	–	70
Statement of other comprehensive income:				
Remeasurements in other comprehensive income (credit)/charge	(99)	(28)	(57)	15

11 Company financial statements continued

11.16 Pensions continued

11.16.1 Defined benefit schemes: summary and description continued

The Schemes are registered schemes under the provisions of Schedule 36 of the Finance Act 2004 and the assets are held in legally separate, trustee-administered funds. The Board of each Scheme is required by law to act in the best interests of the Scheme participants within the context of administering the Scheme in accordance with the purpose for which the trust was created, and is responsible for setting the investment, funding and governance policies of the fund. A representative of the Group attends Trustee Investment Committee meetings in order to provide the Group's view on investment strategy, but the ultimate power lies with the Trustees. The Deed and Rules of the Morrison Scheme gives the Trustees the power to set contributions, while in the RSP this power is given to the Group, subject to regulatory override.

Settlement and curtailment gains in the 53 weeks ended 4 February 2018 include £8m relating to the settlement of retirement benefits resulting from actions taken to further de-risk the Company's pension schemes.

11.16.2 Scheme assets

Assets of the Schemes generate returns and ultimately cash that is used to satisfy the Schemes' obligations. They are not necessarily intended to be realised in the short term. The Trustees of each Scheme invest in different categories of asset and with different allocations amongst those categories, according to the investment principles of that Scheme.

Currently, the investment strategy of the CARE Scheme is to maintain a balance of growth assets (equities and diversified growth funds), income assets (comprising credit investments, corporate bonds and absolute return bonds) and protection assets (comprising a liability driven instruments (LDI) portfolio), with a weighting towards protection assets. There are no direct investments in the Group's own shares or property occupied by any member of the Group.

Fair value of Scheme assets:

	2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Equities (quoted)	206	130	208	107
Corporate bonds (quoted)	106	–	106	–
Absolute return bonds (quoted)	–	–	101	–
Diversified growth funds (quoted)	196	82	129	50
Credit funds (unquoted)	153	–	133	–
Liability driven investments (unquoted)	555	102	508	61
Scottish Limited Partnership (unquoted)	27	–	28	–
Cash (quoted)	6	1	9	1
Total	1,249	315	1,222	219

For definitions of the liability driven instruments, diversified growth funds, credit funds and absolute return bonds, see note 8.3.

The movement in the fair value of the Schemes' assets over the period was as follows:

	2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Fair value of scheme assets at start of period	1,222	219	1,047	138
Interest income	34	7	38	7
Return on scheme assets excluding interest	57	25	171	20
Employer contributions	–	67	2	56
Employee contributions	–	3	–	3
Settlement and curtailment paid	(37)	–	–	–
Benefits paid	(26)	(5)	(34)	(4)
Administrative expenses	(1)	(1)	(2)	(1)
Fair value of scheme assets at end of period	1,249	315	1,222	219

Notes to the Company financial statements continued

53 weeks ended 4 February 2018

11 Company financial statements continued

11.16 Pensions continued

11.16.2 Scheme assets continued

Scottish Limited Partnership

The Company has previously entered into a pension funding partnership structure. In January 2013, the Company made a contribution to the CARE Scheme of £30m. On the same day, the CARE Scheme invested £30m in the Wm Morrison Property Partnership ('SLP') as a limited partner. The SLP holds properties which have been leased back to the Company in return for rental income payments. The Group retains control over these properties, including the flexibility to substitute alternative properties.

As a partner in the SLP, the CARE Scheme is entitled to receive a fixed distribution of £2.2m p.a. from the profits of the SLP for 20 years from 2013, subject to certain conditions. In July 2015, the SLP was amended to enhance the security provided to the Schemes by including additional properties. The terms of these additional properties are such that the CARE Scheme has no entitlement to receive a distribution.

The CARE Scheme's interests in the SLP increases the net pension asset on an IAS 19 accounting basis because the investments held by the CARE Scheme qualify as an asset for Company IAS 19 purposes.

11.16.3 Present value of obligations

The movement in the defined benefit obligation over the period was as follows:

	2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Defined benefit obligation at start of period	(1,102)	(240)	(986)	(130)
Current service cost	–	(91)	–	(71)
Interest expense	(31)	(7)	(36)	(5)
Actuarial gain – demographic assumptions	–	–	36	–
Actuarial gain/(loss) – financial assumptions	42	4	(232)	(40)
Actuarial (loss)/gain – experience	–	(1)	82	5
Settlement and curtailment gain	46	–	–	–
Employee contributions	–	(3)	–	(3)
Benefits paid	26	5	34	4
Defined benefit obligation at end of period	(1,019)	(333)	(1,102)	(240)

The durations of the defined benefit obligations at the end of the 2018 reporting period are: RSP 20 years; CARE 26 years. The weighted average duration of the Schemes is 25 years.

11.16.4 Significant actuarial assumptions

The following are the principal actuarial assumptions at the reporting date (expressed as weighted averages):

Financial assumptions	2018 CARE	2018 RSP	2017 CARE	2017 RSP
Discount rate applied to scheme liabilities (% p.a.)	2.8%	2.7%	2.9%	2.8%
Inflation assumption (RPI) (% p.a.)	3.3%	3.3%	3.5%	3.5%

Life expectancies	2018 CARE £m	2018 RSP £m	2017 CARE £m	2017 RSP £m
Longevity in years from age 65 for current pensioners				
Male	21.8	n/a	21.7	n/a
Female	23.3	n/a	23.2	n/a
Longevity in years from age 65 for current members aged 45				
Male	24.0	n/a	23.9	n/a
Female	25.7	n/a	25.6	n/a

During the year, the Company has updated the methodology for deriving the discount rate assumption used in valuing the pension scheme liabilities. The Company believes that this revised approach better reflects expected yields on high quality corporate bonds over the duration of the Company's pension schemes, as required by IAS 19. The previous methodology estimated the discount rate with reference to both corporate bond and gilt yields. The new method uses high quality corporate bond yields where available. At very long durations, where there are no high quality corporate bonds, the yield curve is extrapolated based on available corporate bond yields of mid to long duration. This change reduced the value placed on the IAS 19 pensions liabilities of the Company by £81m and improved the pre-tax balance sheet position by £81m.

11 Company financial statements continued

11.16 Pensions continued

11.16.4 Significant actuarial assumptions continued

Assumptions regarding future mortality experience are set based on actuarial advice and in accordance with published statistics. Following analysis completed as part of the 2016 actuarial valuation, the 2017 year end mortality tables used have been updated to the S2PMA/S2PFA-Heavy tables (males/females) based on year of birth with a scaling factor of 110% applied to the mortality rates in the CARE Scheme, with CMI 2015 projections and a long-term rate of improvement of 1.5% p.a.

Related actuarial assumptions (expressed as weighted averages)

	2018 CARE	2018 RSP	2017 CARE	2017 RSP
Rate of increases in salaries (% p.a.)	–	2.2%	–	2.4%
Rate of increase of pensions in payment: RPI inflation capped at either 2.5% p.a. or 5% p.a. (% p.a.)	2.1%/3.1%	–	2.2%/3.3%	–
Pre-retirement revaluation for active members (% p.a.)	–	1.8%	–	1.9%
Rate of increase of pensions in deferment: CPI inflation capped at either 2.5% p.a. or 5% p.a. (% p.a.)	-/2.2%	2.2%/-	–/2.4%	2.4%/–
CPI inflation (% p.a.)	2.2%	2.2%	2.4%	2.4%

Sensitivity analysis on significant actuarial assumptions

The following table summarises the impact on the defined benefit obligation at the end of the reporting period if each of the significant actuarial assumptions listed above were changed, in isolation, assuming no other changes in market conditions at the accounting date. In practice any movement in assumptions could be accompanied by a partially offsetting change in asset values, and the corresponding overall impact on the net asset/(liability) is therefore likely to be lower than the amounts below in a number of scenarios. Extrapolation of the sensitivities shown may not be appropriate.

		2018 CARE	2018 RSP	2017 CARE	2017 RSP
Discount rate applied to Scheme obligations	+/-0.1% p.a.	-/+25	-/+7	-/+30	-/+5
Inflation assumption (RPI and associated assumptions)	+/-0.1% p.a.	+/-25	+/-3	+/-25	+/-3
Longevity	+one year	+50	n/a	+50	n/a

11.16.5 Funding

The CARE Scheme is entirely funded by the Company. The Company along with other subsidiaries of the Group participate in the RSP. There is no contractual agreement or stated policy for charging the net defined benefit cost between the Company and its subsidiaries. The contribution of each participating subsidiary to the RSP is currently calculated in proportion to the number of employees that are members of the RSP.

The latest full actuarial valuations were carried out as at 5 April 2016 for the Morrison Scheme and the RSP. The valuations indicated that, on the agreed funding basis, the Morrison and RSP Schemes had surpluses of £1m and £10m respectively. As a result of these funding positions there are currently no deficit contributions payable. As such there is no 'minimum funding requirement' in force.

The results of the 2016 actuarial valuations for the CARE Scheme has been used and updated for IAS 19 'Employee benefits' purposes for the period to 4 February 2018 by a qualified independent actuary. For the RSP an actuarial valuation for the purposes of IAS 19, based on member data as at 31 December 2017, has been completed and updated to 4 February 2018 by a qualified independent actuary. The Schemes expose the Company to inflation risk, interest rate risk and market investment risk. In addition, the CARE Scheme exposes the Company to longevity risk.

At 4 February 2018, schemes in surplus have been disclosed within the assets on the balance sheet. The Company has taken legal advice with regard to the recognition of a pension surplus and also recognition of a minimum funding requirement under IFRIC 14 'IAS 19 – The limit on a defined benefit asset, minimum funding requirement and their interaction'. This advice concluded that recognition of a surplus is appropriate on the basis that the Company has an unconditional right to a refund of a surplus. In respect of the RSP, this is on the basis that paragraph 11(a) of IFRIC 14 applies enabling a refund of surplus during the life of the RSP. In respect of the Morrison Scheme, it is on the basis that paragraph 11(b) or 11(c) of IFRIC 14 applies enabling a refund of surplus assuming the gradual settlement of the scheme liabilities over time until all members have left the scheme or the full settlement of the Scheme's liabilities in a single event (i.e. as a scheme wind up).

Amendments to the current version of IFRIC 14 are currently being considered. The legal advice received by the Company has considered the proposed new wording to paragraph 12(A) of IFRIC 14 concerning whether other parties have a unilateral power to use a scheme's surplus to settle in full the scheme's liabilities and has concluded that the above accounting treatment should not be affected by the current exposure draft, including the planned revised wording, to IFRIC 14.

The current best estimate of Company contributions to be paid to the defined benefit schemes for the accounting period commencing 4 February 2018 is £67m (2017: £68m). This estimate includes amounts payable from the SLP and salary sacrificed contributions from employees.

Notes to the Company financial statements continued

53 weeks ended 4 February 2018

11 Company financial statements continued

11.16 Pensions continued

11.16.6 Defined contribution scheme

As previously announced, the Company opened a new defined contribution pension scheme called the Morrisons Personal Retirement Scheme ('MPRS') for employees during the 53 weeks ended 4 February 2018. The MPRS has become the Auto Enrolment scheme for the Company and as such the Company was liable for backdated contributions for eligible employees to 1 October 2012. This was paid in January 2018.

As the MPRS is a defined contribution scheme, the Company is not subject to the same investment, interest rate, inflation or longevity risks as it is for the defined benefit schemes. The benefits that employees receive are dependent on the contributions paid, investment returns and the form of benefit chosen at retirement. During the 53 weeks ended 4 February 2018, the Company paid contributions of £3m to the MPRS, and expects to contribute £15m for the following period.

11.17 Share capital

	Number of shares millions	Share capital £m	Share premium £m	Total £m
At 30 January 2017	2,335.6	234	128	362
Share options exercised	20.3	2	31	33
At 4 February 2018	2,355.9	236	159	395

The total authorised number of ordinary shares is 4,000 million shares (2017: 4,000 million shares) with a par value of 10p per share (2017: 10p per share). All issued shares are fully paid.

For further details on share capital and share premium, see note 6.5.

11.18 Reserves

	2018 £m	2017 £m
Capital redemption reserve	39	39
Merger reserve	1,604	2,578
Hedging reserve	2	11
Retained earnings	2,568	1,419
Total	4,213	4,047

Capital redemption reserve

The capital redemption reserve at the start of the period related to 389,631,561 of the Company's own shares which it purchased on the open market for cancellation between 31 March 2008 and 8 March 2013 at a total cost of £1,081m.

Merger reserve

The merger reserve represents the reserve arising on the acquisition in 2004 of Safeway Limited. This merger reserve was initially considered unrealised on the basis it was represented by investments held by the Company, which is not qualifying consideration in accordance with Tech 02/17 issued by the Institute of Chartered Accountants in England and Wales (ICAEW). During the 53 weeks ended 4 February 2018, the majority of the Company's investments were transferred to another Group company, Wm Morrison Supermarkets Holdings Limited, in exchange for an intercompany loan. To the extent that this intercompany loan is settled in qualifying consideration, the same proportion of the merger reserve becomes realised. During the period, this intercompany loan balance has been partially settled through £974m of qualifying consideration. As a result, £974m of the merger reserve balance has become realised.

Hedging reserve

This represents the gains and losses arising on derivatives used for cash flow hedging.

11.19 Capital commitments

	2018 £m	2017 £m
Contracts placed for future capital expenditure not provided in the financial statements (property, plant and equipment and intangible assets)	27	20

11 Company financial statements continued

11.20 Operating lease commitments

Total outstanding commitments for future minimum lease payments under non-cancellable operating leases are:

	2018		2017	
	Land and buildings £m	Plant, equipment, fixtures and vehicles £m	Land and buildings £m	Plant, equipment, fixtures and vehicles £m
Within one year	87	13	79	14
More than one year and less than five years	339	22	308	34
After five years	1,308	–	1,263	–
	1,734	35	1,650	48

In addition to the above, the Company has operating lease commitments of £372m (2017: £392m) with other Group companies.

11.21 Guarantees and contingent liabilities

The Company has given an unlimited guarantee in respect of the overdraft of all the subsidiary undertakings within the Group's banking offset agreement. The overdraft position at 4 February 2018 was £nil (2017: £nil). The Company has also provided a guarantee in respect of sterling bonds amounting to £75m at fair value (2017: £147m) in respect of a subsidiary undertaking. Where the Company enters into financial contracts to guarantee the indebtedness of other companies within its Group, the Company considers these to be insurance arrangements, and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

Following the disposal of the land and building of its customer fulfilment centre ('CFC') at Dordon to a third party (see note 3.3) the Company continues to guarantee the lease in respect of this site. If the lessee were to default, their lease obligations could revert back to the Company under the terms of the guarantee and become a liability of the Company. Should the lessee default, the additional future commitment is estimated at up to £32m.

The Company has had an ongoing legal case brought by a number of current and former colleagues relating to employee data theft in the 52 weeks ended 1 February 2015. In December 2017, the High Court concluded that the Company was liable for the actions of the former employee who conducted the data theft. The Company has since launched an appeal to this judgement and the High Court has confirmed that there will be no hearings on the level of compensation until the appeal has been concluded. It is the Directors' view that at this stage of the process the Company can not reliably assess the outcome of the case nor reasonably estimate the quantum of any loss and as such no provision has been recognised in these financial statements.

11.22 Post balance sheet events

Following IAS 10 'Events after the Balance Sheet Date', the Company continues to disclose events that it considers material and non-disclosure of which can influence the economic decisions of users of the financial statements.

On 19 February 2018, the Company acquired Chippindale Foods Limited, a leading supplier of free range eggs, for a consideration of £6m. The Directors consider this event as a non-adjusting post balance sheet event.

Related undertakings

In accordance with section 409 of the Companies Act 2006, a full list of related undertakings including the country of incorporation, the principal activity and the effective percentage of equity owned as at 4 February 2018 is disclosed below. The registered address of all undertakings is Hilmore House, Gain Lane, Bradford, BD3 7DL unless otherwise stated.

Related undertakings of Wm Morrison Supermarkets PLC

Name	Country of incorporation	Principal activity	Interest
Bos Brothers Fruit and Vegetables B.V.[1]	Netherlands	Acquirer of food products	100%
De Mandeville Gate Management Company Limited	United Kingdom	Property maintenance	51%
Dordon SPV Limited[2]	United Kingdom	Dormant	100%
Farock Insurance Company Limited[3]	Isle of Man	Insurance company	100%
Fisherdale Properties Limited[2]	United Kingdom	Dormant	100%
I Morrisons.com Limited	United Kingdom	Dormant	100%
Ipsolus Limited[2]	United Kingdom	Dormant	100%
MHE JVCO Limited[4]	United Kingdom	Joint venture with Ocado	51.5%
MoClo Limited[2]	United Kingdom	Dormant	100%
Morrisons Food Online Limited	United Kingdom	Dormant	100%
Morrisons-online.com Limited	United Kingdom	Dormant	100%
My Morrisons.com Limited	United Kingdom	Dormant	100%
Neerock Farming Limited[5]	United Kingdom	Dormant	100%
Perimeter Holdings Limited[2]	United Kingdom	Property development	100%
Wm Morrison (HK) Limited[6]	Hong Kong	Acquirer of non-food products	100%
Wm Morrison Nominee 1 Limited	United Kingdom	Dormant	100%
Wm Morrison Nominee 2 Limited	United Kingdom	Dormant	100%
Wm Morrison Nominee 3 Limited	United Kingdom	Dormant	100%
Wm Morrison Online Ltd	United Kingdom	Dormant	100%
Wm Morrison Pension Trustee Limited	United Kingdom	Dormant	100%
Wm Morrison Property Investments Limited[7]	United Kingdom	General partner in a partnership	100%
Wm Morrison Supermarkets Holdings Limited	United Kingdom	Holding company	100%

Related undertakings of other Group companies

Name	Country of incorporation	Principal activity	Interest
Alliance Property Holdings Limited	United Kingdom	Dormant	100%
Amos Hinton & Sons Limited	United Kingdom	Dormant	100%
Argyle Securities Limited[7]	United Kingdom	Dormant	100%
Argyll Foods Limited	United Kingdom	Dormant	100%
Argyll Stores (Holdings) Limited	United Kingdom	Dormant	100%
Ascot Road Watford Limited	United Kingdom	Holding company	100%
Cancede Limited	United Kingdom	Property investment	100%
Cordon Bleu Freezer Food Centres Limited	United Kingdom	Dormant	100%
Divertigo Limited	United Kingdom	Dormant	100%
English Real Estates Limited	United Kingdom	Dormant	100%
Erith Pier Company Limited	United Kingdom	Property maintenance	100%
Evermere Limited	United Kingdom	Dormant	100%
Farmers Boy Limited	United Kingdom	Manufacturer and distributor of fresh food products	100%
Farmers Boy (Deeside) Limited	United Kingdom	Dormant	100%
Federated Properties Limited	United Kingdom	Dormant	100%
Firsdell Ltd	United Kingdom	Property investment	100%
Flower World Limited	United Kingdom	Dormant	100%
Freehold Investments Limited[8]	Jersey	Property investment	100%
Holsa Limited	United Kingdom	Dormant	100%
International Seafoods Limited	United Kingdom	Preparation and supply of seafood	100%
J3 Property Limited[7]	United Kingdom	Dormant	100%
Kiddicare Properties Limited	United Kingdom	Lease company	100%
Lease Securities Limited[8]	Jersey	Property investment	100%
Maypole Limited[9]	Guernsey	Investment company	100%
MDW (Eastbourne) Limited	United Kingdom	Dormant	100%
Monument Hill Properties Limited	United Kingdom	Dormant	100%
Neerock Limited	United Kingdom	Fresh meat processor	100%

Related undertakings of other Group companies continued

Name	Country of incorporation	Principal activity	Interest
Newincco 1072 Limited	United Kingdom	Property development	100%
Oldwest Limited[7]	United Kingdom	Dormant	100%
Optimisation Developments Limited	United Kingdom	Property development	100%
Optimisation Investments Limited	United Kingdom	Property investment	100%
Presto Stores (LC) Limited	United Kingdom	Dormant	100%
Presto Stores Limited	United Kingdom	Dormant	100%
Rathbones Bakeries Limited	United Kingdom	Dormant	100%
Rathbone Kear Limited	United Kingdom	Manufacturer and distributor of morning goods and bread	100%
RP (No. 37) Limited[8]	Jersey	Property investment	100%
Safeway (Overseas) Limited	United Kingdom	Grocery retailer (overseas)	100%
Safeway Development Limited	United Kingdom	Dormant	100%
Safeway Food Stores Limited	United Kingdom	Dormant	100%
Safeway Limited	United Kingdom	Holding company	100%
Safeway Pensions Trustees Company Limited	United Kingdom	Dormant	100%
Safeway Pension Trustees Limited	United Kingdom	Dormant	100%
Safeway Properties Limited	United Kingdom	Dormant	100%
Safeway QUEST Trustees Limited	United Kingdom	Dormant	100%
Safeway Stores (Gibraltar) Pension Trustees Limited[10]	United Kingdom	Dormant	100%
Safeway Stores (Ireland) Limited	United Kingdom	Dormant	100%
Safeway Stores Limited	United Kingdom	Grocery retailer	100%
Safeway Trustee (FURB) Limited	United Kingdom	Dormant	100%
Safeway Wholesale Limited	United Kingdom	Dormant	100%
Simply Fresh Foods Holdings Limited	United Kingdom	Dormant	100%
Stalwart Investments Limited[8]	Jersey	Property investment	100%
Stores Group Limited	United Kingdom	Investment company	100%
The Home & Colonial Stores Limited	United Kingdom	Dormant	100%
The Medical Hall Limited[11]	Gibraltar	Pharmaceutical licence holder (Gibraltar)	100%
The Morrisons Foundation	United Kingdom	Charity	100%
Tower Centre Hoddesdon Limited	United Kingdom	Property development	100%
Trilogy (Leamington Spa) Limited	United Kingdom	Property development	100%
Velligrist Limited	United Kingdom	Dormant	100%
Wm Morrison Bananas Limited	United Kingdom	Property investment	100%
Wm Morrison GP 1 Limited	United Kingdom	General partner in a partnership	100%
Wm Morrison GP 2 Limited	United Kingdom	General partner in a partnership	100%
Wm Morrison GP 3 Limited	United Kingdom	General partner in a partnership	100%
Wm Morrison Growers Limited[12]	United Kingdom	Acquirer of fresh produce	100%
Wm Morrison LP 1 Limited	United Kingdom	Limited partner in a partnership	100%
Wm Morrison LP 2 Limited	United Kingdom	Limited partner in a partnership	100%
Wm Morrison LP 3 Limited	United Kingdom	Limited partner in a partnership	100%
Wm Morrison Produce Limited	United Kingdom	Produce packer and purchaser	100%
Wm Morrison Property Partnership LP[7]	United Kingdom	Scottish Limited Property Partnership	100%
Wm Morrison Property Partnership 1 Limited Partnership	United Kingdom	Property partnership	100%
Wm Morrison Property Partnership 2 Limited Partnership	United Kingdom	Property partnership	100%
Wm Morrison Property Partnership 3 Limited Partnership	United Kingdom	Property partnership	100%
Wm Morrison Supermarket Stores Ltd	United Kingdom	Dormant	100%

1 Registered address 3151, ZJ Hoek van Holland, the Netherlands, Amersgat 17.
2 Registered address 1 Ashley Road, 3rd Floor, Altrincham, WA14 2DT.
3 Registered address 1st Floor, Rose House, 51-59 Circular Road, Douglas, Isle of Man, IM1 1AZ.
4 Registered address Buildings 1 & 2, Trident Place, Mosquito Way, Hatfield, Hertfordshire, AL10 9UL
5 Registered address Market Hill, Market Hill Road, Turriff, Aberdeenshire, Scotland, AB53 4PA.
6 Registered address 4304 China Resources Building, 26 Harbour Road, Wanchai, Hong Kong.
7 Registered address Capella Building (Tenth Floor), 60 York Street, Glasgow, G2 8JX.
8 Registered address Lime Grove House, Green Street, St Helier, Jersey, JE1 2ST.
9 Registered address 1st & 2nd floors, Elizabeth House, Les Ruettes Brayes, St Peter Port, Guernsey, GY1 4LX.
10 Registered address Suites 41/42 Victoria House, 26 Main Street, Gibraltar.
11 Registered address 1st Floor, 5 Secretary's Lane, Gibraltar GX11 1AA.
12 Registered address Stubbings Farm, Otley, West Yorkshire, United Kingdom, LS21 1DN.

Five year summary

53 weeks ended 4 February 2018

Consolidated statement of comprehensive income

	2018[1] £m	2017 £m	2016 £m	2015 £m	2014 £m
Revenue	**17,262**	16,317	16,122	16,816	17,680
Cost of sales	**(16,629)**	(15,713)	(15,505)	(16,055)	(16,606)
Gross profit	**633**	604	617	761	1,074
Other operating income	**78**	76	72	78	81
Profit/loss on disposal and exit of properties and sale of investments	**19**	32	97	135	9
Administrative expenses	**(272)**	(244)	(472)	(1,670)	(1,259)
Operating profit/(loss)	**458**	468	314	(696)	(95)
Finance costs	**(94)**	(160)	(112)	(105)	(87)
Finance income	**14**	15	13	7	5
Share of profit of joint venture (net of tax)	**2**	2	2	2	1
Profit/(loss) before taxation	**380**	325	217	(792)	(176)
Analysed as:					
Underlying profit before tax[2]	**374**	337	242	345	719
Impairment and provision for onerous contracts	**6**	6	(87)	(1,273)	(903)
Profit/loss on disposal and exit of properties	**19**	19	131	131	9
Profit arising on disposal of investment	**–**	13	–	–	–
Costs associated with the repayment of borrowings	**(16)**	(56)	–	–	–
Pension scheme set-up credit/(costs)	**13**	–	(35)	–	–
(Loss)/profit arising on disposal of businesses	**–**	–	(34)	4	–
Net pension income/(expenses)	**9**	8	–	1	(1)
Other exceptional costs	**(25)**	(2)	–	–	–
	380	325	217	(792)	(176)
Taxation	**(69)**	(20)	5	31	(62)
Profit/(loss) for the period attributable to the owners of the Company	**311**	305	222	(761)	(238)
Earnings per share (pence)					
– basic	**13.30**	13.11	9.51	(32.63)	(10.23)
– diluted	**13.03**	12.95	9.47	(32.63)	(10.23)
– underlying basic[1]	**12.19**	10.86	7.77	10.93	23.08
Dividend per ordinary share (pence)	**10.09**	5.43	5.00	13.65	13.00

1 Reported on a 53 week basis.
2 2014 underlying profit restated to include new business development costs.

Consolidated balance sheet

	2018 £m	2017 £m	2016 £m	2015 £m	2014 £m
Assets					
Goodwill and intangible assets	428	445	483	520	458
Property, plant and equipment	7,243	7,227	7,161	7,252	8,625
Investment property	33	33	37	68	119
Pension asset	612	293	186	4	–
Investment in joint venture	53	56	63	68	66
Investments	–	–	31	31	31
Other financial assets	16	16	30	–	–
Non-current assets	8,385	8,070	7,991	7,943	9,299
Current assets	1,278	1,176	1,316	1,144	1,430
Assets classified as held-for-sale	4	–	–	84	–
Liabilities					
Current liabilities	(3,081)	(2,864)	(2,755)	(2,273)	(2,873)
Other financial liabilities	(1,246)	(1,555)	(2,058)	(2,558)	(2,516)
Deferred tax liabilities	(478)	(417)	(429)	(415)	(430)
Pension liabilities	(18)	(21)	–	(43)	(11)
Provisions	(299)	(326)	(309)	(288)	(207)
Non-current liabilities	(2,041)	(2,319)	(2,796)	(3,304)	(3,164)
Net assets	4,545	4,063	3,756	3,594	4,692
Shareholders' equity					
Called-up share capital	236	234	234	234	234
Share premium	159	128	127	127	127
Capital redemption reserve	39	39	39	39	39
Merger reserve	2,578	2,578	2,578	2,578	2,578
Retained earnings and other reserves	1,533	1,084	778	616	1,714
Total equity attributable to the owners of the Company	4,545	4,063	3,756	3,594	4,692

Supplementary information

53 weeks ended 4 February 2018

	2018 £m	2017 £m	2016 £m	2015 £m	2014 £m
Increase/(decrease) on previous year %					
Revenue	**5.79**	1.21	(4.13)	(4.89)	(2.41)
Underlying operating profit/(loss)	**3.01**	27.43	(23.30)	(44.60)	(14.86)
Profit/(loss) before taxation	**16.92**	49.77	(127.40)	349.35	(120.02)
Profit/(loss) after taxation	**1.97**	37.39	(129.17)	219.38	(136.79)
Underlying profit before taxation	**10.98**	39.26	(29.86)	(52.02)	(18.67)
Diluted earnings per share	**0.62**	36.74	(129.17)	(218.96)	(138.50)
Ordinary dividend per share	**12.15**	8.60	(18.32)	5.00	10.17
% of revenue					
Underlying operating profit	**2.58**	2.65	2.10	2.63	4.57
Profit/(loss) before taxation	**2.20**	1.99	1.35	(4.71)	(1.00)
Profit/(loss) after taxation	**1.80**	1.87	1.38	(4.52)	(1.35)
Retail portfolio					
Size 000s square feet (net sales area)					
0–5	**4**	4	4	153	102
5–15	**54**	54	57	75	76
15–25	**118**	118	124	126	123
25–40	**259**	259	260	260	252
40+	**56**	56	53	53	52
Total number of stores	**491**	491	498	667	605
Petrol filling stations	**334**	334	336	335	328
Total supermarket takings ex petrol (gross) £m[1]	**14,061**	13,591	13,700	14,033	14,593
Average takings per store per week ex petrol (£000)[1]	**540**	531	521	531	558
Average number of customers per store per week[1]	**24,164**	23,532	22,573	22,034	22,874
Average take per customer (£)[1]	**22.36**	22.62	23.44	23.83	24.41
Employees					
Full time	**40,162**	42,054	47,925	48,519	52,315
Part time	**65,325**	70,311	72,988	71,259	75,088
Total	**105,487**	112,365	120,913	119,778	127,403
Full time equivalent (average)	**73,210**	77,300	82,992	85,545	90,264
Average per FTE employee:					
Turnover (£000s)	**236**	211	194	197	196
Underlying operating profit (£)	**6,078**	5,589	4,085	5,167	8,952
Employee costs (£)	**26,472**	24,900	23,424	23,029	21,847

1 Excludes convenience and online.

The impact of week 53 in the period ended 3 February 2018 was to increase turnover by £318m and increase profit before taxation by £5m.

Glossary

Alternative Performance Measures

In response to the Guidelines on Alternative Performance Measures (APMs) issued by the European Securities and Markets Authority (ESMA), we have provided additional information on the APMs used by the Group. The Directors use the APMs listed below as they are critical to understanding the financial performance and financial health of the Group. As they are not defined by IFRS, they may not be directly comparable with other companies who use similar measures.

Measures	Closest equivalent IFRS measure	Definition and purpose	Reconciliation for 2017/18 Group measures[1]
Profit measures			
Like-for-like (LFL) sales growth	Revenue	Percentage change in year-on-year sales (excluding VAT), removing the impact of new store openings and closures in the current or previous financial year. The measure is used widely in the retail industry as an indicator of underlying sales performance. It is also a key measure for Director and management remuneration. See page 45 in the Directors' remuneration report for more information.	53 weeks ended 4 February 2018 % Group LFL (exc. fuel) 2.8% Group LFL (inc. fuel) 4.1% 53rd week impact 2.0% Impact of store closures (0.3)% **Total revenue year-on-year 5.8%**
Total sales growth	Revenue	**Including fuel:** Percentage change in year-on-year total reported revenue. **Excluding fuel:** Percentage change in year-on-year total reported sales excluding fuel. This measure illustrates the total year-on-year sales growth. This measure is a key measure for Director and management remuneration. See page 45 in the Directors' remuneration report for more information.	A reconciliation of total sales including and excluding fuel is provided in note 1.2 of the financial statements.
Underlying profit before tax (UPBT)	Profit before tax	Reported profit before tax excluding impairment and provisions for onerous contracts, profit/loss on disposal and exit of properties and sale of businesses and investments, the impact of pension volatility and other items that do not relate to the Group's principal activities on an ongoing basis. This measure is a key measure used by the Directors. It provides key information on underlying trends and performance of the Group and is used for Director and management remuneration. See page 45 in the Directors' remuneration report for more information.	A reconciliation of this measure is provided in note 1.4 of the financial statements.
Underlying profit after tax	Profit after tax	UPBT adjusted for a normalised tax charge. This measure is used by the Directors as it provides key information on underlying trends and performance of the Group, including a normalised tax charge.	UPBT of £374m less a normalised tax charge of £89m (see note 1.4 of the financial statements).
Underlying operating profit	Operating profit[2]	Reported operating profit excluding impairment and provisions for onerous contracts, profit/loss on disposal and exit of properties and sale of investments and other items impacting operating profit that do not relate to the Group's principal activities on an ongoing basis. This measure is used by the Directors as it provides key information on underlying trends and performance of the Group.	Reported operating profit (£458m) less impairment and provisions for onerous contracts (£6m), profit/loss on disposal and exit of properties and sale of investments (£19m), pension scheme set-up credit (£13m), plus other exceptional costs of £25m.
Underlying net finance costs	Finance costs	Reported net finance costs excluding net pension income and other items impacting net finance costs that do not relate to the Group's principal activities on an ongoing basis. This measure is used by the Directors as it provides key information on underlying cost of financing excluding the impact of exceptional items.	A reconciliation of this measure is provided in note 6.2 of the financial statements.
Underlying basic earnings per share	Basic earnings per share	Basic earnings per share based on underlying profit after tax rather than reported profit after tax as described above. This measure is a key measure used by the Directors. It provides key information on underlying trends and performance of the Group and is used for Director and management remuneration. See page 45 in the Directors' remuneration report for more information.	A reconciliation of this measure is included in note 1.5 of the financial statements.

1 Certain ratios referred to in the financial statements are calculated using more precise numbers rather than rounded numbers. These stated ratios may therefore differ slightly to those calculated by the numbers in this report due to rounding (as numbers in the financial statements are presented in round millions).
2 Operating profit is not defined under IFRS. However, it is a generally accepted profit measure.

Glossary continued

Measures	Closest equivalent IFRS measure	Definition and purpose	Reconciliation for 2017/18 Group measures[1]
Profit measures continued			
Underlying diluted earnings per share	Diluted earnings per share	Diluted earnings per share based on underlying profit after tax rather than reported profit after tax as described above.	A reconciliation of this measure is included in note 1.5 of the financial statements.
Tax measures			
Normalised tax	Effective tax	Normalised tax is the tax rate applied to the Group's principal activities on an ongoing basis. This is calculated by adjusting the effective tax rate for the period to exclude the impact of profit/loss relating to property disposals and sale of investments, pension interest volatility, impairment and provisions for onerous contracts, and other items that do not relate to the Group's principal activities on an ongoing basis. This measure is used by the Directors as it provides a better reflection of the normalised tax charge for the Group.	A reconciliation of the tax charge is found in note 2.2.3 of the financial statements.
Cash flows and net debt measures			
Free cash flow	No direct equivalent	Movement in net debt before dividends. This measure is used by the Directors as it provides key information on the level of cash generated by the Group before the payment of dividends.	£350m being the movement in net debt (£221m) before payment of dividend (£129m).
Adjusted free cash flow	No direct equivalent	See page 45 in the Directors' remuneration report. This measure is a key measure used by the Directors. It provides key information on the level of cash generated by the Group and is used for Director and management remuneration.	See page 45 in the Directors' remuneration report.
Net debt	Borrowings less cash and cash equivalents and financial assets and liabilities	Net debt is cash and cash equivalents, non-current financial assets and current financial assets, less borrowings, current financial liabilities and non-current financial liabilities.	A reconciliation of this measure is provided in note 6.4 of the financial statements.
Working capital movement	No direct equivalent	Movement in stock, movement in debtors, movement in creditors and movement in provisions.	A reconciliation of this measure is provided in note 5.6 of the financial statements.
Operating working capital movement	No direct equivalent	Working capital movement adjusted for charges for onerous contracts, onerous payments and other non-operating payments. This measure is used by the Directors as it provides a more appropriate reflection of the working capital movement by excluding certain non-recurring movements relating to property balances.	A reconciliation of this measure is provided in note 5.6 of the financial statements.
Other measures			
Return on capital employed	No direct equivalent	Return on capital employed is calculated as return divided by average capital employed. Return is defined as annualised underlying profit after tax adjusted for underlying net finance costs and operating lease rentals (on land and buildings). Capital employed is defined as average net assets excluding net pension assets and liabilities, less average net debt, plus the lease adjustment (10 times rent charged). This measure is used by the Directors as it is a key ratio in understanding the performance of the Group.	ROCE (7.7%) equals return divided by average capital employed: Return (£451m) = Underlying profit after tax annualised (£285m) adjusted for underlying net finance costs (£73m) and operating lease rentals (on land and buildings) (£93m). Average capital employed (£5,884m) = Average net assets excluding the net pension asset (£3,871m), average net debt (£1,084m) and the lease adjustment (£929m).

1 Certain ratios referred to in the financial statements are calculated using more precise numbers rather than rounded numbers. These stated ratios may therefore differ slightly to those calculated by the numbers in this report due to rounding (as numbers in the financial statements are presented in round millions).

Investor relations and financial calendar

Financial calendar 2017/18

Financial events and dividends	
Quarter 1 trading statement	10 May 2018
Final dividend record date	25 May 2018
Annual General Meeting	14 Jun 2018
Final dividend payment date	28 Jun 2018
Half year end	5 Aug 2018
Interim results announcement	13 Sep 2018
Interim dividend record date	28 Sep 2018
Interim dividend payment date	5 Nov 2018
Quarter 3 trading statement	6 Nov 2018
Financial year end	3 Feb 2019

Company Secretary

Jonathan Burke

Company number

00358949

Registered office

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Gain Lane
Bradford
BD3 7DL
Telephone: 0845 611 5000
www.morrisons.com

Investor relations

Telephone: 0845 611 5710
Email: accinvr@morrisonsplc.co.uk

Corporate responsibility enquiries

Telephone: 0845 611 5000

Annual General Meeting

The AGM will be held on 14 June 2018 at Wm Morrison Supermarkets PLC Head Office, Gain Lane, Bradford, BD3 7DL.

A separate notice convening the meeting is sent to shareholders, which includes an explanation of the items of special business to be considered at the meeting.

Dividend reinvestment plan

The Company has a dividend reinvestment plan which allows shareholders to reinvest their cash dividends in the Company's shares bought in the market through a specifically arranged share dealing service. Full details of the plan and its charges, together with mandate forms, are available from the Registrars.

Morrisons website

Shareholders are encouraged to visit our website, www.morrisons.com, to obtain information on Company history, stores and services, latest offers, press information and a local store finder.

Share price information

The investor information section of our website provides our current and historical share price data and other share price tools. Share price information can also be found in the financial press and the Cityline service operated by the Financial Times. Telephone: 0906 843 3545.

Online reports and accounts

Our annual and interim Group financial statements are available to download from the website along with Corporate responsibility reports and other financial announcements. The 2017/18 Annual Report is also available to view in HTML format at www.morrisons-corporate.com/annual-report-2018

The information in the online Annual Report and Financial Statements, Strategic report, and the Interim reports is exactly the same as in the printed version.

Environmental matters

Our environmental footprint is taken very seriously. In the production of the 2017/18 Annual Report, we have contributed to the reduction in environmental damage in the following ways:

a) Website

Shareholders receive notification of the availability of the results to view or download on the Group's website, www.morrisons-corporate.com, unless they have elected to receive a printed version of the results.

Shareholders are encouraged to view the report on the website which is exactly the same as the printed version, but using the internet has clear advantages such as lowering costs and reducing the environmental impact.

b) Recycled paper

This document has been printed on recycled paper that is manufactured in mills with ISO 14001 accreditation from 100% recycled fibre. It is totally chlorine free and is an NAPM certified recycled product.

Investor relations and financial calendar continued

Registrars and shareholding enquiries

Administrative enquiries about the holding of Morrisons shares, such as change of address, change of ownership, dividend payments and the dividend reinvestment plan should be directed to:

Link Asset Services
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU

Telephone: 0871 664 0300
Overseas: +44 371 664 0300
Calls cost 12p per minute plus your phone company's access charge. Calls outside the United Kingdom will be charged at the applicable international rate. We are open between 09:00 – 17:30, Monday to Friday excluding public holidays in England and Wales.

Web: www.signalshares.com

Email: enquiries@linkgroup.co.uk

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Ashurst LLP
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London EC2V 7WS

DWF LLP
1 Scott Place
2 Hardman Street
Manchester M3 3AA

Allen & Overy LLP
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London E1 6AD

Independent auditors

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Chartered Accountants and Statutory Auditors
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29 Wellington Street
Leeds LS1 4DL

Stockbrokers

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68 Upper Thames Street
London EC4V 3BJ

Credit Suisse
One Cabot Square
London E14 4QJ

Shore Capital
Bond Street House
14 Clifford Street
London W1S 4JU

Investment bankers

NM Rothschild & Sons Limited
St Swithin's Lane
London EC4N 8AL

Shareholder information

The number of shareholders at 4 February 2018 was 41,444 (2017: 42,308) and the number of shares in issue was 2,355,814,852 (2017: 2,335,535,537).

Analysis by shareholder	Number of holders	% holders	Balances at 4 Feb 18	% capital
Private shareholder	37,916	91.49	90,473,635	3.84
Nominee companies	2,785	6.72	2,119,626,946	89.98
Deceased accounts	443	1.07	703,766	0.03
Limited companies	129	0.31	2,845,935	0.12
Other institutions	57	0.14	4,267,975	0.18
Bank and bank nominees	77	0.19	110,837,933	4.71
Investment trusts	14	0.03	74,631	0.00
Pension funds	10	0.02	67,372	0.00
Family interests	13	0.03	26,916,659	1.14

Analysis by shareholder	Number of holders	% holders	Balances at 4 Feb 18	% capital
1–1,000	23,246	56.09	9,568,002	0.41
1,001–10,000	15,924	38.42	48,124,134	2.04
10,001–1,000,000	2,099	5.07	178,328,479	7.57
Over 1,000,000	175	0.42	2,119,794,237	89.98

Information at your fingertips

Customer

Our website, www.morrisons.com, allows you to shop online, search hundreds of inspirational products and recipes for the food we make and provide, and find out useful information about our stores and the services they offer.

The delivery service of Morrisons.com now covers over 60% of Great Britain. The geography that we cover is growing all the time with the North East, Isle of Wight and parts of East Anglia opened up to customers in the last 12 months. A postcode checker makes it easy to see if you are eligible for our home delivery service.

At Morrisons.com you can:

- Purchase over 29,000 Morrisons grocery products, including over 1,000 Best products and 9,000 General Merchandise branded products;
- Navigate from our home page to all our various websites, including our newly deployed online Florist (www.flowerworld.co.uk), and our new all year round order and collect service for gatherings and special occasions;
- Benefit from competitive 'one-off' delivery charges or purchase a delivery pass for unlimited deliveries for a one-off fee;
- Check out latest promotions and seasonal events, including online exclusive deals;
- Review and research in-store only events and 'when it's gone it's gone' promotions, such as those offered on Black Five Days;
- Sign up for our latest offers and our marketing by email;
- Find recipes based on our ingredients and inspired by our campaigns and events;
- Read content on healthy eating, reducing food waste and our support for various charitable causes such as CLIC Sargent or the Morrisons Foundation; and
- Leave or research a Trustpilot review about the customer service received at Morrisons, and with four stars Morrisons is rated the highest of the UK multiples.

You can also sign up to and manage your More Card account on our website, and earn points on all your purchases. In our dedicated area, you can find out what our loyalty card scheme has to offer, check your points balance and make changes to preferences.

Not all products are available online. However, the website is an excellent vehicle for finding out more about things we offer and you can do this on the website through your desktop, your smartphone (using our App) and even using your voice through an Alexa device – a first for a UK Supermarket.

You are also able to preview selected items from ranges such as 'Nutmeg' and Market Street, and our new café offers, in-store services, award wins, pharmacies, glass hire and details of our new store openings online. As standard, morrisons.com also provides a mobile-friendly online Store Finder where you can find details of your nearest store, opening times and services it offers.

Corporate

Our corporate website, www.morrisons-corporate.com, is a one-stop portal that exists for the benefit of our investors, the public and the media. This site has the following sections:

About Morrisons

You will find information about the Group, its operations, strategy and structure, and past financial information.

Jobs

Career opportunities and information about working for Morrisons.
For our dedicated recruitment website, go to www.morrisons.co.uk/jobs

Media centre

Latest releases about the growing estate of Morrisons, along with promotions and product news.

Corporate responsibility

Here you can find out about our corporate responsibility ethos, including how we take good care of our environment, society and how we go about business. www.morrisons.co.uk/cr

Investors

Presentations, announcements and financial reports can be quickly and easily downloaded or viewed on-screen as PDFs. You can easily navigate around the Annual Report and Financial Statements 2017/18 on-screen, viewing only the parts you want to, at www.morrisons-corporate.com/annual-report-2018

Webcasts

Webcasts of the Directors delivering the preliminary results for 2017/18 on 14 March 2018 are available.

Shareholder information

Other relevant shareholder information is available, for example share price history, dividends, financial calendar and corporate governance information.

Electronic communications

Electronic communications (eComms) is the fastest and most environmentally friendly way to communicate with our shareholders.

Instead of receiving paper copies of the annual and financial results, notices of shareholder meetings and other shareholder documents, you will receive an email to let you know this information is available on our website.

Visiting our website to obtain our results reduces our environmental impact by saving on paper and also reduces our print and distribution costs.

Sign up to eComms on our website at www.morrisons-corporate.com and follow the investor eComms link.

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Since 1899

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