# Annual report and financial statements 2006

YOUR M&S

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# WE ARE ONE OF THE UK'S LEADING RETAILERS, WITH OVER 15 MILLION PEOPLE VISITING OUR STORES EACH WEEK.

We offer stylish, high quality, great value clothing and home products, as well as outstanding quality foods, all responsibly sourced from suppliers we trust. We employ 65,000 people and have over 450 UK stores, as well as a flourishing international business.

## CLOTHING AND HOME

UK SALES (EX. VAT)
**£3,644.4m** (+0.0%)

We are the UK's largest clothing retailer. Clothing represents 45.2% of our UK business. In 2005/06, we re-launched Menswear 'Autograph', expanded our Womenswear 'Autograph' offer and introduced a 'per una' range in Lingerie and 'Girls Boutique' in Childrenswear. Home represents around 4.9% of our UK turnover and offers great value, stylish furniture and home products.

**See pages 8-11 for more detail.**

## FOOD

UK SALES (EX. VAT)
**£3,630.6m** (+7.0%)

Food accounts for 49.9% of our UK business and we have a market share of 3.2% (source: TNS). In 2005/06, we re-launched the additive and preservative-free 'Marks & Spencer Cook!' range, extended 'Eat Well' to over 1,000 products and started to sell only Fairtrade coffee. We have 144 'Simply Food' stores across the UK.

**See pages 12-15 for more detail.**

## INTERNATIONAL

SALES
**£522.7m** (+14.7%)

Our International business comprises wholly-owned stores, in the Republic of Ireland and Hong Kong, and 198 M&S branded franchise stores worldwide, including 22 stores opened in 2005/06. In March, we agreed the sale of Kings Super Markets, the US supermarket chain, for £35.4m ($61.5m) in the last part of the programme to refocus the business.

**See page 15 for more detail.**

## FINANCIAL HIGHLIGHTS

**GROUP SALES**
2006
£7.8bn
2005 £7.5bn

**GROUP OPERATING PROFIT***
2006
£855.8m
2005 £649.1m

**GROUP PROFIT BEFORE TAX***
2006
£751.4m
2005 £556.1m

**EARNINGS PER SHARE (ADJUSTED)***
2006
31.4p
2005 19.2p

**RETURN ON EQUITY**
2006
52.3%
2005 35.0%

**CASH FLOW**
2006
+£550.5m
2005 -£104.5m

* Before exceptional items and asset disposals.

# Chairman's statement

## Last year we continued to deliver the plan we set out in 2004 to return to growth. We have made progress. However, there is more to do and more value to deliver.

## Paul Myners

### YOUR DIVIDEND

**14.0p**
Total dividend

**4.8p**
First half dividend

**9.2p**
Final dividend

In the last two years, the Group has undergone a period of significant and necessary change under Stuart Rose's able and inspiring leadership.

Stuart joined us in May 2004. The Group and our share price had been underperforming for several years and we were facing an unsolicited offer from Revival Acquisitions.

Stuart has a profound understanding of this extraordinary business. From day one, it was clear he knew the issues that needed to be addressed. He drew up a plan, assembled the team to implement the plan, and then got on with it, in a tireless and focused manner.

The improvements seen in 2005/06, a direct result of this approach, have been reflected in our share price and a two-thirds increase in earnings per share to 31.4p per share (last year 19.2p), a record level for the Group.

On the strength of this, we are proposing a final dividend of 9.2p per share (last year 7.5p), providing a total dividend for the year of 14.0p (last year 12.1p), an increase of 15.7%.

With dividend cover now restored to over two times, the Board's future policy is to grow dividends broadly in line with adjusted earnings per share growth for each half of the financial year. This will enable our shareholders to participate fully in the growth of the business and provide clarity on our approach to future dividend determination.

I would like to thank our many shareholders for their unwavering support during this period and welcome those new to the share register. We are also delighted that we will be sharing our success with all employees at every level in the Group next month. Our reward scheme this year includes a one-off discretionary bonus for our customer assistants of up to £500 each.

Chairing any major public company is an honour, but chairing M&S is a special privilege. Few companies enjoy the sort of relationship we have with our customers – a relationship summed up so well by the 'Your M&S' campaign. That makes our work as directors fulfilling, but it comes with a particular responsibility: we can never afford to be complacent.

We remain committed to our values – Quality, Value, Service, Innovation and Trust. These have a growing resonance as more and more people look to make careful choices about where they shop and what they buy.

This year we have worked to tell our customers even more about how we go about our business through the 'Look behind the label' campaign. We are proud of the sort of company M&S is – both highly commercial and responsible. We are determined to keep it that way.

I said last year that we had some important work to do to make sure the Board was properly structured. There have been significant changes.

Charles Wilson, executive director, left in October 2005. During his time with the Group, Charles played a central role in helping us to cut costs, work that was critical in beginning to return M&S to health and which is now deeply embedded in our processes. I express appreciation to Charles, on behalf of the Board, for the part he played in creating a strong foundation for growth.

We also said goodbye to Anthony Habgood, who stood down as non-executive director to give more time to other business interests. Kevin Lomax will be leaving the Board on 31 August 2006, having served as a director for six years and Senior Independent Director since July 2004. I would like to thank them for their contribution.

We were pleased to see Ian Dyson and Steven Sharp become executive directors. We are also delighted that Louise Patten, Jeremy Darroch and David Michels have brought their varied and broad experience to the Board as new non-executives.

The Board now has the necessary balance of skills. I am confident that challenges to the executive directors from the non-executives will focus on the right issues and will be conducted in a constructive and collegiate manner.

To ensure that the Group has a highly capable executive team, our remuneration packages need to be competitive. We are recommending changes to the Annual Bonus Plan and Performance Share Plan, which I ask you to support.

Bonus targets remain extremely demanding. Over half of any bonus awarded would be paid in shares, which must be held for three years. We are committed to rewarding success, not failure and directors' contracts are subject to a clear obligation to mitigate cost to M&S.

These changes continue to align directors' rewards with the long-term interests of shareholders.

The AGM in July will be my third and last as Chairman. Terry Burns will become your new Chairman after the meeting. I know that he will provide the Board with effective leadership. Terry brings to the task skills honed in a successful career in academia, the Civil Service and, latterly, business, including his Chairmanship of Abbey National.

The plan Stuart and I set out when we first spoke to shareholders in July 2004 is being implemented and remains intact. Today, M&S is in better shape. But there is still much more to do.

Last year in Clothing and Home, we worked hard on restoring our competitiveness, engaging with our suppliers to improve value, styling and the amount of new and exciting product across our ranges. In Food, we continued to focus on offering high quality, innovative products. This is beginning to contribute towards improved customer perceptions, market share and financial performance.

At the same time, we extended our store refurbishment trial and continued to open new mainline and 'Simply Food' stores.

Finally, improved service remained a priority. We undertook our biggest ever customer service training programme. We also overhauled pay rates and improved career planning for customer assistants. This will help us attract and retain the best people for our business.

In 2006/07, we are continuing to build on the progress we made last year, working to offer great product, in great stores through great service.

We are clear about what we have achieved. But we are equally clear that, at a time of intense competition, there can be no let-up in the work to return M&S to profitable growth.

We must remain focused on our main task – to create value for shareholders by developing a trusted brand and delighting customers with superior product at prices which offer real value.

I wish my colleagues all the best in continuing this work during 2006/07 and beyond.

**Paul Myners**, Chairman

# Chief Executive's review

## M&S performs best when we listen to our customers. They want high quality products at competitive prices, in attractive stores that provide excellent service.

## Stuart Rose

In 2005/06, we made real progress on improving our product ranges and started to tackle our customer service and store environments. As a result, our performance improved in what continued to be a tough and competitive marketplace. However, we still have much to do to ensure that we sustain growth in the long term.

Last year, I updated you on progress made on our three-year plan. Starting in 2004/05, we tightly controlled costs, reduced stock commitments, streamlined buying practices and eliminated bureaucracy, as well as reasserting our traditional values of Quality, Value, Service, Innovation and Trust. We started to drive the business in 2005/06, concentrating on: product, environment and service.

Our plan remains unchanged. We will continue the drive phase in the coming year, focusing on further improving product and customer service, while modernising our stores on a scale unmatched in the UK. Beyond this, we have begun to consider opportunities to broaden the business from 2007.

Clear responsibilities will ensure that we achieve our goals with pace. The executive board comprises a team of three. Ian Dyson, our Group Finance Director, is responsible for International, IT, Logistics and Property; Steve Sharp for Marketing, E-Commerce, Store Design and Development and our relationship with HSBC's M&S Money. I continue to oversee Buying and Merchandising in addition to my other responsibilities. We are supported by a strong team of Business Unit Directors – Guy Farrant in Food; Kate Bostock in Womenswear, Girlswear and Babywear; Matthew Hudson in Lingerie and Sleepwear; Andrew Skinner in Menswear, Boyswear, Schoolwear and Children's Nightwear; and Steve Rowe in Home and Beauty; working together with Andrew Moore, who is responsible for all planning for General Merchandise. Our store teams are managed by Anthony Thompson. They are supported by strong teams in logistics, systems, marketing and other essential functions.

### Our performance last year

Operating margins improved to over 10% through a continued tight control of costs, tight management of stock commitments and better buying. Group profit before tax, exceptional items and asset disposals rose 35.1% to £751.4m (last year £556.1m). Total UK retail sales were up 3.4% at £7.3bn, as Food recorded strong growth of 7% and General Merchandise remained broadly level, with Clothing sales flat and Home seeing a 0.8% increase.

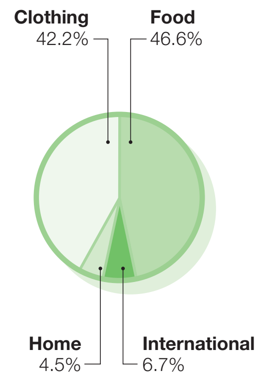
Performance improved progressively throughout the year. In Clothing, all areas experienced a difficult first half as we continued to improve our products, change buying practices and rationalise our brands. From the autumn, our sales performance improved, led by better styling and very competitive pricing. Food sales improved across the year, thanks to our renewed focus on outstanding quality and innovation and our efforts to tell our customers more about what makes us different. The momentum was maintained through Christmas and the final quarter, when, importantly, we saw an improvement in market share by both value and volume.

**4.1%**
increase in sales

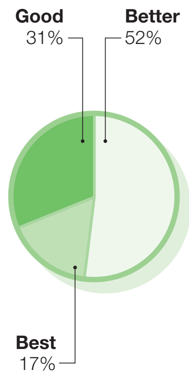
**35.1%**
increase in pre-tax profits

**63.5%**
increase in earnings per share

### SALES BREAKDOWN



## OUR PRICE ARCHITECTURE




**We have restructured our prices, so that our customers get clear choices and great value right across our ranges. 31% of our products are now at opening price points, including £1-per-pair socks and £5 t-shirts.**

Strong advertising, highlighting our quality and value, drove more people into our stores. Customer visits increased by nearly 350,000 a week to just over 15 million (last year 14.7 million). In the last quarter, the number of those purchasing also increased, with a total of 10 million customers every week. We expect to see this positive trend continue as we reap the benefits of offering better products, stores and customer service.

In Clothing, better values, better buying, and better styling resulted in better performance. Womenswear improved from September with well-received ranges beginning to re-establish our fashion credentials, including more frequent additions of new product into stores. 'Per una', led by George Davies and his team, had another very strong year. It is a major brand, approaching £500m, with wide appeal and strong growth potential. Menswear successfully rationalised its brands and further extended its more fashion-led 'Autograph' offer. Lingerie benefited from a clearer offer with only five brands, including the new 'per una' range. Beauty performance was weak and we are re-assessing our offer. Our share of the childrenswear market remained level, with school clothes and Babywear the sole areas of strength. We restructured Childrenswear in November 2005, handing responsibility for it to our Womenswear and Menswear teams, with the aim of regaining our leading position in this important market.

Our decision to concentrate our Home offer on stylish products with mainstream appeal in our core areas of kitchen, dining, bedroom and bathroom is working. Sales increased over the year, supported primarily by a strong performance in furniture and very competitive pricing.

Food had a very successful year thanks to a renewed focus on outstanding quality and innovation, backed by powerful advertising. Sales at £3.6bn were 7.0% higher and 3.6% ahead on like-for-like terms. Demand for responsibly sourced, healthy food is a strong trend we have successfully tapped, not least with our 'Eat Well' products, superfoods like pomegranates and blueberries and our additive-free 'Marks & Spencer Cook!' range. We continue to offer everyday food of exceptional quality, like our 'Oakham' chicken. Customers again made us their first choice for food at key times of the year like Christmas and Easter.

Our stand-alone 'Simply Food' format also performed strongly, supporting overall performance. We are now opening around one new store every week. We are monitoring results of the initiatives we are trialling in our Food Halls – 'Hot Food to Go' and our new bakeries, patisseries and delicatessens – which we launched in 2005/06 to explore new opportunities to extend our Food offer.

Our International business continued to grow and we now have 198 franchise stores in 30 territories, as well as wholly-owned stores in Hong Kong and the Republic of Ireland. We agreed the sale of Kings Super Markets in the US, our only non-M&S branded business, for £35.4m ($61.5m) ahead of the year end. International sales were up 14.7% to £522.7m (up 14.3% at constant exchange rates).

M&S Money provided a net operating profit of £9.6m from our ongoing partnership with HSBC, to whom we sold the business in 2004. This is a strong franchise and we see exciting opportunities to drive the business in the future.

### Product

*Lower prices, quality maintained*

Improving our values was the key objective during the year. In many areas, we had been uncompetitive. In response, we repriced ranges across all price points, without compromising our high quality standards. We benchmark prices against our nearest rivals to offer clear, competitive choices at every level with the major focus being on value for money. Customers have responded very positively and their perceptions on the value we offer improved over the year.

Some 30% of our products are now at 'Opening Price Points'. This compares with 12% in 2003/04. We saw strong sales on basics such as the £6 bra, women's t-shirts from £5, men's jeans at £9, three saucepans for £9.50 and sofas from £349. Our mid and higher priced products also provide outstanding value and by the end of the year we were seeing growth across all price points.

*Better buying*

Better buying has also been an important part of driving the business. Our buyers, merchandisers and designers are trained in our Buying Academy to make sure they

use and share best practices, as we become demand-led, rather than supply-driven. Stock commitments, which were reduced by 35% or £1.3bn in 2004/05, were kept under tight control. Additionally, we set aside some of our budget to chase new trends, missed opportunities and popular products within each season.

We kept a close watch on the number of products on offer, in order to avoid the proliferation that has confused our customers in the past. At the same time, we filled gaps in our offer with 'Petite' and 'Plus' ranges, as well as a small 'Maternity' offer. In order to broaden and offer real choice, we will extend these ranges in 2006.

Our focus on stocks and catalogue width and depth resulted in a significant reduction in markdowns over the year, which contributed some 50% of our margin improvement in 2005/06.

Without the support of our suppliers we could not have transformed our buying or improved our performance. By working together, we now offer more competitive prices at a faster pace, whilst maintaining quality. This, coupled with tighter stock control, is achieving higher volumes, higher margins and better cash flow.

We opened five overseas offices during the year, enabling us to cement relationships with our suppliers and source more efficiently. With 120 people working on the ground overseas, we are also able to make sure our strict trading standards are being met. Our office in Turkey played a key role in speeding up sourcing of the season's trends, with some 'fast fashion' ranges designed, bought, made and delivered in as little as six weeks.

During the year, we increased the amount of product we buy direct from suppliers to 25% (last year 20%). We continue to work extensively with efficient full-service vendors, who purchase on our behalf from suppliers, offering the right product at the right price, at the right time.

*Innovation*

In Food, innovative product development continues to set us apart from the mainstream competition. During 2005/06, we began to do this on a scale we have not achieved for many years. We listened to our customers who are increasingly demanding

## Listening and talking to our customers

**We have continued to restore our brand appeal both in store and through the media, to entice customers to have another look and see the changes we have made to our products, store environment and service.**

Over 15 million people visit our stores each week, with around 10 million of them purchasing from us. While our core customers, aged between 35 and 55, remain a key focus for us, we cater for a wide range of age groups, attitudes and tastes. We listen carefully to our customers, using formal focus groups, customer panels and surveys as well as talking with the people we meet in our stores.

We have used counters in over 160 stores to improve the way we measure customer visits and are trialling new software to analyse conversion – the number of customers who make a purchase when they visit – allowing us to plan better service levels for busy times.

Customer visits rose steadily in 2005/06, with a 4.7% increase since Christmas, against an overall market decline of 7%. Our analysis shows that conversion is lagging behind this growth although improvements were seen in the last quarter. This remains an opportunity for us.

As well as listening more carefully to our customers, we have also been talking to them more. To underline the quality of our products, the value we offer and the care we take in our sourcing, we launched the 'Your M&S' campaign in 2004, which has become an umbrella for all our marketing activities.

Building on this, we ran a series of newspaper and broadcast campaigns in April 2005. The first highlighted our special food, including 'Oakham' chicken and our specially blended wines.

With the introduction of our autumn clothing ranges, we believed that our Womenswear offer had improved enough to warrant new consideration from our customers and we created our now well-known Twiggy, Erin, Laura and Noemie campaign.

This was followed by 'Your M&S for Less', highlighting the dramatic improvement in value; a re-launch of 'Autograph' Menswear; and the 'M&S presents Christmas' campaign.

We launched 'Look behind the label' in late January 2006, telling customers about our ethical standards and the care we take over quality, safety and the environment. After years of pioneering work, we had an important story to tell customers who are increasingly making ethical decisions about what they buy.

Marketing spend increased slightly but was also more focused on high-impact campaigns. Not only did the advertising help boost sales of specific featured products, it also lifted sales across our whole offer and boosted brand perception.

## Market insight

### The UK retail market had a very difficult year and we expect it to remain challenging in the next 12 months.

All parts of the market were affected by fierce competition both from new entrants and from existing operators expanding their space. Consumer spending remained under pressure amid worries about house prices, taxes, interest rates and, latterly, the sharp rise in utility and fuel bills.

As a result, the number of people shopping decreased over the year by 2.1%, exacerbated in city centres by the terrorist attacks in London last summer.

Across the year, retail sales rose by just 1.6% (last year +5.4%). On a like-for-like basis – a measure stripping out sales from stores open for less than a year – sales fell by 1.4% (last year +1.8%).

The first six months of the year were particularly tough and there was little let-up in the second half. Indeed, the British Retail Consortium (BRC) said that sales in January, after a relatively busy Christmas, were at their lowest level since it started reporting in 1995.

Prices of clothing continued to fall during the year and there was a trend for shoppers to look for value items at the expense of bigger ticket items. This stoked intense competition as retailers attempted to lift the volume of sales to make up for lower prices, which benefited sales of casual clothes.

In women's clothing, demand grew for celebrity and catwalk trends like military jackets, shrugs and skinny jeans. Casualwear sales were also healthier in the less fashion-driven menswear market.

The childrenswear market was generally flat, although school clothes, toddler and babywear did best.

Following calls from a number of member states, the EU imposed quotas on imports of certain Chinese textiles in 2005, which led to UK retailers re-assessing their sources of supply. In April 2006, provisional duty also came into effect on leather footwear imports. The UK retail sector continues to lobby the EU against these and other potential trade defence measures.

Throughout the year, the slowdown in house prices had a big impact on sales of home products, particularly furniture. This was not stemmed by the interest rate cut in August 2005 and was compounded by petrol price rises in the same month.

Food sales were much stronger during the year. Healthy eating was a major trend benefiting the sale of salads, fruit, vegetables and healthy drinks.

From December, the interest in ethically sourced products increased. Busy shoppers were also increasingly looking for convenience and sales of ready meals were strong, particularly premier ranges.

Sales of wines, beers and spirits were lifted by frequent promotions.

Analysts continue to forecast sluggish activity in the retail market. Pressure on spending is unlikely to relax while consumers continue to worry about debt, rising bills and soft house prices.

With retailers continuing to expand their space and compete fiercely on price, they will be under pressure to lift their volumes to maintain total sales, while trying to offset higher costs.

Sources:
BRC-KPMG Retail Sales Monitor
Verdict Research, 'retailverdict' reports

foods that are not only good to eat but also fresh and healthy. Some responses included the introduction of our unique, additive-free 'Marks & Spencer Cook!' range and a commitment to remove hydrogenated fats in virtually all of our food by the end of 2006.

We also continued to help our customers put restaurant quality food on their tables with minimum fuss such as our stress-free soufflé, the first oven-ready version that is guaranteed to rise every time.

In Clothing and Home, innovation also adds value to our ranges. We introduced machine-washability to our opening price suiting, such as our £50 women's suit and, in Menswear, we developed a world-first tumble-dryable suit. In Lingerie, we launched seam-free underwear and machine-washable silk nightwear. In Home, we developed a rattan-style material for garden furniture, which can stay outdoors in all weathers, combining convenience with style.

**Environment**

Our store portfolio is the Group's biggest tangible asset and the physical representation of our brand on high streets and shopping centres across the UK. Although we have stores in great locations, many years of underinvestment have left many looking tired and, in some cases, dilapidated. Our major refurbishment programme is designed to provide a great environment for our customers to shop in. By the end of 2006, almost everyone in the UK should be a short drive from a newly modernised M&S store.

Having tested the new look last year in four stores, we extended the trial to a further 17 locations ahead of Christmas 2005. These stores have seen a strong improvement in sales and customer feedback has been very positive.

By Christmas 2006, we will have introduced the new design to 35% of our floor space, as part of a £520m-£570m capital expenditure programme for 2006/07. This new design is more contemporary, lighter and brighter with better layout, equipment, changing rooms, service areas and cafés. This level of investment is expected to continue into 2007/08.

We now have a design which works well and are seeking to roll it out at lower cost. This major project is being carefully managed, with stores being kept open

throughout refurbishment to minimise inconvenience for our customers.

We continue to keep the layout of all our 451 stores under close review, improving configuration and display of new ranges. We also opened eight new mainline stores in 2005/06, seven on retail parks and one in Victoria, London. We closed six underperforming stores during the year. In March 2006, we concluded a £38m deal to buy 28 former Iceland stores which will open this summer as 'Simply Food' outlets, taking our number of stand-alone food stores to 172. We are trialling a 'Simply Food' offer in nine BP Connect service stations, one of which opened after the year end. If this trial is successful, there will be significant opportunity for expansion.

We have recently instigated a review of our total property portfolio in order to better understand our needs and opportunities.

### Service

Consistently good customer service is the third key part of our plan. Starting in June 2005, all 56,000 of our store colleagues in the UK and the Republic of Ireland participated in a specially tailored programme called 'Our Service Style' to help us achieve this. The programme accounted for over one million hours of additional training and was very well-received.

We also restructured customer assistants' pay, introducing some of the best rates on the high street. A host of complicated roles were replaced with just four – Trainee, Qualified, Coach and Section Co-ordinator – offering assistants a clear career path.

Finally, we improved further our staffing schedules, so that more of our customer assistants were on hand during our busiest times.

We need to do a lot more to improve service. The new Coach role will make service training part of everyday life. We will also be adding more specialist sales staff in areas such as bra-fitting, footwear, suits and speciality foods.

Our aim is to make sure we always have well-motivated, properly trained people, in the right place at the right time to help our customers.

Colleagues in our stores played a critical part in improving our performance last year. I am delighted we are able to reward everyone in the Company with a well-deserved bonus to recognise their efforts.

### Looking ahead

In the coming year, we will begin to look at ways to broaden the business. We will continue to expand our franchise operation overseas, where the M&S brand is well-known and popular.

Our work with Amazon will, from 2007 onwards, improve our e-commerce offer.

The 'Simply Food' store format will continue to take our food to new customers and help us build market share.

However, our key priority will remain the revitalisation of our existing core business, building on the work already in hand based on our principles of Quality, Value, Service, Innovation and Trust. We face challenges, including significant cost inflation and relentless competition.

M&S is rediscovering its self-confidence, with morale and motivation at high levels. However, progress will become more challenging as we start to come up against year-on-year growth during 2006/07.

We are under no illusions about the work necessary to place us firmly on a path to long-term growth and are committed to deliver this.

We have achieved much in the last year. None of this would have been possible without the hard work and dedication of our colleagues and our superb and highly committed supply base. They have risen to all the challenges set and deserve our thanks.

Last and not least, I would like to thank Paul Myners for his unstinting support over the last two years. Revitalising a business is difficult at any time; doing it whilst defending a bid and dealing with a highly competitive retail environment was made easier with his continuous support and belief. All shareholders are in his debt.

**Stuart Rose,** Chief executive

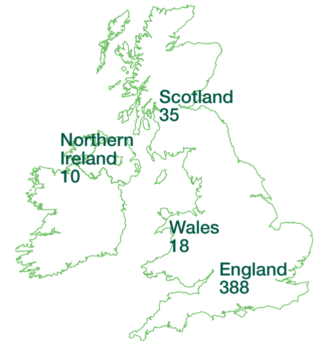
**56,000**

**employees underwent 'Our Service Style' customer service training in 2005/06.**

**35%**

**of our store portfolio, equating to 5 million sq ft of space, will be refurbished by the end of 2006/07.**

## UK STORES




| STORE TYPE | NUMBER OF STORES |
|---|---|
| Major city stores | 48 |
| Major out of town stores | 24 |
| High Street stores | 198 |
| Retail park stores | 13 |
| Outlet stores | 24 |
| Simply Food stores | 101 |
| **Wholly-owned stores** | **408** |
| Simply Food franchises | 43 |
| **Total stores** | **451** |

# Clothing and Home

## This year, we offered customers a much better choice of stylish and fashionable products at outstanding value and our sales improved as a result.

We gave our customers better product, better styling and outstanding prices, while maintaining our high quality standards. We also provided a clearer offer through fewer sub-brands and put new product more frequently into stores.

The year 2005/06 was a story of two halves. The first six months saw a weaker performance as the changes we made took shape. In the second half, customers began to respond to the improvements we had made by buying more, more often.

While we are pleased with the progress we have made this year, there remains much to do to further improve our core offer, as well as new opportunities to go for in the year ahead.

## Performance

M&S continues to be the UK's leading retailer of Clothing and Footwear by both value and volume.

Throughout last year, we improved our market share performance and ended the year ahead in volume terms with 9.9% share (last year 9.7%), as customers bought more in response to better product and pricing; but marginally behind in value terms at 10.2% (last year 10.5%), primarily reflecting price deflation.

In value terms, Womenswear ended the year with 10.5% market share (last year 10.7%); Menswear, 9.5% (last year 9.8%); Lingerie 24.1% (last year 25.5%) and Childrenswear 4.1% (last year 4.3%).

The increase in full price clothing market share was marked, up 2.0% to 14.2%, reflecting the real improvements we made in offering better values, with the first price being the right price.

This resulted in a significant reduction in the level of marked down products, which contributed some 50% of our margin improvement in 2005/06. In the last quarter, we achieved positive market share growth in all departments at a total level for the first time in three years, with gains most marked in Womenswear.

The difficult first half affected the performance of all departments, as we took action to adjust ranges and prices. But performance improved from the autumn, grew stronger over Christmas and momentum was sustained in the last quarter. Total Clothing sales stood level against last year at £3.3bn (last year £3.3bn), while Home turnover was 0.8% up on the year at £353.8m (last year £351.1m).

Womenswear experienced strong second half growth, reflecting our work to keep ranges fresh so every woman can find something new, every time she visits. We responded confidently to key trends including military jackets, re-establishing our reputation for grown-up fashion.

'Per una' performed strongly under the leadership of George Davies. George will take a new role as 'per una' Chairman from July 2006 but will remain very committed to the day-to-day running of the business.

Menswear and Lingerie followed a similar pattern of tough trading in the first half and strong growth in the second, although growth was more muted than that seen in Womenswear.

Menswear reduced its brands to three – 'Autograph', 'Blue Harbour' and 'Collezione' – by autumn 2005. 'Autograph' was re-launched in August 2005, providing a wider offer of designer-led pieces, and was a strong performer. Suiting also performed well and hit a three-year high in its market share. 'Blue Harbour', the biggest casualwear brand for men in the UK, also had a strong year.

In Lingerie, the move to fewer brands in 2005 made the offer clearer and easier to shop, whilst the 'per una' lingerie range, launched in November 2005, brought new excitement. A continued focus on really good basics at our 'Opening Price Points' and great value across the entire offer was complemented by beautiful detailing, colours and fashionable shapes. 'Body', with its simple, clean-cut lines, was particularly strong and now represents 30% of our 'Collections'.

Our Home business continued with its clear strategy of great value and simpler but stylish ranges with mainstream appeal, supported by a much better catalogue and

## CLASSIC COLLECTION

**We now use focus groups to ensure the changes we make hit the mark with customers. In 2005/06, our 'Classic Collection' team canvassed the views of over 800 members of the Women's Institute, who gave a thumbs-up to the improved quality of fit and materials used within the range, but confirmed that we need to continue developing collections with more fashionability. The feedback had a direct impact on our buying. In January, for example, we doubled our order of a favoured printed skirt, so that we could stock it in all stores.**

a comprehensive online offer. This focus on providing what our customers really want meant that performance improved across the year.

As we worked to give customers what they wanted in Childrenswear, our market share slipped apart from in school clothes and babywear.

In November, to improve our performance, we placed Babywear and Girlswear under the control of our Womenswear team, and Boys and Toddler clothes under the management of Menswear. One of the first signs of change was the new fashion range, 'Girls Boutique' for 7-14 year olds, which had a good first season.

### Outstanding value across our ranges

Offering customers outstanding value – great quality at great prices – at all points across our price hierarchy continued to be a key priority. We adjusted our pricing structure, raising the proportion of products we offer at opening prices from an average of 17% in 2004/05 to 31% at the year end.

We continued to re-establish our value credentials. We introduced new offers such as the £5 women's t-shirt and £6 bra, the £50 career girl suit, £9 men's jeans and fleeces.

In Home, we introduced a whole new value range, including a three-steamer set for £9.50 and a £15 bale of six towels. This was well received by customers and resulted in a significant increase in the volume of sales.

We used the autumn 'Your M&S For Less' advertising campaign to emphasise our competitive pricing from basic items to more desirable clothes and fabrics, like linen.

We also increased the number of products offered at the top end of the price spectrum. In Womenswear, we now use the 'Autograph' label across our ranges to distinguish extra special clothes made from the highest quality silks, lace, linen and cashmere. We expect 'Autograph' to become one of the biggest UK luxury women's brands by the end of 2006/07.

### Better buying, better product

Our Buying Academy, set up in 2005, trained our 900 buyers, designers and merchandisers during the year to ensure that we maintain tight control on all aspects of buying.

We set challenging weekly targets to control stock levels at every part of the supply chain, to improve availability and reduce levels of marked down product.

We also reduced the number of products we had to return to the manufacturer because of faults to the lowest level since our records began in 1988.

We are getting new product to stores more quickly and effectively from around the world – in just six weeks for some fast fashion lines.

We are also buying with more confidence, making sure that products we think customers will love are available in sufficient quantity when they want them.

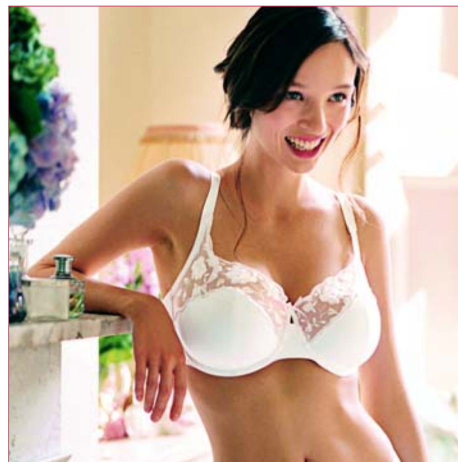
Womenswear chased new trends and fast sellers by using an uncommitted 'Open To Buy' budget. Last autumn, we caught the

## GETTING THE LOOK

**Powerful advertising created huge demand for iconic items like 'the Twiggy cardigan', but customers say that they sometimes like help in co-ordinating outfits.**

**We have introduced 'Get the Look' zones in all stores, using mannequins to show which tops and belts work best with new trends like skinny jeans, for instance. We rotate the look every fortnight.**

**The new 'Girls Boutique' range has gone a step further with special labels and 'Get the Look' books to help girls layer and co-ordinate the latest fashions.**



Our 'Portofino' rattan-style furniture has been developed for all-weather use, combining style with convenience and durability, making them perfect for the patio.

Our DD-G range, which is already one of the widest on the high street, will be extended further this year to include new styles and colours.

As part of our focus on casualwear we have added a casual offer to our 'Classic Collection' to complement our popular smartwear lines.

In 2006, we will re-vamp 'Blue Harbour Vintage', creating a more distinct, slightly younger offer to 'Blue Harbour'.

trend for culottes and city shorts, transferring fabric originally set aside for skirts and trousers. Menswear is looking to use 'Open To Buy' in the same way during 2006/07.

Our 55 technologists introduced industry-leading innovations, including the first tumble-dryable suit and seamless moulded bra. We were also the first major UK retailer to sell Fairtrade cotton products, 'Real Cool Cotton' t-shirts, and 'Heels with a Secret' in women's footwear. Lingerie greatly expanded its range of 'Shapewear', after the success of the 'Magic Knicker', and is planning the first co-ordinated range of mastectomy lingerie. In Home, we introduced all-weather rattan-style furniture and will be offering a wipe-clean fabric across our sofa ranges from autumn 2006.

Our sourcing offices in Hong Kong, India, Bangladesh, Sri Lanka and Turkey were up and running early in 2005/06, allowing us to source more efficiently and keep a close check that our strict ethical standards are being met. They also enable us to buy more product direct from the manufacturer.

## Looking ahead

While we have seen improvements this year, we still see considerable potential over the coming 12 months and beyond.

Casual clothing remains the fastest growing market, in line with increased spending on holidays and weekends away, and will be a focus this year.

We introduced new Womenswear denim shops to all stores in April 2006 with a broader, more fashionable offer. In Menswear, we are re-vamping the casual 'Blue Harbour Vintage' range to create a distinct, slightly younger offer to 'Blue Harbour'.

We will also expand the 'Maternity' offer that we introduced in January 2006 to a full range from t-shirts to suits.

Our 'Classic Collection' will be further developed using feedback from the special customer focus group we have established for the range.

We are repositioning 'Collezione' as our up-market men's smartwear brand and rolling out a new men's shoe shop format to 25 stores, providing better service and doubling the choice of shoes in the same space.

In Lingerie, we will broaden further our DD-G offer, introducing more styles, as well as more colours. We will also continue to add fashionable, trend-led lingerie to our 'Collections'.

Improving Childrenswear is a key priority, as some 70% of women aged between 30 and 45, have children. Our restructure, splitting responsibility for our offer between our Womenswear and Menswear teams, is complete and we are working hard to deliver better product and to provide the different age groups with an appropriate offer.

Finally, we will continue to provide our customers with stylish, great value Home products through our website and improved catalogue, to build further on the progress made during 2005/06.

## FAST FASHION

**In November 2005, the Womenswear team, our new Turkish office and local suppliers worked together to design, buy and deliver a fast-fashion 'Limited Collection Boutique' range in less than eight weeks. Buying at this speed, with product pre-sorted for stores at source, means we have a faster supply of new product.**

**We now use this process regularly to design and deliver 'Limited Collection Boutique' ranges within six weeks. Men's 'Autograph', 'Blue Harbour', and the first 'Girls Boutique' range have also used this supply technique in 2005/06.**

# Food

## Our food business enjoyed a very successful year. Strong product development, new advertising, improved Food Halls and the performance of 'Simply Food' all helped drive sales.

M&S food stands, above all, for outstanding quality and innovation. Our customers expect us to offer them new, delicious food, sourced responsibly, and to create and interpret new trends in eating.

We are most successful when we do this with confidence, combining the skills of our buying teams, our food technologists and our suppliers.

In recent years, we have chased too wide a range of initiatives, often done on too small a scale to have real impact. We have since refined our product strategy, concentrating on four main areas – fresh, natural, healthy food; special celebration products; authentic ready meal ranges and exceptional everyday food like our 'Oakham' chicken and Aberdeen Angus steaks.

During the year we backed this strategy with powerful advertising and bold product development – including launching 1,600 entirely new lines and upgrading a further 1,100. We are also exploring different ways to make our food available to our customers through new locations and formats.

## Performance

Total Food sales grew by 7% to £3.6bn and also enjoyed a 3.6% increase in like-for-like sales. Throughout the year, key areas such as fresh produce, particularly fresh fruit salads and juices, as well as meat, delicatessen and 'Food to Go' products experienced strong growth. Christmas was particularly successful with like-for-like sales growing 5%. Sales in the last quarter continued to improve, helped especially by a healthy eating campaign which included 200 newly developed products.

Improved marketing also contributed to our performance. Customers particularly welcomed our Food Festivals where those spending more than £35 could sample for free some of the products we are most proud of including salmon, wine and chocolate puddings.

## Healthy eating

People want to know more about their food and are becoming increasingly health conscious.

We made healthy eating a particular priority during the year, increasing the number of products carrying our 'Eat Well' sunflower logo by 300 to over 1,000 – around 20% of our food offer.

Our 'Eat Well' logo is placed on foods which do not contain artificial colours, flavourings or sweeteners and are either naturally healthy foods or nutritionally balanced, based on current Government guidelines. This approach has been assessed by independent nutrition experts at the British Nutrition Foundation.

We have provided Guideline Daily Amounts (GDAs) on all our food since August 1999 and now plan to introduce colour-coded GDAs to help customers make healthier food choices.

Concern about additives in foods is also growing and we have moved faster than anyone to remove them. During the year, we were first to commit ourselves to removing hydrogenated fats from virtually all our foods by the end of 2006 – a challenging commitment, already achieved in over 90% of affected products.

Our 'Marks & Spencer Cook!' range – providing customers with prepared raw ingredients to make delicious meals – is already additive-free. The 19 products in our 'Eat Well for Kids' range contain no artificial colours, flavours or sweeteners and no added preservatives.

We remain the only major retailer to have met the British Retail Consortium's salt reduction targets and are on track to meet the Food Standard Agency's targets for 2010.

In another innovation, we introduced a unique Omega-3 rich milk, through a specially-developed feed for our dairy cows which allows them to produce milk rich in the optimum sort of Omega-3, properly balanced with Omega-6.

While healthy eating is a key trend, we never lose sight of the importance of great taste and eating quality. We employ trained chefs to develop new dishes and improve existing lines.

## POMEGRANATE JUICE – A FIRST

of our Food offer carries the 'Eat Well' sunflower logo.

Pomegranates are one of the most popular superfoods, but finding a way to make the first totally natural pomegranate juice required lateral thinking.

Pomegranate crushing machines pulp the whole fruit and not just the sweet centre, so most pomegranate drinks have to be sweetened with added sugars. One of our technologists spotted the potential to adapt a passion fruit crusher to crush only the centre of the pomegranates. The technology was installed in Egypt where pomegranates are grown in abundance. In October, we launched the UK's first fresh and natural pomegranate juice – one of our many innovations last year.

From ethically reared animals to local cheeses, we source the best speciality food from home and abroad. These Cuxwold pork pies are part of our new ‘speciality’ range launched in spring 2006.

All of our wines are blended exclusively for us, sourced from the highest quality vineyards around the world and we have fully-qualified wine advisers in our top stores.

## ADDITIVE-FREE

**The ‘Marks & Spencer Cook!’ range is designed for the busy person who doesn’t always have the time or expertise to cook great food. Launched in the autumn, it provides prepared or fresh ingredients for dishes like salmon fillets with soy, honey and ginger glaze.**

**All 120 products in the range are preservative and additive-free. We have even replaced the salt we use with one which is free of an anti-caking agent. We have also created a new supply base for the range to make sure we get the ingredients right.**

We are also continuing to work hard to improve everyday food. Our ‘Oakham’ chicken and ‘Muirden’ pork – both unique, naturally reared products – remain popular with customers. We were the first major food retailer in Europe to sell tenderstem broccoli, high in essential vitamins, and we now have a 40% UK market share. We also won 360 awards last year for our cheeses.

### Responsible food sourcing

Our ‘Look behind the label’ campaign, launched in January 2006, allowed us to tell customers how carefully we source food. It highlighted our work to remove additives, reduce salt, ban GM-foods and encourage responsible fish sourcing. There is more detail on the campaign in our Corporate Social Responsibility Report online (www.marksandspencer.com/csrreport2006).

Our ‘Oakham’ chicken was recognised with an award from Compassion in World Farming and during the year, we introduced more naturally grown breeds of turkey and pork.

In March, we announced that we would switch all the coffee and tea we sell in our Food Halls to Fairtrade.

Last year, we introduced cardboard sandwich packs made from well-managed timber supplies with a biodegradable cornstarch film window.

### Speciality foods

We go to great lengths to source speciality foods from home and abroad, assisted by our own team of agronomists, farmers, chefs, winemakers, animal welfare and marine specialists.

In spring 2006, we introduced a new range of 300 speciality products which illustrate the care we take in sourcing our food. The range includes Cuxwold pork from Norfolk and Lincolnshire and Apple and Cider Jelly from Biddenden, Kent.

During the year, we also set about giving all our food a distinctive look and will have re-packaged almost all our lines by the end of 2006. This work is already noticeable in our stores, particularly on ‘Food to Go’ items, like sandwiches and drinks, and on grocery, bakery and delicatessen products which have attractive, eye-catching designs.

### Celebrate

We remain a first choice for customers looking for high quality, trusted food at celebration times like Easter and Valentine’s Day.

We saw strong demand at Christmas for products like ham and turkey joints and specially-prepared vegetables, including glazed parsnips. At Valentine’s, sales of single long-stem roses increased by 160%, helped by advertising.

In May 2006, we extended our in-store food ordering service, increasing our range of party food and personalised cakes by around a quarter.

### Reaching new customers

Our ‘Simply Food’ stores continue to reach new customers who like the convenience offered by locations such as railway stations and motorway service areas.

We are currently reviewing the trial of 'Simply Food' in eight BP forecourts, which we launched in autumn 2005, and one which we opened after the year end.

The market for M&S food is potentially much wider. In seven stores we tested new formats including 'Hot Food to Go', like hot wraps and soups, and in four stores we introduced new bakeries, selling fresh crusty bread and first class patisseries and delicatessens where customers can sit and eat breakfast, brunch, a light lunch or supper. These ideas help bring theatre and excitement to our stores.

### Looking ahead

We will continue to provide innovative food of exceptional quality in 2006/07. Healthy eating will remain a priority for us.

We plan to increase our 'Eat Well' products, extend our additive-free 'Marks & Spencer Cook!' range and continue to reduce salt and remove hydrogenated fats from our food. We will also continue to highlight the special quality of our food and its provenance.

Building on our popularity at Christmas and other key times of the year, we will seek to become the preferred destination for personal celebrations like birthdays, weddings and anniversaries.

We will open more 'Simply Food' stores and extend the trial of new formats, like our 'Eat Over Deli' bars, bringing our food to a wider audience. Later this year we will open our first stand-alone restaurant at our Newcastle store, where customers will be able to dine out on a range of our food.

# International

## Our International business contributed 9.1% to the Group's pre-tax profits.

Comprising wholly-owned stores as well as franchise stores around the world, our International division continues to flourish. In 2005/06, it generated a turnover of £522.7m (last year £455.8m) and an operating profit of £65.6m (last year £60.4m). As part of our plan to refocus the business we agreed the sale of our US supermarket chain, Kings Super Markets, for £35.4m ($61.5m) in March 2006.

### Franchise

We operate 198 franchise stores in 30 territories around the world. During the year, 22 stores opened including two in Moscow, an additional four in the Czech Republic and three more in India. We have also closed a number of stores in the period, either to move to better sites or to concentrate on larger, more profitable stores. Total space grew from 1.30 million sq ft to 1.43 million sq ft.

We see considerable scope to increase the number of franchise stores in our current territories and to enter new ones. We opened in Switzerland in April 2006, and have plans to open in Ukraine and Latvia, as well as to expand our Russian presence to St Petersburg, in 2006/07. Franchise stores give us the opportunity to expand internationally without significant capital cost. By continuing to work with trusted partners, we benefit from both their local knowledge and increased economies of scale.

### Wholly-owned

We have eight wholly-owned stores in Hong Kong and this continues to be an attractive and profitable market for us. Competition for good sites remains tough and rents are high, but we are keen to expand our presence there.

Our stores in the Republic of Ireland are thriving. In 2005/06, we opened two stores in Blackrock and Galway and in April 2006 we opened another in Newbridge Retail Park, west of Dublin. We will open in Drogheda in summer 2006, bringing the number of stores there to 13.

We are pleased with the customer response to the stores we refurbished in our trial and now plan to roll the new design out across the chain, with more than 60 additional stores in the plan for this year.

By the end of 2006, every customer in the UK will be within easy driving distance of a newly refurbished M&S store.

# Our Stores

## We are carrying out our biggest store refurbishment programme ever and continuing to open new stores in key locations.

### SIMPLY FOOD TO THE FORE

**We joined forces with BP Connect in 2005 to trial our Simply Food offer in BP forecourts. The trial provided a new, convenient option for existing customers and also introduced new customers to our Food offer.**

Our biggest tangible asset is our store portfolio. It is also the way that our customers experience our brand. Our stores are in great locations, but they have been subject to underinvestment in past years. We have embarked on a major refurbishment programme to rectify this and bring our stores up to the standards our customers expect. At the same time, we will open in new locations where opportunities exist to further grow our business.

### Improving our stores

Following a four store trial in 2004/05, we refurbished 17 more stores by Christmas 2005. By this December, we will have converted around 35% of our store portfolio, equating to five million sq ft.

The format has a lighter, brighter feel, new equipment and an improved layout. We continue to make improvements, including to Womenswear, where we trialled a more femine, clearer layout in March 2006, which is now being rolled out as part of the refurbishment programme.

We are also improving the consistency of standards across all stores, so that they look, feel and are maintained in the same way. In early 2006, we issued detailed visual packs called ‘The Look’, showing how each department should be laid out, to ensure a consistent spring product launch. Store standards remain a focus for us in 2006/07.

### Meeting needs in new locations

We continue to look at locations where we are under-represented and opened eight main chain stores in 2005/06. We also took decisive action where stores were under-performing and closed seven. Following a net increase in store numbers of 29, we now have a total of 451 across the UK, including 43 ‘Simply Food’ franchise stores.

‘Simply Food’ stores are an important way to meet customer demand in convenient locations. During the year, we acquired 28 stores in select locations from Iceland for £38m. These will open this summer, taking the number of ‘Simply Food’ outlets to 172. Currently, we are opening around one store a week, either alone or in partnership with SSP at railway stations or Moto at motorway services.

Our Outlet stores allow us to sell excess product year-round, without taking space away from new ranges in our main stores. During 2005/06, we opened four new Outlets, taking the total number to 24, and expect to open more in the year ahead.

# Our People

## Last year we invested more than ever to enable our people to meet and exceed the expectations of our customers.

### MEET ONE OF OUR NEW COACHES

Jill Gadsdon is one of our Coaches at the Finsbury Pavement store in the City of London. She was trained and accredited for the role in November 2005 and has since trained six of her colleagues at the store. When asked about what Coaching meant to her, Jill said: "The best thing about being a Coach is watching people I've trained doing a good job, approaching customers and going the extra mile to help them. It's nice to know that my help and advice has given them the confidence to be better at their jobs."

Turnover of staff, which fell by 1% during the year, is amongst the lowest in the sector. This means that we are retaining more expertise and talent in the business.

Our store teams now have clearer responsibilities, better scheduling and have all undertaken our customer service training programme, so that they are better able to look after our customers' needs.

Improving our employees' ability to fulfil their roles is key to our success. To achieve this, we needed to simplify the way we pay, train and motivate people.

### A clear structure with real opportunities

In May 2005, we introduced a new four-point pay and career structure for customer assistants, creating some of the highest rewards in retail and replacing a myriad of rates with clear career progression through the new roles – Trainee, Qualified, Coach and Section Co-ordinator. These changes mean we can now better recruit and retain talented people.

In 2006/07, we will continue to develop the 'Your M&S Career Path' and will also create a similar structure for Section and Store Managers. This builds on our new retail management structure which ensures that some of our most talented people manage our flagships, helping these key stores perform ahead of the chain.

### Training to deliver

Last year, we worked hard to achieve consistently good service in every store. Although there is more to do, our customer research and monthly mystery shopper programme found significant improvements, following our biggest ever service training programme, with 56,000 completing 'Our Service Style' customer service training during the year.

One in six of our customer assistants has been trained as a Coach, responsible for training new staff and upskilling colleagues. Our 8,000 Coaches are critical in ensuring product knowledge, work methods and customer service are at the highest levels.

In head office, the Buying Academy has trained 900 staff in buying and merchandising practices, achieving far shorter lead times and increasing availability whilst managing tight markdown targets.

### Listening to employees

Some 1,500 people across M&S are elected representatives on our Business Involvement Groups (BIGs), our vehicle for employee communication, consultation and involvement. We have broadened the BIG constitution, increased training to make it a more effective forum and now fund three full-time representatives.

We introduced a new employee survey in February 2006, 'Your M&S, your say', which allows us to compare satisfaction scores against other leading UK companies for the first time.

# Responsible retailing

## For many years we have applied strict ethical standards so our customers can make responsible choices.

We became the first major UK retailer to start selling clothing made from Fairtrade certified cotton.

In a year of significant achievement, a number of initiatives stood out.

We became the only major UK retailer to sell only Fairtrade coffee, both in our 200 'Café Revive' coffee shops and our Food Halls. The Fairtrade Foundation estimates that this commitment will lift UK Fairtrade coffee sales by 18%.

We also announced that by the end of 2006 all our tea will be Fairtrade-only. In March, we also became the first major UK retailer to offer a range of Fairtrade cotton t-shirts and socks.

Healthy eating is increasingly important to our customers. Our healthy foods, identified by the 'Eat Well' sunflower, now make up 20% of our entire food catalogue. During the year, we were the first major UK retailer to commit to removing hydrogenated fats from virtually all our food and we are reducing salt ahead of industry and Government targets.

We take animal welfare seriously in the manufacture of all our products. The RSPCA recognised this when they gave us their 2005 Alternative Award for Fashion Retail for our policies on animal welfare.

On fish sourcing, Greenpeace, the Marine Conservation Society and the Seafood Choices Alliance named us the leading retailer in the protection of endangered fish species. This applies across our offer from fresh fillets to fish in sandwiches and pies.

Our customers have asked us to develop packaging that is more environmentally friendly. This year, we used around 1,500 tonnes of recycled plastic in our packaging and tested in-store recycling schemes. These efforts won us the Best Retail Recycling Initiative in the 2005 National Recycling Awards and the 2005 Institute of Grocery Distributors/Tetra Pak Environmental Award.

During the year, we invested heavily in our staff. You can read more about 'Our People' on page 17 and also in our Corporate Social Responsibility Report which is available to download from our website www.marksandspencer.com/csrreport2006.

We also continued to support the communities in which we operate and invested a total of £9.3m, in cash and in kind, in community initiatives.

Through 'Marks & Start', the biggest of these initiatives, we provided 2,635 people with work experience placements. 40% of adult participants, drawn from groups such as the disabled and homeless, went on to find work.

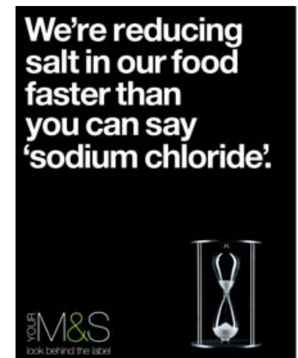
Finally, we worked closely with Care International and communities in Sri Lanka to re-build 80 homes destroyed by the 2004 tsunami. In addition, we helped the affected villagers set up their own businesses and provided them with training.

We recognise that climate change is a serious issue and have stepped up efforts to address it. Improved efficiencies together with our use of greener electricity meant that last year we produced 9% less carbon dioxide pollution than in 2002/03.

### LOOK BEHIND THE LABEL

**In January 2006, we launched 'Look behind the label', a campaign about the way our products are sourced and made. We want our customers to know about the lengths we go to to give them responsible and ethical choices – we want them to know what sets us apart from our peers.**

**The campaign covered areas such as animal welfare, Fairtrade, responsible fish sourcing, responsible use of chemicals, free-range eggs, non-GM foods, removing hydrogenated fats from virtually all our foods and leading the industry on salt reduction.**



# Your directors

PAUL MYNERS

LORD BURNS

STUART ROSE

IAN DYSON

STEVEN SHARP

KEVIN LOMAX

JEREMY DARROCH

STEVEN HOLLIDAY

JACK KEENAN

DAVID MICHELS

LOUISE PATTEN

**PAUL MYNERS**
CHAIRMAN ▲
Appointed as a non-executive director in April 2002 and as Chairman in May 2004. Age 57. Paul is Chairman of Aspen Insurance Holdings Limited; Guardian Media Group plc; The Low Pay Commission; and the Trustees of Tate. He is a non-executive director of the Bank of New York and a member of the Court of Directors of the Bank of England.

**LORD BURNS**
DEPUTY CHAIRMAN ⁕ ▲ (Chairman)
Appointed in October 2005. Age 62. Terry will become Chairman following our AGM in July 2006. He is Chairman of Abbey National plc and Glas Cymru Ltd (Welsh Water) and a non-executive director of Banco Santander Central Hispano SA and Pearson Group plc. He was formerly Permanent Secretary to the Treasury and chaired the Parliamentary Financial Services and Markets Bill Joint Committee.

**STUART ROSE**
CHIEF EXECUTIVE
Appointed in May 2004. Age 57. Stuart was Chief Executive of Arcadia Group plc between 2000 and 2002. Previously he was Chief Executive of Booker plc and Argos plc. He is a non-executive director of Land Securities plc and Chairman of the British Fashion Council.

**IAN DYSON**
GROUP FINANCE DIRECTOR
Appointed in June 2005. Age 43. Ian was formerly Finance Director of The Rank Group plc and previously Group Financial Controller of Hilton Group plc, prior to which he was Finance Director of Le Meridien Hotels a division of Forte plc. He has also been a partner of Arthur Andersen. Ian was a non-executive director of Misys plc until September 2005.

Kevin Lomax, Senior Independent Director, is retiring from the Board on 31 August 2006, when he will have completed two three-year terms as a non-executive director. On 1 September 2006, David Michels will succeed Kevin as Senior Independent Director and Jeremy Darroch as Audit Committee chairman.

**STEVEN SHARP**
EXECUTIVE DIRECTOR MARKETING, E-COMMERCE, STORE DESIGN AND DEVELOPMENT
Appointed in November 2005. Age 55. Steven started his retail marketing career with the Bejam Group in 1978. He progressed to the Argyll Group and became Marketing Director of Asda in 1987. He joined the Board of Debenhams in 1989, and became Group Marketing Director of the Burton Group. Steven has been Marketing Director of Booker plc and Arcadia Group plc.

**KEVIN LOMAX**
SENIOR INDEPENDENT DIRECTOR
⁕ ▲ ■ ● (Chairman)
Appointed in September 2000. Age 57. A founding investor in Misys plc in 1979, Kevin was non-executive Chairman from May 1980 until June 1985 when he became Executive Chairman, leading Misys through a period of significant growth. On the appointment of a non-executive Chairman in November 2005, he is now Chief Executive of Misys.

**JEREMY DARROCH**
NON-EXECUTIVE DIRECTOR ⁕ ▲ ●
Appointed in February 2006. Age 43. Jeremy is Chief Financial Officer at British Sky Broadcasting Plc. He was previously at DSG International plc (Dixons Group plc), where he became Group Finance Director in 2002. Formerly, Jeremy was Finance Director for Procter & Gamble's European Healthcare division. He is a member of the 100 Group of Finance Directors.

**STEVEN HOLLIDAY**
NON-EXECUTIVE DIRECTOR ⁕ ▲ ● ■
Appointed in July 2004. Age 49. Steve is Group Deputy CEO of National Grid plc, where he will become Group CEO by the end of 2006. He was formerly an executive director of British Borneo Oil and Gas. Previously, he spent 19 years with the Exxon Group. His international experience includes a four-year spell in the US.

**JACK KEENAN**
NON-EXECUTIVE DIRECTOR
⁕ ▲ ● ■ (Chairman)
Appointed in September 2001. Age 69. Jack is CEO of Grand Cru Consulting Ltd. He was previously Deputy CEO of Guinness UDV and a Board member of Diageo plc. He is a non-executive director of Tomkins plc, Amphora Fine Wine Fund plc and Senior Non-Executive Director of The Body Shop International plc. Jack is Patron of Cambridge University's Centre for International Business and Management.

**DAVID MICHELS**
NON-EXECUTIVE DIRECTOR ⁕ ▲ ● ■
Appointed in March 2006. Age 59. David previously worked with Grand Metropolitan, Hilton International and Stakis before rejoining Hilton International in 1999 as Chief Executive, becoming Chief Executive of Hilton Group plc from 2000 to 2006. David was formerly a non-executive director of Arcadia Group plc and is a non-executive director of The British Land Company plc, easyJet plc and Strategic Hotels & Resorts.

**LOUISE PATTEN**
NON-EXECUTIVE DIRECTOR ⁕ ▲ ■
Appointed in February 2006. Age 52. Louise is Non-Executive Chairman of Brixton plc, a non-executive director of Bradford & Bingley plc and a senior adviser to Bain & Co. She began her career at Citibank and remained in financial services until 1993 when she joined Bain & Co as a Partner. She was formerly a non-executive director of Hilton Group plc, GUS plc and Somerfield plc.

- ⁕ Independent
- ● Audit Committee
- ■ Remuneration Committee
- ▲ Nomination Committee

# Financial review

## Group summary

| Summary of results | 2006 £m | 2005 £m |
|---|---|---|
| Continuing operations before exceptional items and asset disposals | | |
| Revenue | **7,797.7** | 7,490.5 |
| Operating profit | **855.8** | 649.1 |
| Net interest payable | **(121.9)** | (104.4) |
| Other finance income | **17.5** | 11.4 |
| Profit before tax, exceptional items and asset disposals | **751.4** | 556.1 |
| Loss on property disposals | **(5.7)** | (0.4) |
| Exceptional operating charges | **–** | (50.6) |
| **Group profit before tax from continuing operations** | **745.7** | 505.1 |
| **Earnings per share from continuing operations** | | |
| Basic earnings per share | **31.3p** | 17.6p |
| Adjusted earnings per share | **31.4p** | 19.2p |
| **Earnings per share** | | |
| Basic earnings per share | **31.4p** | 29.1p |
| Adjusted earnings per share | **31.5p** | 20.8p |

Continuing operations include the results of the UK Retail and International Retail businesses. The results for Financial Services, which was sold last year, have been disclosed as discontinued operations together with the results from Kings Super Markets. Income received under the arrangement with HSBC is included within UK Retail.

Adjusted earnings per share excludes the impact of exceptional items and asset disposals and is provided to allow shareholders to understand the underlying performance of the Group.

### Group revenue from continuing operations

### Group operating profit from continuing operations (before exceptional items and assets disposals)

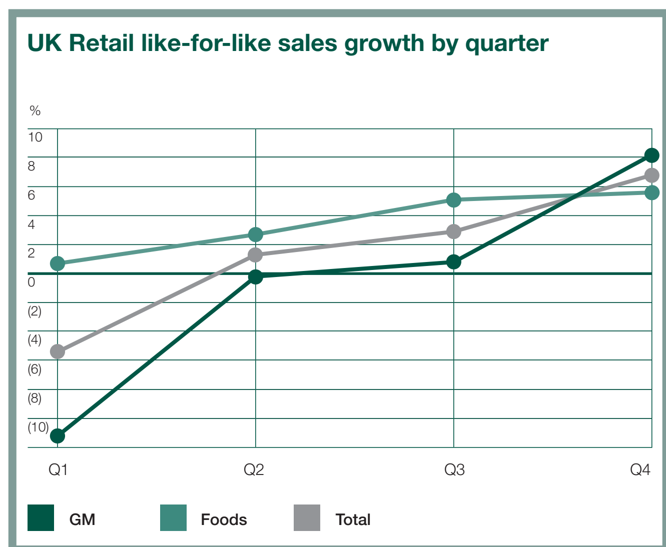
## UK Retail

| | **2006** | 2005 |
|---|---|---|
| Revenue (£m) | **7,275.0** | 7,034.7 |
| Operating profit[1] (£m) | **790.1** | 588.4 |
| Number of stores at year end | **408** | 399 |
| Selling space at year end (m sq ft) | **13.1** | 12.9 |

[1] Before exceptional items and asset disposals.

Sales for the 52 weeks ended 1 April 2006 were £7,275.0m, up 3.4% and up 1.3% on a like-for-like basis. Sales of General Merchandise remained broadly level, with Clothing sales flat and Home seeing a 0.8% increase. Foods recorded strong growth of 7%.

Sales improved as the year progressed, as shown in the chart below:

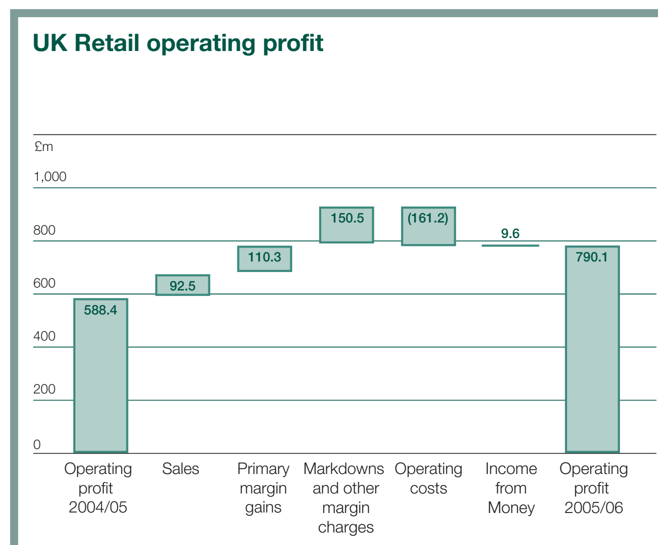



In Clothing, better values, better buying, and better styling resulted in better performance as the year progressed with sales up 4.4% in the second half. Womenswear benefited from well-received ranges, including more frequent additions of new product into stores. 'Per una' had another very strong year. It is now a major brand with wide appeal and strong growth potential. Menswear successfully rationalised its brands and extended its Autograph offer. Lingerie benefited from a clearer offer with five brands, including the new 'per una' range. We restructured our Childrenswear area, where performance was poor, with the aim of regaining a leading position in this important market.

Food had a very successful year with sales up 7.0%, up 3.6% on a like-for-like basis. This performance was driven by our focus on outstanding quality and innovation, backed by powerful advertising. We successfully tapped demand for responsibly sourced, healthy food, not least with our additive-free 'Marks & Spencer Cook!' range. We continue to offer everyday food of exceptional quality, like 'Oakham' chicken, and customers made us their first choice at key times like Christmas and Easter. Our stand-alone 'Simply Food' format performed strongly.

UK operating profit before exceptional items and asset disposals for the 52 weeks to 1 April 2006 was £790.1m, up 34.3% (last year £588.4m).

The major components of the year-on-year increase in UK Retail operating profit are shown below:




The growth in operating profit reflects the benefits of the actions taken last year to improve supplier terms and control stock and commitment, which have contributed to an increase in the UK gross margin of 3.6 percentage points to 42.8% (last year 39.2%). UK operating costs of £2,330.4m were up 7.4% on the year, reflecting the impact of new space and the provision for a staff bonus of £73m. Excluding the bonus, costs were up 4.1%.

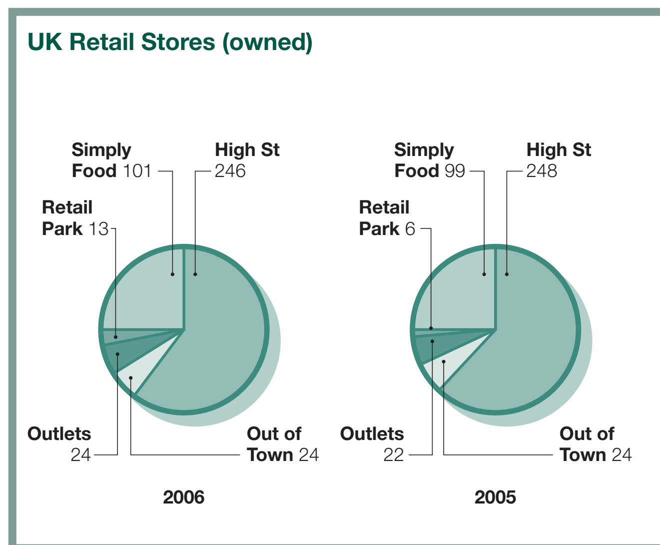
Following the sale of M&S Money to HSBC in November 2004, we retained an economic interest which benefits the Group in two ways. The Group receives incentives based on sales volumes, e.g. new cards, insurance, savings and investments products. In addition, the Group receives income in the form of fees equating to 50% of the profits of M&S Money (after a notional tax charge and after deducting agreed operating and capital costs). For the year, a net operating profit of £9.6m has been recorded and is included within the results for UK Retail. This is a strong franchise and we see exciting opportunities to drive the business in the future.

# Financial review continued

## UK Retail continued

Total footage for the year has increased by 1.5% with the opening of seven retail parks and seven 'Simply Food' stores.

### UK Retail Stores (owned)




Twenty-three stores are now in the new, modernised format and we plan to accelerate the roll-out of this format in 2006/07. By the end of March 2007 we expect c.35% of the chain to be in the new format.

We are also set to open 28 new 'Simply Food' stores in the summer which were acquired from Iceland.

## International Retail

| | 2006 52 weeks | 2005 52 weeks |
|---|---|---|
| Revenue (£m) | **522.7** | 455.8 |
| Operating profit[1] (£m) | **65.7** | 60.7 |
| Number of stores at year end | | |
| – Owned | **19** | 18 |
| – Franchises | **198** | 191 |
| Selling space at year end (m sq ft) | | |
| – Owned | **586** | 586 |
| – Franchises | **1,433** | 1,317 |

[1] Before exceptional items and asset disposals.

Revenue for the year increased by 14.7% to £522.7m. The Franchise business performed particularly well, helped by organic growth, the replacement of some older stores with newer footage and new store openings. International operating profit increased by 8.2% to £65.7m. The Republic of Ireland, where we have 11 stores with a further store in the pipeline, continues to perform well, although the results for the year were impacted by the cost of opening new stores. Like-for-like results in Hong Kong were good but the overall result was affected by the loss of the Pacific Place store and the relocation of the Times Square store.

Following the announcement on 31 March 2006, the results for Kings Super Markets have been disclosed within discontinued operations. For the year, revenue was £228.2m (up 0.3% at constant exchange rates) with operating profit down by 33% to £3.0m as a result of decisions taken to close underperforming stores.

## Exceptional items

| | 2006 £m | 2005 £m |
|---|---|---|
| Head office relocation | **–** | (8.8) |
| Head office restructuring programme | **–** | (6.3) |
| Board restructure | **–** | (8.4) |
| Closure of Lifestore | **–** | (29.3) |
| Defence costs | **–** | (38.6) |
| Sale of head office premises | **–** | 31.1 |
| Release of provision held against European closure | **–** | 9.7 |
| | **–** | (50.6) |

## Interest

Net interest expense was £104.4m compared to £93.0m for last year. Excluding the impact of the increase in pension finance income, interest expense was up 16.8% to £121.9m following last year's corporate and balance sheet restructuring.

| | 2006 £m | 2005 £m |
|---|---|---|
| Interest payable | **(134.9)** | (120.9) |
| Interest receivable | **13.0** | 16.5 |
| Net interest payable | **(121.9)** | (104.4) |
| Other finance income | **17.5** | 11.4 |
| **Total** | **(104.4)** | (93.0) |

The average interest rate for the year was 5.8% (last year 5.7%). The average interest on fixed debt was 6.1%, which represents half of total debt, whilst the average rate of floating debt was 5.4%. Interest cover was 7.0x compared to 5.7x for the same period last year. Proportionately higher profits in the year have more than offset the increase in the interest charge following last year's corporate restructuring, resulting in an overall increase in interest cover.

## Taxation

The tax charge reflects an effective tax rate for the full year of 30.2% compared to 29.7% last year.

## Shareholder returns and dividends

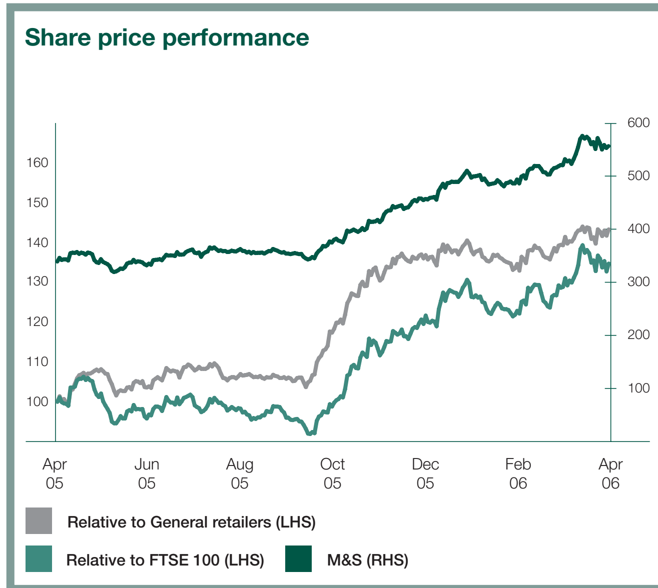
Adjusted earnings per share from continuing operations, which excludes the effect of exceptional items and asset disposals, has increased by 63.5% to 31.4p per share.

The dividend charge for the year of £204.1m (last year £236.9m) reflects dividends paid of 12.3p per share (last year 11.7p per share).

The Directors have proposed a final dividend of 9.2p per share, an increase of 22.7%. In accordance with IAS 10 – 'Events after the Balance Sheet Date' this proposed dividend has not been recognised within these results.

The following chart shows the Group's share price performance over the year (right hand scale) together with its performance relative to the FTSE 100 and General Retailers indices.

### Share price performance



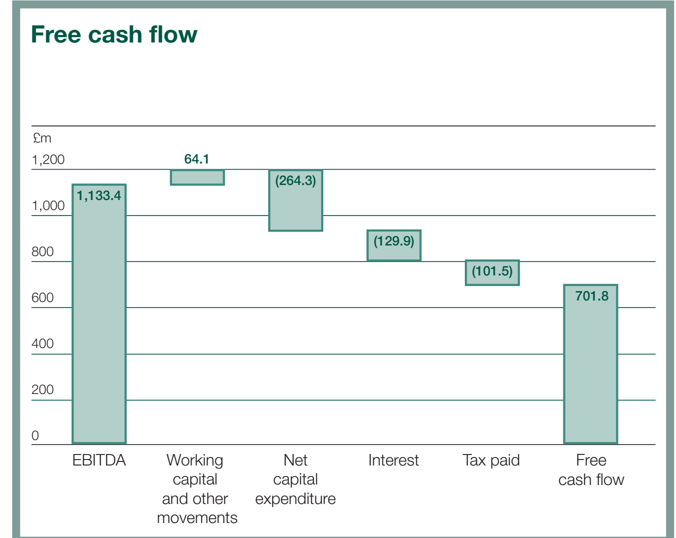

The share price ended the year at 556.5p and traded between 319.25p and 575.75p during the year.

## Cash flow

The Group generated a cash inflow from operations of £1,197.5m (last year £1,601.8m). Within this, the cash inflow from continuing operating activities increased by £309.2m to £1,183.6m reflecting higher operating profits, a marginally lower investment in working capital, and a reduction in cash outflows relating to exceptional items.

The components of the Group's free cash flow are shown in the chart below:

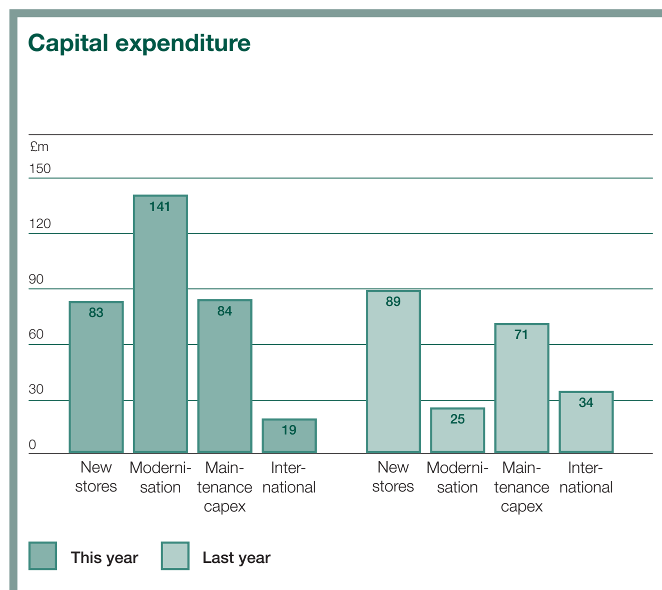
### Free cash flow




Within working capital, investments in stock have been more than offset by the £73m bonus which has been provided for, but will not be paid until July, together with an increased level of trade payables.

# Financial review continued

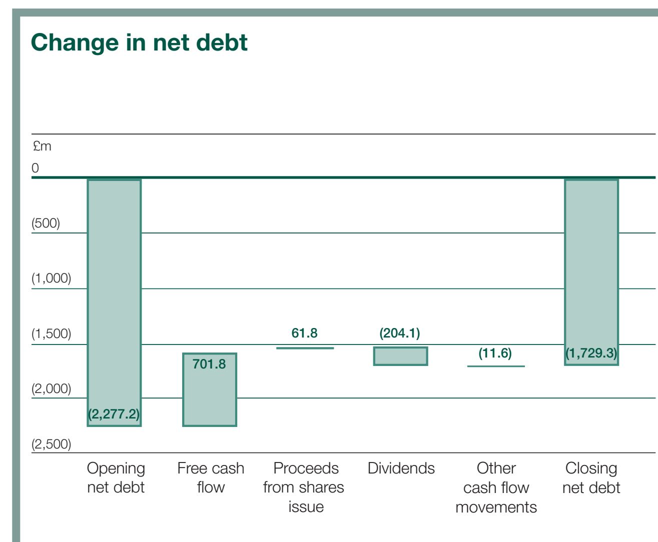
During the year, the Group acquired tangible non-current assets of £326.8m (last year £218.5m). The major components are analysed in the chart below:




The increase in capital expenditure in the year mainly relates to new space and the store modernisation programme. In total, we added 250,000 square feet of new space in the year. By the end of the year we had modernised 23 stores comprising approximately one million square feet. We are now rolling out the modernisation programme and expect to modernise a further 60 to 70 stores by the end of 2006/07 as part of a £520m to £570m capital expenditure programme.

After taking into account the timing of payments, the cash outflow for capital expenditure was £298.5m (last year £232.2m). This excludes the £38.0m the Group paid to acquire 28 properties from Iceland which is included as a movement in working capital, reflecting the revised classification of leasehold properties.

Free cash flow was £701.8m compared to £1,205.9m last year. After taking into account the proceeds from the issue of new shares, the payment of dividends and other movements, net debt at the end of the year was £1,729.3m, a decrease of £547.9m.




## Balance sheet

| | 2006 £m | 2005 £m |
|---|---|---|
| Intangible non-current assets | **163.5** | 165.4 |
| Tangible non-current assets | **3,614.3** | 3,624.8 |
| Other non-current assets | **290.6** | 244.8 |
| Inventories | **374.3** | 338.9 |
| Other receivables | **210.5** | 213.8 |
| Derivative financial instruments | **58.9** | – |
| Net assets of Kings (excl. net cash) | **27.3** | – |
| Trade and other payables | **(1,031.6)** | (809.9) |
| Provisions | **(28.3)** | (44.9) |
| Retirement benefit obligations | **(794.9)** | (676.0) |
| Net debt | **(1,729.3)** | (2,147.7) |
| **Net assets** | **1,155.3** | 909.2 |
| **Gearing % (including post-retirement liability)** | **69.7%** | 75.8% |

Tangible non-current assets decreased by £10.5m to £3,614.3m. Included within this are properties owned by the Group with a net book value of £2.3bn, of which £2.0bn was unencumbered. Intangible assets of £163.5m principally relate to the acquisition of 'per una'.

Inventories at the end of the year were £374.3m, 10% up on last year, largely as a result of an increase in direct sourcing for general merchandise which results in the Group taking ownership of the stock earlier in the supply chain.

Trade and other payables increased by £221.7m compared to last year. This reflects an accrual of £73m in respect of bonuses for all employees. In line with the increase in stock, there has also been a corresponding increase in trade payables of £47.3m driven by the direct business. Tax payable has also increased by £43.2m, primarily as a result of the increase in taxable profits compared to last year.

Provisions for liabilities and charges decreased by £16.6m as a result of costs incurred principally relating to head office restructuring and the closure of Lifestore, which were both provided for last year. The net post retirement liability increased by £118.9m primarily due to the decrease in the corporate bond rate – the rate used to discount the liabilities.

Shareholders' funds amounted to £1,155.3m, equivalent to 68.7p per share (last year 54.8p per share), an increase of £246.1m in the year. Gearing was 69.7% (last year 75.8%) and return on equity was 52.3% (last year 35.0%).

### Financing and capital structure

In October 2005, the Group renewed the £3bn Euro Medium Term Note (MTN) programme and as at 1 April 2006, £1.7bn of MTNs were outstanding.

In March 2006, the £1.2bn five-year committed syndicated bank facility was re-financed in the light of improved market conditions. At 1 April 2006, this facility was undrawn. The £1.5bn Commercial Paper programme continues to be available to the Group. As at 1 April 2006, no paper had been issued or was outstanding under this programme.

On 26 September 2005 and 27 March 2006, 7,406,349 and 8,232,253 B shares respectively were redeemed at par at a total cost of £11.0m. Following this redemption, 78,184,314 B shares remained in issue at 1 April 2006, all of which were redeemed on 5 May 2006 at a cost of £54.7m.

### Pensions

The Group provides a variety of post-employment benefit arrangements covering both funded and unfunded defined benefit schemes and funded defined contribution schemes. The most significant scheme is the Marks & Spencer UK Pension Scheme. This has a defined benefit section, which was closed to new entrants with effect from 1 April 2002, and a defined contribution section which has been open to new members with effect from 1 April 2003.

The last actuarial valuation of the UK defined benefit section was carried out as at 31 March 2003 and showed an actuarial deficit of £585m. Since then, the Group has paid additional contributions of £400m in March 2004 and a further £115m in March and April 2005. These payments were in addition to annual service contributions at a level of 15.8% of pensionable salaries.

As at 1 April 2006, the IAS 19 deficit for the UK defined benefit scheme was £775m. The amount of the deficit is sensitive to changes in the main financial assumptions, particularly the rate used to discount the liabilities (the discount rate). If the discount rate increased/decreased by 0.1% the IAS 19 deficit would decrease/increase by c.£100m.

A full actuarial valuation of the UK defined benefit section is being carried out as at 31 March 2006, the results of which will be available later this year.

Further details on pensions are provided in note 11 to the financial statements.

### International Financial Reporting Standards

This is the first year that the Group has adopted International Financial Reporting Standards. The greatest impact on the Group arises from changes in the accounting treatment for property, share-based payments, financial instruments and software. The Group has restated the results for the period ended 2 April 2005 to reflect these changes, with the exception of those changes relating to financial instruments which, in accordance with the relevant standard, have only been applicable to the current year. The restated results have been used for the comparatives in the consolidated financial statements. Details of the changes are set out in notes 33 and 34 to the financial statements.

# Group directors' report

### Principal activities and business review

Marks and Spencer Group plc is the holding company of the Marks & Spencer group of companies (the "Group"). We are one of the UK's leading retailers of clothing, food and home products. We also trade in wholly-owned stores in the Republic of Ireland and Hong Kong, as well as in worldwide franchise stores. On 28 April 2006 we completed the sale of Kings Super Markets, our wholly-owned supermarket chain in the US.

More detailed information about the Group's activities and the main trends and factors likely to affect the future development, performance and position of the Group's business can be found in the Chairman's statement on pages 1 and 2, Chief Executive's review on pages 3 to 7, the Operating review on pages 8 to 18 and Financial review on pages 20 to 25.

Further information on environmental matters, employees, and social and community issues can be found in the Corporate Social Responsibility Report, available on the Company's website at www.marksandspencer.com/csrreport2006.

### Principal risks and uncertainties

A summary of the Group's principal risks and uncertainties has been provided within the Corporate Governance statement, on page 37.

### Profit and dividends

The profit for the financial year, after taxation and non-equity dividends, amounts to £523.1m (last year £583.4m). The directors have declared dividends as follows:

| **Ordinary shares** | £m |
|---|---|
| Paid interim dividend of 4.8p per share (last year 4.6p per share) | 79.8 |
| Proposed final dividend of 9.2p per share (last year 7.5p per share) | 154.8 |
| **Total ordinary dividend, 14.0p per share** (last year 12.1p per share) | 234.6 |

During the year, dividends of £2.3m (last year £2.8m) have been paid on non-equity shares.

The final ordinary dividend will be paid on 14 July 2006 to shareholders whose names are on the Register of Members at the close of business on 2 June 2006.

### Changes in share capital

**(i) Issue of new ordinary shares**

During the period, 24,341,872 ordinary shares in the Company were issued as follows:

- 13,100 shares under the terms of the 1984 Executive Share Option Scheme at a price of 458p;
- 787,031 shares under the terms of the 1997 Executive Share Option Scheme at prices between 278p and 557p;
- 2,938,371 shares under the terms of the 2000 Executive Share Option Scheme at prices between 215p and 349p;
- 5,944,531 shares under the terms of the 2002 Executive Share Option Scheme at prices between 270p and 350p; and
- 14,658,839 shares under the terms of the United Kingdom Employees' Save As You Earn Share Option Scheme at prices between 156p and 349p.

### (ii) Purchase of ordinary shares

The Company is authorised by the shareholders to purchase, in the market, the Company's own shares, as permitted under the Company's Articles of Association. The Company engages in share buy-backs to create value for the shareholders, when cash flow permits and there is not an immediate alternative investment use for the funds. During the year, no shares were bought back under this authority. This authority is renewable annually and approval will be sought from shareholders at the Annual General Meeting in 2006 to renew the authority for a further year. It is the Company's present intention to cancel any shares it buys back, rather than hold them in treasury.

### (iii) Redemption of B shares

During the year, the Company redeemed 15,638,602 B shares, with a nominal value of £11.0m. All 78,184,314 remaining B shares with a nominal value of £54.7m were redeemed on 5 May 2006.

## Major shareholders

As at 9 May 2006, the Company's register of substantial shareholdings showed the following interests in 3% or more of the Company's shares:

| | Ordinary shares | % share capital |
|---|---|---|
| Brandes Investment Partners, LLC | 199,889,342 | 11.88 |
| Legal & General Investment Management | 55,032,628 | 3.20 |
| Fidelity International | 50,690,284 | 3.01 |

## Board of directors

On 26 May 2006, the directors were Paul Myners, Lord Burns, Stuart Rose, Ian Dyson, Steven Sharp, Kevin Lomax, Jeremy Darroch, Steven Holliday, Jack Keenan, David Michels and Louise Patten. Their biographical details are given on page 19.

Lord Burns was appointed as Deputy Chairman with effect from 1 October 2005 and will become Chairman at the conclusion of the Annual General Meeting on 11 July 2006.

Ian Dyson was appointed Group Finance Director on 27 June 2005 and Steven Sharp was appointed as an executive director of the Company on 8 November 2005. Louise Patten and Jeremy Darroch were appointed non-executive directors on 1 February 2006 and David Michels on 1 March 2006.

Kevin Lomax, Senior Independent Director, is retiring from the Board on 31 August 2006, when he will have completed two three-year terms as a non-executive director. On 1 September 2006, David Michels will succeed Kevin as Senior Independent Director and Jeremy Darroch as Audit Committee chairman.

Alison Reed retired as Group Finance Director on 30 April 2005. Anthony Habgood retired as a non-executive director on 30 August 2005 and Charles Wilson retired as an executive director on 28 October 2005.

# Group directors' report continued

## Directors' interests

The beneficial interests of the directors and connected persons in the shares of the Company are shown below. Options granted under the Save As You Earn Share Option and Executive Share Option Schemes are shown on pages 46. Further information regarding employee share option schemes is given in note 12 to the financial statements.

There have been no other changes in the directors' interests in shares or options granted by the Company and its subsidiaries between the end of the financial year and 26 May 2006, other than those noted below in respect of Paul Myners and Lord Burns. The Register of Directors' Interests (which is open to shareholders' inspection) contains full details of directors' shareholdings and options to subscribe for shares. No director had any interest in any of the Company's subsidiaries at the beginning or end of the year.

| | **Ordinary shares as at 1 April 2006** | Ordinary shares as at 2 April 2005 or date of appointment |
|---|---|---|
| Paul Myners | **178,741*** | 50,660 |
| Lord Burns (appointed 1 October 2005) | **5,545**** | 2,000 |
| Ian Dyson (appointed 27 June 2005) | **60,000** | – |
| Stuart Rose | **500,416** | 350,416 |
| Steven Sharp (appointed 8 November 2005) | **27,816** | 27,565 |
| Kevin Lomax | **16,190** | 16,190 |
| Jeremy Darroch (appointed 1 February 2006) | **2,000** | – |
| Steven Holliday | **2,500** | 2,500 |
| Jack Keenan | **53,238** | 3,238 |
| David Michels (appointed 1 March 2006) | **4,000** | – |
| Louise Patten (appointed 1 February 2006) | **4,000** | 4,000 |

* Paul Myners bought 50,000 shares on 23 May 2006, increasing his shareholding to 228,741.

** Lord Burns bought 1,073 shares on 4 April 2006 under the terms of his appointment, being the purchase of shares on a quarterly basis, using approximately 25% of his net income from the Company, increasing his shareholding to 6,618.

## Directors' responsibilities

The directors are obliged under company law to prepare financial statements for each financial year and to present them annually to the Company's members at the Annual General Meeting.

The financial statements, of which the form and content is prescribed by the Companies Act 1985 and applicable accounting standards, must give a true and fair view of the state of affairs of the Company and the Group at the end of the financial year, and of the profit for that period.

The directors are also responsible for the adoption of suitable accounting policies and their consistent use in the financial statements, supported where necessary by reasonable and prudent judgements.

The directors confirm that the above requirements have been complied with in the financial statements.

In addition, the directors are responsible for maintaining adequate accounting records and sufficient internal controls to safeguard the assets of the Group and to prevent and detect fraud or any other irregularities, as described more fully in the Corporate Governance statement on page 38.

## Audit information

The directors confirm that, so far as they are aware, there is no relevant audit information of which the auditors are unaware and that each director has taken all reasonable steps to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

## Directors' indemnities

The Company maintains liability insurance for its directors and officers. Following shareholder approval in July 2005, the Company has also provided an indemnity for its directors and the secretary, which is a qualifying third party indemnity provision for the purposes of the Companies Act 1985.

## Employee involvement

We have maintained our commitment to employee involvement throughout the business.

Employees are kept well informed of the performance and objectives of the Group through personal briefings, regular meetings and email. These are supplemented by our employee publication, and video presentations. Business Involvement Groups in stores, and head office locations represent employees in two-way communication and are involved in the delivery of change and driving business improvement.

The eleventh meeting of the European Council took place last July. This council provides an additional forum for communicating with employee representatives from the countries in the European Community.

Directors and senior management regularly visit stores and discuss, with employees, matters of current interest and concern to the business.

We continue to support employee share ownership through long-established employee share schemes, membership of which is service-related, details of which are given on pages 69 to 72.

We maintain contact with retired staff through communications from the Company and the Pension Trust. Elections are currently underway to appoint member-nominated trustees to the Pension Trust Board, including employees and pensioners. Our retired staff have also recently benefited from a significant increase in their M&S discount entitlement.

# Group directors' report continued

### Equal opportunities

The Group is committed to an active Equal Opportunities Policy from recruitment and selection, through training and development, appraisal and promotion to retirement. It is our policy to promote an environment free from discrimination, harassment and victimisation, where everyone will receive equal treatment regardless of gender, colour, ethnic or national origin, disability, age, marital status, sexual orientation or religion. All decisions relating to employment practices will be objective, free from bias and based solely upon work criteria and individual merit.

The Group is responsive to the needs of its employees, customers and the community at large and we are an organisation that endeavours to use everyone's talents and abilities to the full.

### Employees with disabilities

It is our policy that people with disabilities should have full and fair consideration for all vacancies. During the year, we continued to use the Government's 'two tick' disability symbol to demonstrate our commitment to interviewing those people with disabilities who fulfil the minimum criteria, and endeavouring to retain employees in the workforce if they become disabled during employment. We will actively retrain and adjust their environment where possible to allow them to maximise their potential. We continue to work with external organisations to provide workplace opportunities on the 'Workstep Programme'.

### Creditor payment policy

For all trade creditors, it is the Group's policy to:

- agree the terms of payment at the start of business with that supplier;
- ensure that suppliers are aware of the terms of payment; and
- pay in accordance with its contractual and other legal obligations.

The main trading company, Marks and Spencer plc, has a policy concerning the payment of trade creditors as follows:

- general merchandise is automatically paid for 11 working days from the end of the week of delivery;
- food is paid for 13 working days from the end of the week of delivery (based on the timely receipt of an accurate invoice); and
- distribution suppliers are paid monthly, for costs incurred in that month, based on estimates, and payments are adjusted quarterly to reflect any variations to estimate.

Trade creditor days for Marks and Spencer plc for the year ended 1 April 2006 were 13.1 days, or 8.8 working days (last year 12.0 days, or 8.0 working days), based on the ratio of company trade creditors at the end of the year to the amounts invoiced during the year by trade creditors.

### Market value of properties

The last formal valuation of the Group's properties was carried out in July 2004. Taking into account movements in the Group's property portfolio since that date, the directors are of the opinion that the market value of the Group's properties, at 1 April 2006, exceeded their net book value (including prepayments in respect of leasehold land) by approximately £0.7bn.

### Charitable donations

During the year, the Group made charitable donations to support the community of £9.3m (last year £9.8m). These principally consisted of cash donations of £3.4m (last year £3.0m) which includes the cost of our flagship community programme 'Marks & Start', Breakthrough Breast Cancer and other charitable donations, £1.3m (last year £2.0m) of employee time principally for the 'Marks & Start' programme and local community projects, and stock donations of £4.2m (last year £4.3m) to a variety of charities including Shelter, Fareshare, Birth Defects Foundation as well as to the local community.

### Political donations

Under the provisions of the Political Parties, Elections and Referendums Act 2000, shareholder authority is required for Political Donations to be made or Political Expenditure to be incurred by the Company or any of its subsidiaries in the EU.

It is our policy not to make Donations to EU Political parties or incur EU Political Expenditure and accordingly neither the Company nor its subsidiaries made any Political Donations or incurred Political Expenditure in 2005/06. However, the legislation gives a wide definition of what constitutes Political Donations and expenditure including sponsorship, subscriptions, payment of expenses, paid leave for employees fulfilling public duties and support for bodies representing the business community in policy review or reform. To enable the Company and its principal employing companies, (Marks and Spencer plc, Marks & Spencer Outlet Limited, Marks and Spencer Shared Services Limited, Marks and Spencer Simply Foods Limited and Marks and Spencer (Ireland) Limited) to continue supporting the community and such organisations without inadvertently breaching the legislation, authority is being sought at the Annual General Meeting on 11 July 2006 to make Donations or incur Expenditure in the EU up to an aggregate limit of £100,000 for each company until 11 July 2010.

This authority expires in 2010 as permitted by the legislation. The policy of not making Donations to any EU Political Organisation will continue. However, should the Board wish to change this policy during the term of this authority, the Company will seek renewed shareholder approval prior to making any such Donation.

### Going concern

After making enquires, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they have adopted the going concern basis in preparing the financial statements.

### Auditors

Resolutions to re-appoint PricewaterhouseCoopers LLP as auditors of the Company and to authorise the Audit Committee to determine their remuneration will be proposed at the Annual General Meeting.

### Annual general meeting

The Notice of the Annual General Meeting to be held on 11 July 2006 is given, together with explanatory notes, in the booklet which accompanies this report.

By order of the Board
**Graham Oakley,** Group Secretary
London
26 May 2006

# Corporate governance

The Board is focused on achieving long term success for the Company through the pursuit of sound business strategies whilst maintaining high standards of corporate governance and corporate responsibility. The following statement explains our governance policies and practices and provides insight into how the Board and management run the business for the benefit of shareholders. A detailed account of how we comply with the Combined Code on Corporate Governance (the 'Code') provisions can be found on the Company's website, together with the terms of reference of the Audit, Remuneration and Nomination committees, at www.marksandspencer.com/investorrelations.

## The Board

On 1 April 2006 the Board comprised the Chairman, Deputy Chairman, Chief Executive, two executive directors and six non-executive directors, who are collectively responsible for the success of the Company. A list of directors, with details of their biographies and committee membership, is given on page 19.

Paul Myners is Chairman and he is responsible for the working of the Board, for the balance of its membership subject to Board and shareholder approval, and for ensuring that all directors are able to play their full part in its activities to deliver value to shareholders. He ensures effective communication with shareholders and that Board members have a sound understanding of the views of investors.

Paul retires as Chairman following the Annual General Meeting on 11 July 2006 when Lord Burns succeeds him, having been appointed Deputy Chairman in October 2005. Paul is also stepping down from the Board as, under the Code principles, having served as Chairman, he can no longer be considered as an independent director.

Stuart Rose is Chief Executive and he is responsible for all aspects of the management of the Group and its business, which includes developing the appropriate business strategies for Board approval and achieving timely and effective implementation. He ensures that, within the strategies agreed by the Board, appropriate objectives and policies are adopted for each area of the business, that appropriate budgets are set and that their performance is effectively monitored with guidance or direction given as appropriate.

The Chairman ensures that the directors receive accurate, timely and clear information. Directors are encouraged to update their skills, knowledge and familiarity with the Group through their initial induction, on-going participation at Board and committee meetings, and through meeting our people at store locations and elsewhere. Views of customers and shareholders are also shared through Board presentations and individual meetings. The Board is regularly updated on governance and regulatory matters. There is an established procedure whereby any director, wishing to do so in the furtherance of their duties, may take independent professional advice through the Group Secretary at the Company's expense. This facility has been extended to the Audit, Remuneration and Nomination committees. The Company maintains liability insurance for its directors and officers. The directors and secretary have also been granted qualifying third party indemnities following shareholder approval in July 2005.

Kevin Lomax is Senior Independent Director and he is charged with establishing a communication channel between the Chairman and the non-executive directors and ensuring that the views of each non-executive director are given due consideration. He is also an additional contact point for shareholders if they have reason for concern which contact through the normal channels of Chairman, Chief Executive or Finance Director has failed to resolve or for which contact is inappropriate.

Kevin Lomax is retiring from the Board on 31 August 2006, when he will have completed two three-year terms as a non-executive director. On 1 September 2006, David Michels will succeed Kevin as Senior Independent Director and Jeremy Darroch as Audit Committee Chairman.

The non-executive directors provide a wide range of skills and experience to the Group. They bring an independent judgement on issues of strategy, performance, risk and people through their contribution at Board and committee meetings. The Board considers that throughout the year each non-executive director was independent in character and judgement and that they also met the independence criteria set out in the Code. The non-executive directors have ensured that they have sufficient time to carry out their duties. Any term beyond six years (ie two three-year terms) for a non-executive director is subject to particularly rigorous review.

Following the completion of the non-executive director and successional review, the Board has reviewed committee membership to refresh the skills, knowledge and experience of the Audit and Remuneration committees.

Graham Oakley, Group Secretary, acts as a sounding board to the Chairman and individual directors. He supports the Chairman in ensuring the effective functioning of the Board. He is secretary of the Audit, Remuneration and Nomination committees. He also heads the Corporate Governance Group, which supports the Board and its committees and commercial colleagues on a range of issues.

The Board has a formal schedule of matters reserved for its decision. It determines the overall Group strategy; creation, acquisition or disposal of material corporate entities or assets; development and protection of the brand; matters of public interest that could affect the Group's reputation; public announcements including statutory accounts; significant changes in accounting policy; capital structure and dividend policy; operating plans and key performance indicators; prosecution, defence or settlement of material litigation; Group remuneration policy and Board structure, composition and succession.

The Board receives regular updates on performance against the annual operating plan and investment decisions, together with business reports and presentations from senior management.

During 2005/06, in Clothing and Home, we worked hard on restoring our competitiveness, engaging with our suppliers to improve value, styling and the amount of new and exciting product across our ranges. In Food, we continued to focus on offering high quality, innovative products. This is beginning to contribute towards improved customer perceptions, market share and financial performance. At the same time, we extended our store refurbishment trial and continued to open new mainline and 'Simply Food' stores. Finally, improved service remained a priority. We undertook our biggest ever customer service training programme. We also overhauled pay rates and improved career planning for customer assistants. This will help us attract and retain the best people for our business. We are clear about what we have achieved. But we are equally clear that, at a time of intense competition, there can be no let-up in the work to return the Group to profitable growth.

There have been significant changes to Board membership during the year and increased focus given to succession planning and leadership development within the Group (described on page 36).

The Board delegates to management, through the Chief Executive, the overall performance of the Group, which is conducted principally through the setting of clear objectives and effective performance coaching against business competencies, building long-term management capability and ensuring that the business is managed in a fit and proper manner in keeping with its values and business principles. The business unit directors report directly to the Chief Executive and give regular presentations to the Board on strategies and performance in their relevant areas of the business.

We are committed to our principles of Quality, Value, Service, Innovation and Trust. Trust is earned from others as a result of our commitment to long-held values and the way we behave. In April 2006, we re-launched our Code of Ethics which outlines the behaviours that M&S expects from employees whether they are dealing with our customers, suppliers, shareholders or colleagues. It also includes guidelines on the environment, fraud and financial reporting and the management of conflicts of interest.

### Committees of the Board

The **Audit Committee** comprises Kevin Lomax (Chairman), Jeremy Darroch, Steven Holliday, David Michels and Jack Keenan, all of whom are independent, non-executive directors. Anthony Habgood was a member until he resigned from the Board on 30 August 2005. Jeremy Darroch joined the Committee on 1 February 2006 and David Michels on 26 May 2006. Kevin Lomax is retiring from the Board on 31 August 2006. On 1 September 2006, Jeremy Darroch will succeed him as Committee Chairman.

The committee assists the Board in fulfilling its oversight responsibilities. Its primary functions are:

- to monitor the integrity of the financial statements and other information to shareholders;
- to review the systems of internal control and risk management; and
- to maintain an appropriate relationship with the Company's external auditors and to review the effectiveness and objectivity of the audit process.

Items reviewed during the year include: General Merchandise stock commitment controls, Food new product development process, business continuity planning and controls over advertising expenditures and payroll. Whistleblowing procedures were reviewed and updated and a new Code of Ethics policy was recommended to the Board and subsequently approved.

Private meetings have also been held separately with the external auditors and the Chief Internal Auditor. From 1 May 2005 Stuart Rose and Charles Wilson, supported by the Finance Group, assumed the responsibilities normally performed by a Finance Director until the appointment of Ian Dyson on 27 June 2005.

The Audit Committee keeps under review the independence and objectivity of the external auditors, PricewaterhouseCoopers LLP (PwC), including the review of audit fee proposals and non-audit fees. An engagement and fee approvals process is in place which requires prior approval from the Committee for some engagements and excludes others. In some cases, the nature of the non-audit advice may make it more timely and cost-effective to select PwC, who already have a good understanding of the Group. PwC may also be appointed for consultancy work, but only after rigorous checks, including competitive tender, to confirm they are the best provider. PwC is also subject to professional standards which safeguard the integrity of the auditing role performed on behalf of shareholders. Following shareholder approval at the AGM in July 2005 the Audit Committee now determines the level of remuneration for the external auditors on behalf of the Board. Details of this year's fees are given in note 4 to the financial statements.

The Board is confident that the collective experience of the Audit Committee members enables them, as a group, to act as an effective audit committee and does not single out any one Committee member as having recent and relevant financial experience. With the appointment of Jeremy Darroch on 1 February 2006 as a non-executive director and member of the Audit Committee, the skills and experience of the Committee as a whole have been refreshed. The Committee also has access to the financial expertise of the Group and its auditors and can seek further professional advice at the Company's expense if required.

The **Remuneration Committee** comprises Jack Keenan (Chairman), Steven Holliday, David Michels, Kevin Lomax and Louise Patten, all of whom are independent, non-executive directors. Anthony Habgood was a member until he resigned from the Board on 30 August 2005. Louise Patten joined the Committee on 1 February 2006 and David Michels on 26 May 2006. Kevin Lomax will retire from the Board and the Committee on 31 August 2006. Its primary role is to recommend to the

# Corporate governance continued

Board the remuneration strategy and framework, giving due regard to the financial and commercial health of the Company and to ensure the executive directors and senior management are fairly rewarded for their individual contributions to the Company's overall performance. The remuneration of the non-executive directors is determined by the Chairman and the executive directors.

The Remuneration Report is set out on pages 40 to 48 as required by the Directors' Remuneration Report Regulations 2002.

The **Nomination Committee** comprises Lord Burns (Chairman), Jeremy Darroch, Steven Holliday, Jack Keenan, Kevin Lomax, David Michels, Paul Myners and Louise Patten, the majority of whom are independent non-executive directors. Paul Myners was Chairman of the Nomination Committee until the completion of the non-executive search in January 2006, which resulted in the appointment of new directors to the Board. Anthony Habgood was a member until he resigned from the Board on 30 August 2005. Louise Patten and Jeremy Darroch joined the Committee on 1 February 2006 and David Michels on 1 March 2006. Kevin Lomax will retire from the Board and the Committee on 31 August 2006. Its role is to ensure that appropriate procedures are in place for the nomination, selection, training and evaluation of directors and for successional plans. It reviews Board structure, size, composition and successional needs, thereby keeping under review the balance of membership and the required blend of skills, knowledge and experience of the Board.

In June 2005, following an external candidate search, Ian Dyson was appointed Group Finance Director with responsibility for Finance and International, increased from end October 2005 to include IT, Logistics and Property. In November 2005, taking into account the challenges and opportunities facing the Company, Steven Sharp was appointed to the Board as executive director with responsibility for Marketing, E-commerce and Store Design and Development, having joined the Company in May 2004. Appointments were made on merit and against objective criteria to ensure that the Board maintains an appropriate balance of skills and experience.

Paul Myners led the search for new non-executive directors appointing an external firm to select candidates to meet successional needs, provide consumer, retail and financial experience and increase the Board's diversity. A search specification was circulated to all directors who were invited to review the proposed candidate list. A shortlist was then prepared for interview by Paul Myners and Stuart Rose and preferred candidates then seen by a wider group of directors, including Lord Burns. As a result the following appointments were made to the Board: Jeremy Darroch and Louise Patten on 1 February 2006 and David Michels on 1 March 2006.

In July 2005, we announced the resignation of Charles Wilson as executive director effective October 2005 when he became Chief Executive of Booker. In August 2005, we announced the resignation of Anthony Habgood with immediate effect after he had to resume, unexpectedly, the Executive Chairmanship of Bunzl in June 2005.

Under the Company's Articles of Association, all directors seek election at their first AGM following appointment and all directors are required to offer themselves for re-election at least every three years. In addition, any director who is aged 70 or more is required to retire and seek re-election annually.

The **Corporate Social Responsibility (CSR) Committee** comprises Paul Myners (Chairman), Lord Burns, Jack Keenan and Steven Sharp and seven members of management.

Alison Reed was a member until her retirement on 30 April 2005. Lord Burns will become Chairman in July 2006 following Paul Myners' retirement from the Board. The Committee provides the Board with an overview of the social, environmental and ethical impacts of the Group's activities. Key CSR risks and opportunities are reviewed in areas such as sustainable raw materials, responsible use of technology, animal welfare, ethical trading, employment policy, health and safety and community programmes. Customers are increasingly asking for more information about CSR issues and in January 2006 we launched 'Look behind the label' to tell customers about the special qualities, many of them CSR based, that make Marks & Spencer products unique. The continued progress we made in important areas of CSR during the year was recognised by a number of independent organisations. We were included in the Dow Jones Sustainability and FTSE4Good indices and were ranked in the top 20 companies in Business in the Community's Corporate Responsibility Index with a score of 95%. Further information is given on page 18 and in our CSR report, available on our website at www.marksandspencer.com/csrreport2006, which includes more detail on processes and references to the United Nations Global Reporting Initiative.

The following table sets out the number of meetings of the Board and its committees during the year and individual attendance by Board and committee members at those meetings:

| | Group Board | Audit Committee | Remuneration Committee | Nomination Committee | CSR Committee |
|---|---|---|---|---|---|
| **Meetings held during the year** | 11 | 5[1] | 7 | 4 | 3 |
| Paul Myners, Chairman | 11 | – | – | 4 | 3 |
| Lord Burns, Deputy Chairman (appointed 1 October 2005) | 6 | – | – | 2 | 2 |
| Stuart Rose, Chief Executive | 11 | – | – | – | – |
| **Executive Directors** | | | | | |
| Ian Dyson (appointed 27 June 2005) | 9 | – | – | – | – |
| Steven Sharp (appointed 8 November 2005) | 5 | – | – | – | 2[2] |
| Charles Wilson (resigned 28 October 2005) | 6 | – | – | – | – |
| **Non-Executive Directors** | | | | | |
| Jeremy Darroch (appointed 1 February 2006) | 2 | – | – | – | – |
| Anthony Habgood (resigned 30 August 2005) | 3 | 1 | 1 | 2 | – |
| Steven Holliday (appointed 15 July 2004) | 10 | 4 | 4 | 4 | – |
| Jack Keenan | 11 | 5 | 7 | 4 | 3 |
| Kevin Lomax | 11 | 5 | 7 | 4 | – |
| David Michels (appointed 1 March 2006) | 2 | – | – | – | – |
| Louise Patten (appointed 1 February 2006) | 2 | – | 1 | – | – |

[1] The Audit Committee has rescheduled its meetings, bringing forward its April 2006 meeting to January 2006. As a result 5 meetings were held in 2005/06.

[2] Steven Sharp has been a member of the CSR committee since 13 October 2004.

Steven Holliday and Anthony Habgood were unable to attend the AGM in Birmingham on 12 July 2005 due to previous personal commitments and business priorities respectively.

Alison Reed resigned on 30 April 2005 and did not attend any of the above meetings.

## Performance evaluation

### Collective performance: Board and committees

The collective performance of the Board and its committees has been reviewed through a combination of questionnaire responses, individual discussions and Board meetings to review findings. Progress has been tracked during the year against an agreed action plan.

In March 2005 the Chairman consulted with the Board on the most appropriate way to evaluate performance. Appreciating that time together as a new Board was relatively short and that its reconstitution was not yet complete, it was still felt that a rigorous review would be valuable. The Chairman issued a detailed questionnaire to all directors who were invited to focus specifically on areas requiring priority action and to give honest and constructive feedback so that the Board could review its performance in a thorough and thoughtful manner.

The process was extended further this year to include external advice and support, together with individual discussions, allowing greater opportunity to explore issues on an individual basis. A non-attributable executive summary focusing on the key themes was issued to directors in preparation for a Board discussion led by the Chairman. A detailed plan was drawn up which identified a number of areas for action. Timescales and owners were allocated to each subject matter and this action plan has been subsequently regularly reviewed by the Board at each Board meeting.

# Corporate governance continued

The success of this year's approach has been primarily due to:

- combining internal expertise with external support which ensured that the review was M&S focused, leading edge in terms of methodology and cost-efficient;
- conducting one-to-one interviews, in addition to a questionnaire; and
- keeping the process live after the survey, by integrating it into the Board meeting agenda and the Chairman receiving regular updates on its progress.

Given the changes to the Board over the last few months, and with the pending change of Chairman, the Board has agreed that the 2006/07 evaluation take place in autumn 2006.

### Individual performance

The executive directors continue to have their performance individually reviewed by the Chief Executive against set objectives. Remuneration is directly linked to these reviews and determined by the Remuneration Committee. Similarly, the Chief Executive and Group Secretary's performance is reviewed by the Chairman. The Senior Independent Director reviews the Chairman's performance against a set of previously agreed objectives. The performance of the non-executive directors is reviewed individually by the Chairman. This year's questionnaire has also invited each director to comment on the individual performances of themselves, other directors and the Chairman.

### Succession planning and senior leadership development

Following a period of significant business change, and agreement by the Board that management succession was a key priority, the Board confirmed the need to review regularly succession planning and leadership development at the top of the organisation. It highlighted the need to raise the visibility of talent across the organisation and ensure appropriate career development plans are in place.

In January 2006 the Board reviewed:

- current successional and development plans for individuals at Reward Level G (one level below Board);
- succession potential for the teams that report into Reward Level G and information on our 'high potential' individuals from lower down the organisation with examples of development plans; and
- risk assessment and our future challenges.

Opportunities are provided for the non-executive and executive directors to meet with business unit directors and our 'high potential' individuals on a regular basis.

## Accountability and audit

The Group's overriding corporate objective is to maximise long-term shareholder value whilst exceeding the expectations of our customers, employees and partners. In doing so, the directors recognise that creating value is the reward for taking and accepting risk.

The Board has overall responsibility for the Group's approach to assessing risk and systems of internal control, and for monitoring their effectiveness in providing shareholders with a return that is consistent with a responsible assessment and mitigation of risks. This includes reviewing financial, operational and compliance controls and risk management procedures. The role of executive management is to implement the Board's policies on risk and control, and to provide assurance on compliance with these policies. Independent assurance is provided by internal audit, which operates across the Group, and the external auditors. All employees are accountable for operating within these policies.

Because of the limitations that are inherent in any system of internal control, this system is designed to manage, rather than eliminate, the risk of failure to achieve corporate objectives. Accordingly, it can only provide reasonable but not absolute assurance against material misstatement or loss.

### Risk assessment

Every six months the Board reviews the Group Risk Profile – the tool that drives risk assessment and action planning. This is supported by an on-going process for identifying, evaluating and managing the significant risks faced by the Group. As an integral part of planning and review, managers from each business area and major projects:

- identify the risks to their plans;
- evaluate the risks using likelihood and impact; and
- document the actions being taken to manage those risks.

This process has been in place for the year under review and up to the date of approval of the Annual report and accounts. It has been regularly reviewed by the Board and accords with the Internal Control Guidance for directors on the Code produced by the Financial Reporting Council.

## Principal risks and uncertainties

There are a number of risks and uncertainties which could impact the Group's long-term performance. The risk assessment process is designed to identify, manage and mitigate business risk. The table below gives examples of activities across Group functions to mitigate against risks and uncertainties in achieving business goals. Further information is given in the Chairman's statement on pages 1 and 2, the Chief Executive's review on pages 3 to 7, the Operating review on pages 8 to 18 and the Financial review on pages 20 to 25.

| Area | Description | Examples of Mitigating Activities |
|---|---|---|
| Clothing & Home | Delivering profit growth:<br>• Increasing competition<br>• Low price high volume retailing<br>• Economic factors | • Increased full price market share<br>• 'Open to Buy' – fast sellers, new fashion, improved availability<br>• Better product, better styling and better value<br>• Overseas sourcing offices<br>• Ethical sourcing of products<br>• Look behind the label<br>• Growth of international business |
| Food | Growing space and market share:<br>• Increasing competition<br>• Limited availability of sites<br>• Economic factors | • Simply Food expansion<br>• New formats, eg 'Hot Food to Go', bakeries, cafés, restaurants<br>• Product innovation, eg 'Marks & Spencer Cook!'<br>• Responsible food sourcing<br>• 'Look behind the label'<br>• Response to customer expectations eg 'Eat Well' and Fairtrade tea and coffee |
| People | Succession planning, retention and capability | • Competitive pay and performance related bonus<br>• Career progression for customer assistants, section and store managers<br>• Customer service training – 'Our Service Style'<br>• Buying Academy in head office<br>• Business Involvement Group (BIG) – employee communication, consultation and involvement |
| Stores | Store modernisation and new routes to market | • Store refurbishment programme<br>• Improved store layouts<br>• Consistency of standards across stores<br>• Expansion opportunities at home and overseas<br>• Improved e-commerce offer |
| Business interruption | Business continuity planning | • Workplace recovery solutions<br>• Recoverability solutions for IT operations<br>• Business Recovery and Crisis Management plan preparedness<br>• Communications and business continuity planning with key suppliers |

# Corporate governance continued

### Internal control

The Board maintains full control and direction over appropriate strategic, financial, organisational and compliance issues. It has delegated to executive management the implementation of the systems of internal control within an established framework.

The Board has put in place an organisational structure with formally defined lines of responsibility and delegation of authority. There are also established procedures for planning, capital expenditure, information and reporting systems, and for monitoring the Group's businesses and their performance. These include:

**Plans and policies**

- communication of the Group's strategy, objectives and targets;
- annual operating and capital plans and future projections;
- operating policies and procedures;
- clearly defined capital investment control guidelines;
- review of treasury policies by the treasury committee; and
- review of social, environmental and ethical matters by the Corporate Social Responsibility Committee.

Competent people

- appointment of employees of the necessary calibre to fulfil their allotted responsibilities; and
- clear roles and accountabilities with regular performance reviews.

Monitor and control

- review by operating divisions of their plans with the relevant executive directors prior to submission to the Board for approval, including identification and assessment of risks;
- monthly comparison of operating divisions' actual financial performance against budget; and
- regular consideration by the Board of year-end forecasts.

Regulatory update

- reporting of accounting and legal developments; and
- regular briefings on latest best practice corporate governance to the Board.

### Assurance

On behalf of the Board, the Audit Committee examines the effectiveness of the Group's:

- assessment of risk by reviewing evidence of risk assessment activity and a report from internal audit on the process undertaken;
- systems of internal control, primarily through approving the internal audit plan and reviewing its findings, reviews of the annual and interim financial statements and a review of the nature, scope and reports of the external audit;
- action plans taken, or to be taken, to remedy any significant failings or weaknesses identified; and
- action plans in place to manage significant risks.

The Audit Committee has completed its review of the effectiveness of the Group's systems of internal control during the year and confirms the necessary action plans to remedy identified weaknesses in internal control are in place.

Internal audit's work is focused on areas of priority as identified by the Group Risk Profile and in accordance with an annual audit plan approved each year by the Audit Committee and by the Board. The Board receives a full report from the Chief Internal Auditor each year on the department's work and findings and regular interim updates on specific issues.

The external auditors are engaged to express an opinion on the financial statements. They review and test the systems of internal financial control and the data contained in the financial statements to the extent necessary to express their audit opinion. They discuss with management the reporting of operational results and the financial position of the Group and present their findings to the Audit Committee.

### Relations with shareholders

We are committed to on-going engagement with shareholders and have a well established cycle of communication based on the Group's financial reporting calendar. We promote the use of electronic communication – all Company announcements and presentations are made available simultaneously on our website, together with webcasts of our financial results presentations. The website also contains corporate and customer information which is updated on a regular basis. There is a corporate governance section which includes our full response to the Code and terms of reference for the principal Board Committees. Our registrars have also developed www.shareview.co.uk – an electronic service where shareholders can check their shareholding, update their personal details and elect to receive communications electronically, rather than through the post.

We aim to make our Annual report documents as accessible as we can. Audio and large print versions of our Annual review are available on our website, which now has improved navigation and accessibility. This year we will advertise our half-year results rather than publishing a booklet to mail to shareholders. The full statement will be available on our website for those wanting more detail.

Our Investor Relations department is the focal point for contact with institutional investors and maintains regular dialogue throughout the year. The Chairman ensures that the Board is regularly updated on the views of our major shareholders, following meetings they have with him, the Chief Executive, the Finance Director or Investor Relations. In June, the Board receives a presentation from external advisers summarising the opinions of our principal shareholders following an extensive survey on their views after the release of our fourth-quarter trading statement in April.

By the standards of large UK companies, a particularly high percentage of M&S shares are owned by private investors. The Company makes a special effort to ensure its communications and policies are appropriate to the needs of the private investor.

The AGM is an important forum for us to meet with shareholders and it is normally well attended. An exhibition is hosted by our senior retail and business managers. The Chairman and Chief Executive give business presentations which are made available on our website, together with the questions and answers raised at the meeting. Two of our non-executive directors, Steven Holliday and Anthony Habgood, were unable to attend the meeting in July 2005 due to previous personal commitments and business priorities respectively.

The Board has taken the following steps to encourage increased shareholder voting and improve the integrity and effectiveness of the voting process at the AGM:

- promoted 'your vote counts' and encouraged the greater use of electronic voting;
- invited three-way voting on resolutions: 'for', 'against' and 'vote withheld'; and
- conducted the vote by poll rather than by show of hands. The result is more democratic as all shares represented at the meeting are voted, added to the proxy vote lodged in advance of the meeting and published.

The indicative results are declared at the meeting, then announced to the London Stock Exchange and published on our website. In July 2005, all resolutions were passed on a poll conducted electronically. Approximately 46% of the ordinary share capital was represented with votes 'for' resolutions ranging from 82% to 99%.

At this year's meeting, in addition to routine resolutions, shareholders will be asked to vote on the:

- renewal of shareholder authority to make donations to EU political organisations and to incur EU political expenditure under the provisions of the Political Parties, Elections and Referendums Act 2000, of up to £100,000 each year. The Company does not make donations to political parties. However, the legislation gives a wide definition of political donations and accordingly we seek authority on a precautionary basis;
- adoption of new Articles of Association, which have been reviewed against current legislation and best practice. To make them more accessible they are in plain English and will be made available on our website; and
- amendment to the terms of the Performance Share Plan.

Many shareholders are also customers and in 2004 we sent them Spend & Save vouchers for the first time, to use on full price autumn merchandise in stores. In 2005, we extended the offer to nominees, increasing distribution from 300,000 to 400,000 investors. The vouchers have proved very popular and we will be mailing vouchers again in July, which will be valid in our stores in September and October 2006.

We encourage shareholders to make their views known to us by email at chairman@marks-and-spencer.com, by telephone on 0845 302 1234 for customer queries and 0845 609 0810 for shareholder queries as we continue to develop our products and services.

### Compliance with the Combined Code

For the year ended 1 April 2006 the Company complied with all the provisions of the Combined Code on Corporate Governance, with the exception of:

#### Audit Committee membership

C.3.1 The Board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience. The Company's position is explained on page 33.

#### Annual General Meeting attendance

D.2.3 The Chairman should arrange for the chairmen of the Audit, Remuneration and Nomination Committees to be available to answer questions at the AGM and for all directors to attend. The Company's position is explained on this page.

### Governance of the Group's pension schemes

The Group operates a defined benefit scheme for all employees with an appointment date prior to 1 April 2002 and a defined contribution scheme open to those joining the Company on or after 1 April 2002. More information is given in the Remuneration Report on page 43 and note 11 to the Accounts.

The Board of the Pension Trust (Trustee Board) manages the assets of the pension schemes which are held under trust separately from those of the Group. The Company and the Trustee Boards have agreed a new trustee composition of two independent trustees, five company representatives and five member representatives. Tony Watson (retiring Chief Executive of Hermes Pensions Management Limited) has been appointed as independent Chairman and Law Debenture Trust as independent trustee. Elections are currently under way to appoint the member representatives.

# Remuneration report

The Remuneration Committee has adopted the principles of good governance relating to directors' remuneration as set out in the Combined Code. This report complies with the Companies Act 1985, amended by the Directors' Remuneration Report Regulations 2002 and the Listing Rules of the Financial Services Authority. These regulations require the Company's auditors to report on the 'audited information' within the report and to state if this section of the report has been properly prepared in accordance with the regulations. This report has therefore, been divided into separate sections for unaudited and audited information. The report has been prepared on behalf of the Board by the Remuneration Committee.

## PART 1: UNAUDITED INFORMATION

### Remuneration Committee

The Committee comprises Jack Keenan (Chairman), Steven Holliday, Kevin Lomax, David Michels and Louise Patten, all of whom are independent non-executive directors. Louise Patten joined the Committee on 1 February 2006 and David Michels on 26 May 2006. Anthony Habgood was a member of the Committee until his resignation from the Board on 30 August 2005. There were seven meetings of the Remuneration Committee during the period under review and all individuals who were a member of the Committee at that time attended the meetings, with the exception of Anthony Habgood who did not attend the meetings on 20 April and 13 July 2005 and Steven Holliday who did not attend the meetings on 17 May and 13 July 2005 and 28 March 2006, due to prior commitments.

The Committee keeps itself fully informed of all relevant developments and best practice in the field of remuneration and seeks advice where appropriate from external advisors. New Bridge Street Consultants LLP has provided material advice to the Committee on directors' remuneration and share schemes in the past year.

The Company Chairman, the Deputy Chairman, Chief Executive, Group Secretary and the Head of Senior Remuneration also materially assisted the Committee in its deliberations, except in relation to their own remuneration.

The Remuneration Committee's remit is set out in the terms of reference which are reviewed annually by the Board. A copy of the terms of reference is available on the Company's website. The primary purposes include:

- to recommend to the Board the remuneration strategy and framework, giving due regard to the financial and commercial health of the Company;
- to determine the individual remuneration packages within that framework for the executive directors and senior management;
- to approve the design of annual and long-term incentive arrangements and agree the targets and levels of award;
- to determine and agree the general terms and conditions of service contracts and the specific terms for an individual either on recruitment or termination; and
- to determine the policy for, and scope of, executive pension arrangements.

The Board considers the principles of good governance when deciding the remuneration strategy, and recognises that the level of remuneration and benefits we offer is key to recruiting and retaining talented individuals and maintaining our market position as an employer of choice.

### Remuneration policy

The Committee continually reviews the remuneration strategy to ensure it will enable the recruitment and retention of highly skilled individuals who are key to the recovery and future success of Marks & Spencer. In 2005 changes were made to the long-term incentive arrangements to rebalance the package and provide a more effective link between pay and performance for the various levels of executive and to ensure the most senior executives have a high proportion of pay at risk with a greater emphasis on the longer term.

Over the last year, the Company has delivered significantly improved performance and generated a substantial increase in profit and shareholder value. Despite this improvement, much remains to be done and it is vital that the senior team is incentivised and retained. In light of this the Committee proposes to make revisions to the remuneration package for senior executives, and is seeking shareholder approval at the forthcoming Annual General Meeting (AGM) for an amendment to the Performance Share Plan. Executives will be required to achieve demanding targets under the annual and long-term arrangements to receive rewards. The package is designed to support the Company's strategy and drive continuous and sustainable improvement in shareholder value.

Total remuneration for executive directors comprises salary, variable pay, pension and benefits. Salary and benefits are set having regard to market practice and levels paid by similar companies. Variable pay provides the opportunity to earn greater amounts for the highest standards of performance. The performance-related element forms a significant proportion of the total potential package.

There are two key components of variable pay: an Annual Bonus Scheme (incorporating a deferred share element) and a Performance Share Plan. The ability to earn variable pay is linked to the delivery of significant company performance and the expected value of the package both at on-target and maximum is shown on page 41.

### Expected value of future annual remuneration package for executive directors

**'On-target' performance**

| Salary | Pension | Annual cash bonus | Long-term incentives |
|---|---|---|---|
| 36% | 9% | 9% | 46% |

**'Maximum' performance**

| Salary | Pension | Annual cash bonus | Long-term incentives |
|---|---|---|---|
| 10% | 3% | 10% | 77% |

The value placed on long-term incentives comprises the expected cash value to executives after three years, discounted back to its present value, of (i) bonus compulsorily deferred into shares and (ii) performance shares awarded under the Performance Share Plan.

### Chairman's and non-executive directors' remuneration

The remuneration for the non-executive directors is determined by the Chairman and executive directors and is designed both to recognise the responsibilities of non-executive directors and to attract individuals with the necessary skills and experience to contribute to the future growth of the Company. The non-executive directors are paid a basic fee with additional fees payable for Committee membership and to the chair of the Committees. These fees are neither performance related nor pensionable. Non-executive directors do not participate in any of the Company's share schemes nor the Annual Bonus Scheme. The fees shown in the emoluments table reflect the fees paid during the year. The basic fee increases from £40,000 to £50,000 per annum with effect from 1 April 2006. The additional fees for acting as Committee Chairman or member remain unchanged at £10,000 and £5,000 per annum respectively. The Chairman indicated that he did not wish his fee of £200,000 to be reviewed during the year.

### Salaries and benefits

Salaries for executive directors are reviewed annually and any change to salary is normally effective from 1 January. The Remuneration Committee takes into consideration a range of factors when reviewing salaries such as Company performance, level of salaries for large retailers and for other major FTSE 100 companies, market conditions, the level of increase awarded to employees throughout the business and the responsibilities of individual directors. Current annual salaries for executive directors are set out in the Directors' emoluments table (page 45).

Stuart Rose, Ian Dyson and Steven Sharp received payments of 20% of total salary in lieu of pension. This payment rises to 25% of total salary with effect from 1 April 2006 following an exercise to benchmark pension-related benefits taking into account market practices and changes in legislation. A payment was also made to Charles Wilson of 20% of total salary until his resignation from the Company on 31 October 2005.

For executive directors, where applicable, the provision of a car or car allowance, fuel and chauffeur is included in the emoluments table as part of benefits.

### Annual Bonus Scheme

The Annual Bonus Scheme is designed to focus and reward executives for specific operational improvements which will drive the Company's recovery. The 2005/06 bonus for directors started at 60% of salary for on-target performance rising to a maximum of 150% for exceeding targets.

The targets for the Company are determined annually by the Committee and for 2005/06 incorporated a mixture of corporate profit before tax and business unit sales and profit. The targets for the executive directors were entirely based on the delivery of corporate profit before tax. The Committee assesses the achievement of targets for all executive directors and senior management prior to any bonus awards being made.

This year the profit before tax targets have been delivered above target and represent a significant improvement both on the reported profits for 2004/05 and against market expectations at the beginning of the financial year. As a result, maximum awards under the scheme of 150% of salary have been made to Stuart Rose, Ian Dyson and Steven Sharp.

The executive directors are required to defer 50% of the bonus paid into shares which will be held for three years. There will be no match paid against these deferred shares, although the value of dividends accrued will be paid at the end of the period. The emoluments table and notes give the level of cash payments and the value of shares to be awarded at the beginning of June 2006, which will be based on the average share price over the preceding five trading days.

For 2006/07 the Committee intends to increase the bonus potential for executive directors to a maximum of 250% for exceeding targets. The level for on-target performance will remain at 60%. The level of deferred shares will increase from 50% of any bonus earned to 60%. Bonus potential is being raised to this maximum level for the three executive directors to help incentivise and secure further significant growth in corporate profits.

# Remuneration report continued

## Long-term Incentive Schemes

### Performance Share Plan

The Performance Share Plan is the primary form of long-term incentive for the top 100 senior management. Under the plan, annual awards of up to 200% of salary may be offered based on performance and potential, with the exception of a 300% limit in the year of recruitment.

Performance targets are based on Adjusted Earnings per Share (EPS) growth. The Remuneration Committee considers this target to be the key measure of management performance to generate significant increases in profits and increase shareholder value. The Committee regularly reviews the level of targets to ensure they are demanding in the context of the Company's circumstances and projected performance. For the awards made in 2005 the targets were as follows:

| Average Annual EPS Growth in excess of Inflation (RPI) | % of Award Vesting |
|---|---|
| 8% | 20% |
| 15% | 100% |
| Between 8% and 15% | Pro rata |

The base EPS figure used for grants made in 2005 was 23.5p, which was the adjusted EPS figure for 2004/05 on a pro-forma basis. The figure has been restated to 22.2p as the Group is now reporting under IFRS.

The Committee is seeking shareholder approval to increase the maximum level of grant under the Performance Share Plan to 400% of salary. The normal annual grant level will remain at up to 200% of salary and it is intended to use the increased level to give flexibility in exceptional cases including retention and recruitment. The Committee expects to exceed the 200% base salary limit in 2006/07 for around six individuals. Shareholders were informed when the Performance Share Plan was adopted last year that the Committee may set different EPS targets for awards made in future years. In particular, it was pointed out that if the Company's EPS grew substantially in 2005/06, a change to the targets was likely to be necessary for awards made in 2006/07, provided that the Committee consider that any new targets are at least as challenging as the targets applying to the initial awards. The Committee has therefore reviewed the appropriate level of targets for grants made in 2006 and considers these revised targets to be equally challenging taking into account the anticipated performance over the fixed measurement period. The targets are as follows:

| Average Annual EPS Growth in excess of Inflation (RPI) | % of Award Vesting |
|---|---|
| 5% | 20% |
| 12% | 100% |
| Between 5% and 12% | Pro rata |

### Executive Share Option Scheme

Executive Share Option Schemes have operated for over 20 years and in recent years have been open to approximately 400 senior management. Although a new Executive Share Option Scheme was adopted at the 2005 AGM, the Committee does not intend to use this Scheme on a regular basis. However, it does wish to have the flexibility to make grants from time to time if it considers it appropriate to do so in the future. No grants have been made under this Scheme in the year under review. The performance targets in this Scheme will be based on EPS growth and the following targets would have applied if any grants had been made in the year under review:

| Average Annual EPS growth of the Company over the three-year performance period | % of Award Vesting |
|---|---|
| Less than RPI + 8% | 0% |
| RPI + 8% | 20% |
| RPI + 15% or more | 100% |
| Between RPI + 8% and RPI +15% | Between 20% and 100% on a straight-line basis |

The Committee intends to use the same EPS range for both the Performance Share Plan and the Executive Share Option Scheme. The target range for any Executive Share Option grants to be made in 2006 is as shown under the Performance Share Plan.

There are options outstanding for management under a number of previous schemes which will vest, subject to the delivery of the performance conditions, in 2006, 2007 and 2008. Executive directors have options outstanding under the 2002 Scheme only, details of which are shown in the table on page 46.

The performance targets for the 2002 Scheme are Adjusted EPS growth measured from the most recent financial year ending prior to grant of at least:

- RPI plus an average of 3% per annum for 50% of each grant; and
- RPI plus an average of 4% per annum for the other 50% of each grant.

Performance targets are assessed over an initial three-year period from the date of grant. There is no ability to retest any grants made since 2004/05, which includes all grants made to the executive directors.

### Executive Share Matching Plan

An Executive Share Matching Plan for senior management operated in 2002, 2003 and 2004 for approximately 25 selected senior management. The Company did not operate this plan for executive directors in 2005 and does not intend to operate it in future years. There are no current executive directors in this plan. Participants were required to invest one-third of any annual bonus earned in shares of the Company. Any part of the balance may have been invested voluntarily.

The pre-tax value of the invested bonus is matched by an award of shares, with the extent of the match determined by performance conditions. The performance conditions are:

- 50% of the invested bonus receives a matching award based on the Company's Total Shareholder Return (TSR)[1] compared to the constituents of the FTSE 100 at the start of the performance period; and
- 50% of the invested bonus receives a matching award based on the Company's TSR compared to a selected comparator group of UK retailers.

At the end of the three-year performance period[2], the Company's TSR performance is ranked against the two comparator groups and the following matching ratios applied:

| TSR performance Ranking in group | Ratio of Matching Award to relevant portion of Invested Bonus |
|---|---|
| Top Decile | 2.5:1 |
| Between Median and Top Decile | Pro-rata between 1:1 and 2.5:1 |
| Median | 1:1 |
| Below Median | Zero[3] |

[1] TSR – The return to shareholders comprising the increase or decrease in share price plus the value of dividends received assuming that they are reinvested.

[2] The performance period for the 2002 award consisted of the three consecutive years following the most recent announcement of results prior to the date of award. For subsequent awards, the performance period will consist of three consecutive financial years.

[3] Any element of bonus that is compulsorily invested in the Plan receives a minimum matching ratio of 0.25:1 irrespective of performance.

### All-Employee Share Schemes

Executive directors can also participate in the share schemes open to all employees of the Company, currently the Save As You Earn scheme (SAYE). Details of participation by executive directors in the SAYE scheme are given in part 2 of this report.

A SAYE Option Scheme was approved by shareholders in 1981 and renewed by shareholders in 1987 and 1997. HMRC rules limit the maximum amount saved to £250 per month. When the savings contract is started, options are granted to acquire the number of shares that the total savings will buy when the contract matures. Options cannot normally be exercised until a minimum of three years has elapsed.

### Director changes during the year

There were two new executive directors appointed to the Board during the year. Ian Dyson was appointed Group Finance Director with effect from 27 June 2005 and Steven Sharp was appointed Executive Director of Marketing, E-commerce, Store Design and Development with effect from 8 November 2005. Charles Wilson resigned from the Board and left the Company at the end of October 2005.

Non-executive director Anthony Habgood resigned from the Board on 30 August 2005. Lord Burns was appointed to the Board as Deputy Chairman on 1 October 2005 and will be appointed as Chairman following the AGM in July 2006 when Paul Myners retires. Louise Patten and Jeremy Darroch were appointed to the Board on 1 February and David Michels was appointed on 1 March 2006, all as non-executive directors.

### Shareholding policy

A requirement was introduced in 2002 that, within five years of 1 June 2002 or within five years of appointment (whichever is the later), the Chief Executive should hold shares whose market value at that time is equivalent to or greater than twice his then current gross annual base salary and for executive directors to hold shares equivalent to or greater than their, then current salary. The Remuneration Committee is satisfied that under these rules, all current executive directors will have sufficient holdings in the Company to be able to comply with this requirement in the appropriate timescale.

### Pension provision

#### The Marks & Spencer Retirement Plan

Employees joining the Company on or after 1 April 2002 are, on completion of one year's service, invited to join the contributory Retirement Plan. The Plan is a defined contribution arrangement, where employees may choose to contribute between 3-15% of their salary. Member contributions of 3-6% are matched by Company contributions of 6-12%. The employee is free to choose from a range of investment vehicles, where the total contribution will be invested. During the first year of membership, employees can contribute 3-15% of their salary and receive 6-24% from the Company to enable the employee to be compensated for the waiting period.

During the one-year waiting period before joining the Plan, employees will be covered for death in service by a capital payment of twice salary, increasing to four times salary from the date of joining the Plan, subject to the statutory earnings cap. There are no current executive directors who are a member of this plan.

#### The Marks & Spencer Pension Scheme

Employees with a permanent appointment date prior to 1 April 2002 are eligible to participate in the Company's Defined Benefit Pension Scheme. The Scheme is non-contributory and the subject of an Independent Trust. The normal retirement age under the Pension Scheme for senior management is 60. Alison Reed was the only executive director during the period under review who was a member of this scheme until she left the Company on 30 April 2005.

The Marks & Spencer Pension Scheme was closed to new members with effect from 31 March 2002.

# Remuneration report continued

### External appointments
The Company recognises that executive directors may be invited to become non-executive directors of other companies and that such appointments can broaden their knowledge and experience, to the benefit of the Company. The individual director retains the fees. Stuart Rose serves as a non-executive director at Land Securities and received a fee of £45,000 during the year under review.

### Service contracts
All members of senior management, including executive directors, have service contracts. These contracts can be terminated by the Company giving 12 months' notice and by the employee giving six months' notice. Exceptions may exist where new recruits have been granted longer notice periods for the initial period of their employment.

The Company retains the right to terminate the contract of any director summarily, in accordance with the terms of their service agreement, on payment of a sum equivalent to the contractual notice entitlement of 12 months' salary and specified benefits. In the case of service agreements concluded after 1 April 2004, the Company reserves the right on termination to make phased payments which are paid in monthly instalments and subject to mitigation. However, entitlement to participate in future share scheme awards ceases on termination.

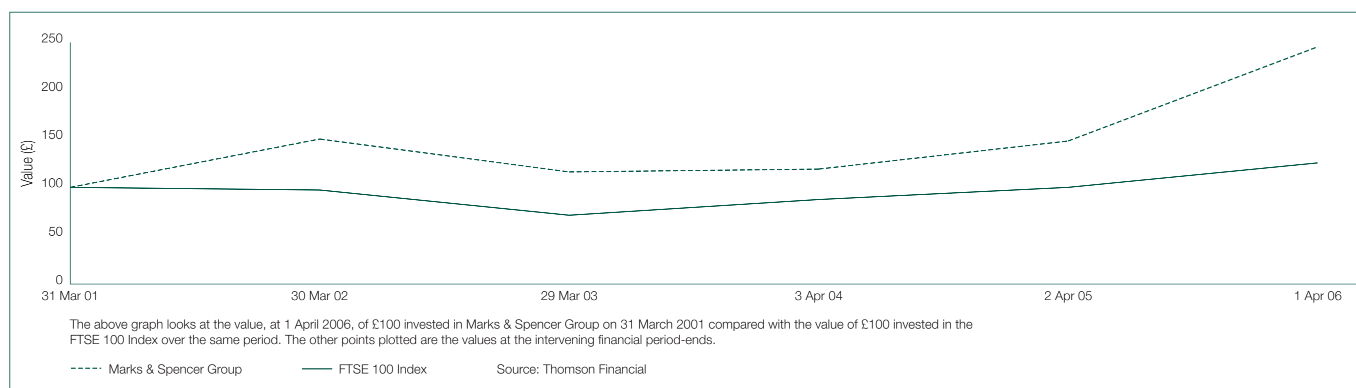
Paul Myners has a service agreement with the Company which, at his request, requires no notice of termination by the Company, but requires him to give six months' notice should he wish to terminate the agreement.

### Non-executive directors
The non-executive directors have service agreements with the Company for an initial three-year term, which are terminable on three months' notice. Anthony Habgood resigned from the Board on 30 August 2005. Lord Burns was appointed to the Board as Deputy Chairman on 1 October 2005 and will be appointed as Chairman following the AGM in July 2006 when Paul Myners retires. Lord Burns has a contract which is terminable on three months' notice. Once appointed to Chairman, his service agreement will require 12 months' notice from the Company or six months' notice should he wish to terminate the agreement. Louise Patten and Jeremy Darroch were appointed to the Board on 1 February and David Michels was appointed on 1 March 2006.

| Name | Date of appointment | Notice period/unexpired term |
|---|---|---|
| Lord Burns | 01/10/05 | 3 mths/3 mths |
| Jeremy Darroch | 01/02/06 | 3 mths/3 mths |
| Steven Holliday | 15/07/04 | 3 mths/3 mths |
| Jack Keenan | 01/09/01 | 3 mths/3 mths |
| Kevin Lomax | 01/09/00 | 3 mths/3 mths |
| David Michels | 01/03/06 | 3 mths/3 mths |
| Louise Patten | 01/02/06 | 3 mths/3 mths |

### Performance graph
This graph illustrates the performance of the Company against the FTSE 100 over the past five years. The FTSE 100 has been chosen as it is a recognised broad equity market index of which the Company has been a member throughout the period. Performance, as required by the legislation, is measured by TSR (share price growth plus dividends paid).

**Total Shareholder Return**




The above graph looks at the value, at 1 April 2006, of £100 invested in Marks & Spencer Group on 31 March 2001 compared with the value of £100 invested in the FTSE 100 Index over the same period. The other points plotted are the values at the intervening financial period-ends.

## PART 2: AUDITED INFORMATION

### 1 Directors' emoluments

| | Current annual salary/fee £000 | Salary/fee £000 | Benefits £000 | Bonus £000 | Termination payments £000 | **Total 2006 £000** | Total 2005 £000 |
|---|---|---|---|---|---|---|---|
| **Chairman** | | | | | | | |
| Paul Myners[1] | 200 | 200 | 3 | – | – | **203** | 149 |
| **Chief Executive** | | | | | | | |
| Stuart Rose[2, 7] | 950 | 875 | 198 | 1,232 | – | **2,305** | 2,119 |
| **Executive directors (appointed from)** | | | | | | | |
| Ian Dyson (27 June 2005)[3, 6] | 475 | 335 | 83 | 267 | – | **685** | – |
| Steven Sharp (8 November 2005)[4, 6] | 475 | 181 | 41 | 142 | – | **364** | – |
| **Deputy Chairman** | | | | | | | |
| Lord Burns (1 October 2005)[5] | 175 | 88 | – | – | – | **88** | – |
| **Non-executive directors** | | | | | | | |
| Jeremy Darroch (1 February 2006) | 50 | 8 | – | – | – | **8** | – |
| Steven Holliday | 50 | 50 | – | – | – | **50** | 36 |
| Jack Keenan | 60 | 60 | – | – | - | **60** | 56 |
| Kevin Lomax | 60 | 60 | – | – | – | **60** | 60 |
| David Michels (1 March 2006) | 50 | 4 | – | – | – | **4** | |
| Louise Patten (1 February 2006) | 50 | 8 | – | – | – | **8** | – |
| **Directors retiring from the Board during the year** | | | | | | | |
| Alison Reed (30 April 2005)[8] | – | 33 | 2 | – | 622 | **657** | 624 |
| Charles Wilson (31 October 2005) | – | 290 | 68 | – | – | **358** | 1,414 |
| Anthony Habgood (30 August 2005) | – | 21 | – | – | – | **21** | 36 |
| **Former directors** | – | – | – | – | – | **–** | 5,173 |
| **Total** | | 2,213 | 395 | 1,641 | 622 | **4,871** | 9,667 |

The elements included in the benefits column of the emolument table are described in detail in the Salaries and benefits section on page 41 and have been audited.

[1]Paul Myners will retire from the Board on 11 July 2006.
[2]Stuart Rose (appointed 31 May 2004) received a salary increase from £850,000 to £950,000 effective from 1 January 2006.
[3]Ian Dyson received a salary increase from £420,000 to £475,000 effective from 1 January 2006.
[4]Steven Sharp was promoted to the Board on 8 November 2005 at a salary of £420,000. He received a salary increase to £475,000 effective 1 January 2006.
[5]Lord Burns salary on appointment to Chairman on 11 July 2006 will increase to £400,000 pa.
[6]Total Bonus payments for 2005/06 were: Ian Dyson £534,000 and Steven Sharp £712,000 (of which £284,000 was earned as an executive director). Of the total bonus, 50% is paid in cash as shown in the table, and 50% paid in shares as part of the Deferred Share Bonus Plan as described under the Annual Bonus Scheme on page 41. The Deferred Share Bonus Plan shares will be granted in June 2006.
[7]The total bonus payment for Stuart Rose is £1,425,000. The Remuneration Committee has agreed that he will be entitled to receive £519,000 of his £713,000 Deferred Share Bonus in cash provided this is donated to his charity of choice (Friends of Mvumi Secondary School, Tanzania). In turn he is released from his promise to gift to that same charity any gains on his share options (granted in 2004) up to a share price of £4.00, the equivalent of £519,000. His bonus deferred into shares will therefore be £193,000, and will be granted in June 2006.
[8]Alison Reed's termination payment was made up of salary £400,000, bonus £130,000 and benefits £92,000.

# Remuneration report continued

## 2 Directors' interests in long-term incentive schemes

### Performance Share Plan

| | Maximum receivable at 2 April 2005 or date of appointment | Awarded in year | Vested in year | Lapsed in year | **Maximum receivable at 1 April 2006 or date of leaving[1]** | Date of award | Performance period for award |
|---|---|---|---|---|---|---|---|
| **Chief Executive** | | | | | | | |
| Stuart Rose | – | 473,868 | – | – | **473,868** | 25/07/2005 | 2005 – 2008 |
| **Executive directors** | | | | | | | |
| Ian Dyson | – | 234,146 | – | – | **234,146** | 25/07/2005 | 2005 – 2008 |
| Steven Sharp | 234,146 | – | – | – | **234,146** | 25/07/2005 | 2005 – 2008 |

[1] The number of performance shares is the maximum (100% of the award vesting) that could be receivable by the executive if the EPS performance conditions are fully met as outlined on page 42. For the year ending in March 2006, the EPS growth in excess of inflation (RPI) was 39.5%. The maximum vesting would be receivable if this percentage is maintained.

### Directors' Share Option Schemes

| | At 2 April 2005 or date of appointment | Granted during the year | Exercised/ lapsed during the year | **At 1 April 2006 or date of leaving** | Option price (p) | Exercise price (p) | Option period |
|---|---|---|---|---|---|---|---|
| **Chief Executive** | | | | | | | |
| **Stuart Rose** | | | | | | | |
| Not Exercisable (B) | 979,825 | | | **979,825** | 347.0 | | Jul 2007 – Jul 2014 |
| SAYE | | 4,613 | | | 349.0 | | Jan 2011 – Jun 2011 |
| **Executive directors** | | | | | | | |
| **Ian Dyson** | | | | | | | |
| SAYE | | 4,613 | | | 349.0 | | Jan 2011 – Jun 2011 |
| **Steven Sharp** | | | | | | | |
| Not Exercisable (B) | 406,603 | | | **406,603** | 344.3[1] | | Jul 2007 – Nov 2014 |
| SAYE | | 2,679 | | | 349.0 | | Jan 2009 – Jun 2009 |
| **Directors leaving during the year** | | | | | | | |
| **Alison Reed[3]** | | | | | | | |
| Exercisable (B) | 289,460 | | | **525,150** | 262.8[1] | | Sept 2003 – Apr 2006 |
| Exercisable (A) | 286,150 | | | **474,720** | 372.9[1] | | Jun 1998 – Apr 2006 |
| Not Exercisable (B) | 235,690 | | | | | | |
| Not Exercisable (A) | 344,188 | | | | | | |
| Lapsed[2] | | | 155,618 | | | | |
| SAYE | 10,166 | | | **9,478** | 166.7[1] | | May 2005 – Oct 2005 |
| SAYE Lapsed | | | 688 | | | | |
| **Charles Wilson** | | | | | | | |
| Not Exercisable (A) | 576,367 | | | | | | Jul 2007 – Jul 2014 |
| Lapsed[2] | | | 576,367 | | 347.0 | | |

[1] Weighted average price.

[2] Options may have lapsed under one of the following scheme rules:
(i) The options vesting period has expired.
(ii) The options lapsed on resignation from the Company.

[3] The Remuneration Committee used its discretionary authority to waive to the time pro-rating of Alison Reed's options on leaving.

The market price of the shares at the end of the financial year was 556.5p; the highest and lowest share prices during the financial year were 575.75p and 319.25p respectively.

Within the table, the breakdown of options is as follows:
Exercisable (A) – option price is above the market value on either 1 April 2006 or date of leaving, options have vested.
Exercisable (B) – option price is below the market value on either 1 April 2006 or date of leaving, options have vested.
Not Exercisable (A) – option price is above the market value on 1 April 2006, options have not matured.
Not Exercisable (B) – option price is below the market value on 1 April 2006, options have not matured.

In addition, the performance criteria attached to the Executive Share Matching Plan and the Executive Share Option Schemes as described in long-term incentive schemes on page 42 and page 43 have been audited.

## Restricted Share Plan

| | Maximum receivable at 2 April 2005 or date of appointment[1] | Awarded in year | Vested in year | Lapsed in year | **Maximum receivable at 1 April 2006 or date of leaving** | Date of award | Date of vesting |
|---|---|---|---|---|---|---|---|
| **Executive directors** | | | | | | | |
| Steven Sharp | 90,000 | – | – | – | 90,000 | 24/06/2005 | 24/07/2007 |

[1] A Restricted Share Plan was established in 2000 as part of the reward strategy for retention of senior employees who are vital to the success of the business recovery and growth. The plan operates for senior executives below executive director level. Awards under the plan are made as part of ongoing reviews of reward packages, and recruitment tools for new employees. The shares are held in trust for a period of between one and three years, at which point they are released to the employee, subject to them still being in employment. Steven Sharp was awarded these shares before he was appointed an executive director.

## Executive Share Matching Plan

| | Maximum receivable at 2 April 2005 or date of appointment[1] | Awarded in year | Vested in year | Lapsed in year | **Maximum receivable at 1 April 2006 or date of leaving** | Date of award | Performance period for matching award |
|---|---|---|---|---|---|---|---|
| **Directors leaving during the year** | | | | | | | |
| Alison Reed[2] | 76,841 | – | 16,596 | 60,245 | – | 30/07/2002 | 2002 – 2005 |
| | 246,983 | – | 8,232 | 238,751 | – | 23/06/2003 | 2003 – 2006 |
| | **323,824** | **–** | **24,828** | **298,996** | **–** | | |

No current executive directors participate in the Share Matching Plan.

[1] The number of matching shares is the maximum (a match of 2.5:1) that could be receivable by the executive if the TSR performance conditions outlined on page 43 are met in full. These calculations have been independently performed by New Bridge Street Consultants LLP using data from Datastream (an independent data services provider).

[2] All outstanding matching shares lapsed when Alison Reed left the Group's employment, apart from 16,596 shares, which represented a 0.54:1 match respectively on shares purchased with invested bonus, and 8,232 matching shares, which represented a 0.25:1 match on shares purchased with compulsorily invested bonus. The Remuneration Committee used its discretionary authority to waive the time pro-rating of options. The TSR performance was calculated at 31 December 2005. The matching shares vested on 30 April 2005 when the share price was 336.5p, giving an equivalent gain of £84,000.

# Remuneration report continued

### 3 Directors' pension information

#### a) Pension Benefits

The Directors' Remuneration Report Regulations 2002 require disclosure of defined benefit pension arrangements on a different basis to that specified in the Listing Rules. Details of pension benefits earned by the executive directors during the year ended 1 April 2006 are shown below on both bases.

| | Accrued entitlement at 2 April 2005 £000 | Additional pension earned in the year £000 | Additional pension earned in the year in excess of inflation £000 | Transfer value of additional pension in excess of inflation (net of director's contribution) £000 | **Accrued entitlement at 1 April 2006 £000** | **Age at 1 April 2006 or date of leaving** | Transfer value of pension at 2 April 2005 £000 | **Transfer value of pension at 1 April 2006 £000** | Increase in transfer value (net of director's contribution) £000 |
|---|---|---|---|---|---|---|---|---|---|
| Alison Reed | 182 | 15 | 15 | 136 | **197** | **49** | 1,697 | **1,930** | 233 |

The accrued entitlement at 2 April 2005 represents the deferred pension at age 60 to which the director would have been entitled had they left the Company on 2 April 2005. The accrued entitlement at 1 April 2006 or date of leaving represents the deferred pension at age 60 based upon the actual leaving date of 30 April 2005. The additional pension relates to the increase in the deferred pension during the year gross and net of inflation under the Directors' Remuneration Report Regulations 2002, and the Listing Rules respectively.

The transfer value of the deferred pension calculated as at 1 April 2006, or date of leaving, has been calculated at the actual leaving date of 30 April 2005 and is based on factors supplied by the actuary of the relevant Company pension scheme in accordance with Actuarial Guidance Note GN11. The equivalent transfer value calculated as at 2 April 2005 is on the assumption that the director had left service at that date.

Inflation has been assumed to be equivalent to the actual rate of price inflation which was 2.7% for the year to 30 September 2005. The measurement date accords with the Listing Rules. The transfer values are the lump sums which could have been paid to another pension scheme for the benefit of the director. It is not possible for a transfer value to be paid directly to the director personally.

Stuart Rose, Ian Dyson and Steven Sharp do not participate in the Company Pension Scheme.

#### b) Payments to former directors

Details of payments made to former directors during the year are:

| Early retirement pensions[1] (payable until) | **2006 £000** | 2005 £000 |
|---|---|---|
| James Benfield (22 April 2009) | **77** | 75 |
| Derek Hayes (19 November 2008) | **72** | 70 |
| **Unfunded pensions** | | |
| Clinton Silver[2] | **97** | 94 |

[1] Under the Early Retirement Plan, the Remuneration Committee could, at its discretion, offer an unfunded Early Retirement Pension, separate from the Company pension, which was payable from the date of retirement to age 60. With effect from 31 March 2000, the Early Retirement Plan was withdrawn but payments continue for awards made before this date.

[2] The pension scheme entitlement for Clinton Silver is supplemented by an additional, unfunded pension paid by the Company.

Approved by the Board
**Jack Keenan**, Chairman of the Remuneration Committee
London
26 May 2006

# Auditors' report

## INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF MARKS AND SPENCER GROUP PLC

We have audited the group and parent company financial statements (the ''financial statements") of Marks and Spencer Group plc for the year ended 1 April 2006 which comprise the consolidated and Company income statements, the consolidated and Company balance sheets, the consolidated and Company cash flow statements, the consolidated statement of recognised income and expense, the Company statement of changes in shareholders' equity and the related group and parent Company notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, 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.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We report to you whether in our opinion the information given in the Group Directors' Report is consistent with the financial statements. The information in the Group Directors' Report includes that specific information presented in the Corporate Governance Statement that is cross referred from the Directors' Report. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Financial Review, the Group Directors' Report, the Corporate Governance Statement, the unaudited part of the Directors' Remuneration Report, the Group Financial Record and the Shareholder Information. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' Remuneration Report to be audited.

### Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's and the parent Company's affairs as at 1 April 2006 and of the Group's and the parent Company's profit and cash flows for the year then ended;
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

**PricewaterhouseCoopers LLP**

Chartered Accountants and Registered Auditors

London

26 May 2006

# Consolidated income statement

| | Notes | **52 weeks ended 1 April 2006 £m** | 52 weeks ended 2 April 2005 £m |
|---|---|---|---|
| **Revenue** | 2 | **7,797.7** | 7,490.5 |
| **Operating profit** | | | |
| Before exceptional operating charges | | **850.1** | 648.7 |
| Exceptional operating charges | | **–** | (50.6) |
| | 2,3 | **850.1** | 598.1 |
| Interest payable and similar charges | 5 | **(134.9)** | (120.9) |
| Interest receivable | 5 | **30.5** | 27.9 |
| **Profit on ordinary activities before taxation** | | **745.7** | 505.1 |
| Analysed between: | | | |
| Before exceptional operating charges and property disposals | | **751.4** | 556.1 |
| Loss on property disposals | 3 | **(5.7)** | (0.4) |
| Exceptional operating charges | 3 | **–** | (50.6) |
| Income tax expense | 6 | **(225.1)** | (150.1) |
| **Profit on ordinary activities after taxation** | | **520.6** | 355.0 |
| Profit from discontinued operations | 7A | **2.5** | 231.2 |
| **Profit for the year attributable to shareholders** | | **523.1** | 586.2 |
| Earnings per share | 8A | **31.4p** | 29.1p |
| Diluted earnings per share | 8B | **31.1p** | 28.9p |
| Earnings per share from continuing operations | 8A | **31.3p** | 17.6p |
| Diluted earnings per share from continuing operations | 8B | **31.0p** | 17.4p |
| Non-GAAP measure: | | | |
| Adjusted profit before tax (£m) | 1 | **751.4** | 556.1 |
| Adjusted earnings per share | 8A | **31.4p** | 19.2p |
| Adjusted diluted earnings per share | 8B | **31.1p** | 19.0p |

# Consolidated statement of recognised income and expense

| | Notes | **52 weeks ended 1 April 2006 £m** | 52 weeks ended 2 April 2005 £m |
|---|---|---|---|
| **Profit for the year attributable to shareholders** | | **523.1** | 586.2 |
| Exchange differences on translation of foreign operations | | **11.1** | – |
| Actuarial losses on defined benefit pension schemes | | **(169.3)** | (78.1) |
| Tax on items taken directly to equity | | **80.7** | 24.9 |
| Hedging reserve | | | |
| – fair value movement | | **(3.1)** | – |
| – recycled and reported in net profit | | **(1.4)** | – |
| – amount recognised in inventories | | **(3.8)** | – |
| Net losses not recognised in the income statement | | **(85.8)** | (53.2) |
| **Total recognised income and expense for the year** | | **437.3** | 533.0 |
| **Effect of changes in accounting policy:** | | | |
| First time adoption of IAS 39 (net of tax) | 34 | **(1.9)** | |

# Consolidated balance sheet

| | Notes | 2006 £m | 2005 £m |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Intangible assets | 13 | **163.5** | 165.4 |
| Property, plant and equipment | 14 | **3,575.8** | 3,586.2 |
| Investment property | 15 | **38.5** | 38.6 |
| Investments in joint venture | 16 | **9.0** | 8.7 |
| Other financial assets | 17 | **3.3** | 0.3 |
| Trade and other receivables | 18 | **242.8** | 211.2 |
| Deferred income tax assets | 25 | **35.5** | 24.6 |
| | | **4,068.4** | 4,035.0 |
| **Current assets** | | | |
| Inventories | | **374.3** | 338.9 |
| Other financial assets | 17 | **48.8** | 67.0 |
| Trade and other receivables | 18 | **210.5** | 213.8 |
| Derivative financial instruments | 22 | **76.4** | – |
| Cash and cash equivalents | 19 | **362.6** | 212.6 |
| Assets of discontinued operation | 7C | **69.5** | – |
| | | **1,142.1** | 832.3 |
| **Total assets** | | **5,210.5** | 4,867.3 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Trade and other payables | 20 | **867.8** | 717.9 |
| Derivative financial instruments | 22 | **8.0** | – |
| Borrowings | 21 | **1,052.8** | 478.8 |
| Current tax liabilities | | **58.7** | 15.5 |
| Provisions | 24 | **9.2** | 25.2 |
| Liabilities of discontinued operation | 7C | **20.5** | – |
| | | **2,017.0** | 1,237.4 |
| **Non-current liabilities** | | | |
| Borrowings | 21 | **1,133.8** | 1,948.5 |
| Retirement benefit obligations | 11 | **794.9** | 676.0 |
| Other non-current liabilities | 20 | **74.8** | 71.8 |
| Derivative financial instruments | 22 | **9.5** | – |
| Provisions | 24 | **19.1** | 19.7 |
| Deferred income tax liabilities | 25 | **6.1** | 4.7 |
| | | **2,038.2** | 2,720.7 |
| **Total liabilities** | | **4,055.2** | 3,958.1 |
| **Net assets** | | **1,155.3** | 909.2 |
| **EQUITY** | | | |
| Called up share capital – equity | 26,27 | **420.6** | 414.5 |
| Called up share capital – non-equity | 27 | **–** | 65.7 |
| Share premium account | 27 | **162.3** | 106.6 |
| Capital redemption reserve | 27 | **2,113.8** | 2,102.8 |
| Hedging reserve | 27 | **(8.0)** | – |
| Other reserves | 27 | **(6,542.2)** | (6,542.2) |
| Retained earnings | 27 | **5,008.8** | 4,761.8 |
| **Total equity** | | **1,155.3** | 909.2 |

Approved by the Board
26 May 2006

**Stuart Rose**, Chief Executive
**Ian Dyson**, Group Finance Director

# Consolidated cash flow information

## CASH FLOW STATEMENT

| | Notes | 52 weeks ended 1 April 2006 £m | 52 weeks ended 2 April 2005 £m |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Cash generated from operations – continuing | 29A | **1,183.6** | 874.4 |
| Cash generated from operations – discontinued | 29B | **13.9** | 727.4 |
| Tax paid | | **(101.5)** | (166.7) |
| **Net cash inflow from operating activities** | | **1,096.0** | 1,435.1 |
| **Cash flows from investing activities** | | | |
| Acquisition of subsidiary, net of cash acquired | | **–** | (125.9) |
| Disposal of subsidiary, net of cash disposed | | **–** | 477.0 |
| Capital expenditure and financial investment | 29C | **(266.3)** | (113.5) |
| Interest received | | **12.9** | 15.4 |
| **Net cash (outflow)/inflow from investing activities** | | **(253.4)** | 253.0 |
| **Cash flows from financing activities** | | | |
| Interest paid | | **(142.8)** | (116.5) |
| Non-equity dividends paid | | **–** | (2.8) |
| Other debt financing | 29D | **(420.0)** | 757.1 |
| Equity dividends paid | | **(204.1)** | (236.9) |
| Other equity financing | 29E | **55.8** | (2,265.1) |
| **Net cash outflow from financing activities** | | **(711.1)** | (1,864.2) |
| **Net cash inflow/(outflow) from activities** | | **131.5** | (176.1) |
| Effects of exchange rate changes | | **1.6** | 1.1 |
| Opening net cash | | **149.3** | 324.3 |
| **Closing net cash** | 30 | **282.4** | 149.3 |

## RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

| | 52 weeks ended 1 April 2006 £m | 52 weeks ended 2 April 2005 £m |
|---|---|---|
| **Opening net debt** | **(2,147.7)** | (2,043.9) |
| Reclassification on the adoption of IAS 32 and IAS 39 | **(129.5)** | – |
| **Opening net debt – under IFRS** | **(2,277.2)** | (2,043.9) |
| Net cash inflow/(outflow) from activities | **131.5** | (176.1) |
| Cash inflow from decrease in current asset investments | **(1.0)** | (11.0) |
| Cash outflow/(inflow) from decrease/(increase) in debt financing | **420.0** | (757.1) |
| Debt financing net of liquid resources disposed with subsidiary | **–** | 839.7 |
| Exchange and other movements | **(2.6)** | 0.7 |
| **Movement in net debt** | **547.9** | (103.8) |
| **Closing net debt** | **(1,729.3)** | (2,147.7) |

# Notes to the financial statements

## 1 ACCOUNTING POLICIES

### Basis of preparation

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted by the European Union and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS. The disclosures required by IFRS 1 – 'First-time Adoption of International Financial Reporting Standards' concerning the transition from UK GAAP to IFRS are given in notes 33 and 34. The date of transition to IFRS is 4 April 2004.

The impacts of IFRSs issued but not yet effective at the balance sheet date would not have a significant impact on these financial statements.

A summary of the Company's and the Group's accounting policies is given below.

### Accounting convention

The financial statements are drawn up on the historical cost basis of accounting, except as disclosed in the accounting policies set out below.

### Basis of consolidation

The Group financial statements incorporate the financial statements of Marks and Spencer Group plc and all its subsidiaries made up to the year end date. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

Subsidiary undertakings are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. Subsidiary undertakings acquired during the year are recorded using the acquisition method of accounting and their results included from the date of acquisition.

The separable net assets, both tangible and intangible of the newly acquired subsidiary undertakings are incorporated into the financial statements on the basis of the fair value as at the effective date of control.

Results of subsidiary undertakings disposed of during the financial year are included in the financial statements up to the effective date of disposal. Where a business component representing a separate major line of business is disposed of, or classified as held for sale, it is classified as a discontinued operation. The post-tax profit or loss of the discontinued operation is shown as a single amount on the face of the income statement, separate from the other results of the Group.

Intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated.

### First time adoption of International Financial Reporting Standards

IFRS 1 – 'First-time Adoption of International Financial Reporting Standards' sets out the requirements for the first time adoption of IFRS. The Group is required to establish its IFRS accounting policies for the year to 1 April 2006 and, in general, apply these retrospectively to determine the IFRS opening balance sheet at its date of transition, 4 April 2004.

The standard permits a number of optional exemptions to this general principle. The Group has adopted the following approach to the key exemptions:

- business combinations: the Group has chosen not to restate business combinations prior to the transition date;
- fair value or revaluation as deemed cost: the Group has adopted a valuation as deemed cost on transition for freehold land and buildings;
- employee benefits: all cumulative actuarial gains and losses, having been recognised in equity under FRS 17 for UK GAAP purposes, have continued to be recognised in equity at the transition date;
- financial instruments: the Group has taken the exemption not to restate comparatives for IAS 32 – 'Financial Instruments: Disclosure and Presentation' and IAS 39 – 'Financial Instruments: Recognition and Measurement'. Comparative information for 2005 in the 2006 financial statements in respect of these items is presented on a UK GAAP basis as previously reported;
- share-based payments: the Group has not adopted the exemption to apply IFRS 2 – 'Share-Based Payments' only to awards made after 7 November 2002. Instead, a full retrospective approach has been followed on all awards granted but not fully vested at the date of transition to maintain consistency across reporting periods; and
- cumulative translation differences: the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to IFRS.

### Revenue

Revenue comprises sales of goods to customers outside the Group less an appropriate deduction for actual and expected returns, discounts and loyalty scheme voucher costs, and is stated net of Value Added Tax and other sales taxes. Sales of furniture are recorded on delivery.

### Dividends

Dividends are recorded in the financial statements in the period in which they are approved by the Company's shareholders. Interim dividends are recorded in the period in which they are approved and paid.

### Pensions

Funded pension plans are in place for the Group's UK employees and the majority of employees overseas. The assets of these pension plans are managed by third-party investment managers and are held separately in trust.

Regular valuations are prepared by independent professionally qualified actuaries in respect of the defined benefit schemes. These determine the level of contribution required to fund the benefits set out in the rules of the plans and allow for the periodic increase of pensions in payment. The service cost

# Notes to the financial statements continued

## 1 ACCOUNTING POLICIES continued

of providing retirement benefits to employees during the year, together with the cost of any benefits relating to past service, is charged to operating profit in the year.

A credit representing the expected return on the assets of the retirement benefit schemes during the year is included within interest. This is based on the market value of the assets of the schemes at the start of the financial year.

A charge is also made within interest representing the expected increase in the liabilities of the retirement benefits schemes during the year. This arises from the liabilities of the schemes being one year closer to payment.

The difference between the market value of the assets and the present value of accrued pension liabilities is shown as an asset or liability in the balance sheet.

Actuarial gains and losses are recognised immediately in the statement of recognised income and expense.

### Intangible Assets

**A Goodwill**

Goodwill arising on consolidation represents the excess of the cost of acquisitions over the Group's interest in the fair value of the identifiable assets and liabilities (including intangible assets) of the acquired entity at the date of the acquisition. Goodwill is recognised as an asset and assessed for impairment at least annually. Any impairment is recognised immediately in the income statement.

Upon disposal of a subsidiary the attributable goodwill is included in the calculation of the profit or loss arising on disposal. Goodwill written off to reserves under UK GAAP prior to 31 March 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

**B Brands**

Acquired brand values are held on the balance sheet at cost and amortised on a straight-line basis over their estimated useful lives. Any impairment in value is recognised immediately in the income statement.

**C Software intangibles**

Where computer software is not an integral part of a related item of computer hardware, the software is treated as an intangible asset. Capitalised software costs include external direct costs of material and services and the payroll and payroll-related costs for employees who are directly associated with the project.

Capitalised software development costs are amortised on a straight-line basis over their expected economic lives, normally between three to five years.

### Property, Plant and Equipment

**A Land and buildings**

Under UK GAAP property was stated at historical cost, subject to certain properties having been revalued as at 31 March 1988. The property portfolio was revalued as at 2 April 2004. The Group adopted the following values on transition to IFRS:

- freehold land and buildings: the 2004 revaluation was adopted as deemed cost under the exemptions available under IFRS 1;
- leasehold buildings: cost or 1988 revaluations were adopted as deemed cost under the provisions of IFRS 1; and
- leasehold land: any revaluations held against leasehold land were derecognised and the remaining cost included in prepayments.

Given that under IFRS leasehold land cannot be revalued, the 2004 valuation as it related to leasehold properties was not adopted on transition.

The Group's policy is to state property, plant and equipment at cost less accumulated depreciation and not to revalue property for accounting purposes.

**B Interest**

Interest is not capitalised.

**C Depreciation**

Depreciation is provided to write off the cost of tangible non-current assets (including investment properties), less estimated residual values, by equal annual instalments as follows:

- freehold land: not depreciated;
- freehold and leasehold buildings with a remaining lease term over 50 years: depreciated to their residual value over their estimated remaining economic lives;
- leasehold buildings with a remaining lease term of less than 50 years: over the remaining period of the lease;
- fit-out: 10-25 years according to the estimated life of the asset; and
- fixtures, fittings and equipment: 3-15 years according to the estimated life of the asset.

Residual values and useful economic lives are reviewed annually. Depreciation is charged on all additions to, or disposals of, depreciating assets in the year of purchase or disposal. Any impairment in value is charged to the income statement.

**D Assets held under leases**

Where assets are financed by leasing agreements where the risks and rewards are substantially transferred to the Group ('finance leases') the assets are treated as if they had been purchased outright and the corresponding liability to the leasing company is included as an obligation under finance leases. Depreciation on leased assets is charged to the income statement on the same basis as owned assets. Leasing payments are treated as consisting of capital and interest elements and the interest is charged to the income statement.

## 1 ACCOUNTING POLICIES continued

All other leases are 'operating leases' and the costs in respect of operating leases are charged on a straight-line basis over the lease term. The value of any lease incentive received to take on an operating lease (for example, rent free periods) is recognised as deferred income and is released over the life of the lease.

**Investment Properties**
Investment properties are recorded at cost less accumulated depreciation and any recognised impairment loss.

**Leasehold Prepayments**
Payments made to acquire leasehold land are included in prepayments at cost and are amortised over the life of the lease.

**Share-Based Payments**
The Group issues equity settled share-based payments to certain employees. A fair value for the equity settled share awards is measured at the date of grant. The Group measures the fair value using the valuation technique most appropriate to value each class of award, either the Black-Scholes or Monte Carlo method.

The fair value of each award is recognised as an expense over the vesting period on a straight-line basis, after allowing for an estimate of the share awards that will eventually vest. The level of vesting is reviewed annually; and the charge is adjusted to reflect actual and estimated levels of vesting.

**Inventories**
Inventories are valued at the lower of cost and net realisable value using the retail method. All inventories are finished goods.

**Foreign Currencies**
The results of overseas subsidiaries are translated at the weighted average of monthly exchange rates for sales and profits. The balance sheets of overseas subsidiaries are translated at year-end exchange rates. The resulting exchange differences are dealt with through reserves and reported in the consolidated statement of recognised income and expense.

Transactions denominated in foreign currencies are translated at the exchange rate at the date of the transaction. Foreign currency assets and liabilities held at the balance sheet date are translated at the closing balance sheet rate. The resulting exchange gain or loss is dealt with in the income statement.

**Taxation**
The tax charge comprises current tax payable and deferred tax.

The current tax charge represents an estimate of the amounts payable to tax authorities in respect of the Group's taxable profits and is based on an interpretation of existing tax laws.

Deferred tax is recognised on temporary differences between the carrying amount of an asset or liability in the balance sheet and its tax base at tax rates that are expected to apply when the asset is realised or the liability settled, based on tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is not recognised in respect of:

- the initial recognition of goodwill that is not tax deductible; and
- the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction does not affect accounting or taxable profits.

Deferred tax assets are only recognised when it is probable that taxable profits will be available against which the deferred tax asset can be utilised.

Deferred tax liabilities are not provided in respect of undistributed profits of non-UK resident subsidiaries where (i) the Group is able to control the timing of distribution of such profits and (ii) it is not probable that a taxable distribution will be made in the foreseeable future.

**Financial Instruments**
The Group has adopted both IAS 32 – 'Financial Instruments: Disclosure and Presentation' and IAS 39 – 'Financial Instrument: Recognition and Measurement' from 3 April 2005. Under the IFRS 1 transition rules IAS 32 and IAS 39 are not applied to comparative figures.

Financial assets and liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

A **Trade receivables**
Trade receivables are recorded at their nominal amount less an allowance for any doubtful debts.

B **Investments**
Investments are classified as either 'available for sale', 'fair value through profit or loss' or 'held to maturity'. They are initially measured at cost, including transaction costs, with the exception of 'fair value through profit and loss'. Where securities are designated as 'fair value through profit or loss', gains and losses arising from changes in fair value are included in net profit or loss for the period. For 'available for sale' investments, gain or losses arising from changes in fair value are recognised directly in equity, until the security is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period. Equity investments that do not have a quoted market price in an active market and whose fair value can not be reliably measured by other means are held at cost. 'Held to maturity' investments are measured at amortised cost using the effective interest method.

Investments in subsidiaries are held at cost less impairment. Dividends received from the pre-acquisition profits of subsidiaries are deducted from the cost of investment.

C **Financial liability and equity**
Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

# Notes to the financial statements continued

## 1 ACCOUNTING POLICIES continued

**D Non-equity shares**
Under IAS 32, the Group's non-equity B shares in the Group are held as a current liability and the dividend paid is included within the interest charge for the year.

**E Bank borrowings**
Interest-bearing bank loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise.

**F Loan notes**
Long-term loans are held at amortised cost unless the loan is hedged by a derivative financial instrument in which case hedge accounting treatment will apply.

**G Trade payables**
Trade payables are stated at their nominal value.

**H Equity instruments**
Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

**Derivative financial instruments and hedging activities**
The Group primarily uses interest rate swaps and forward foreign currency contracts to manage its exposures to fluctuating interest and foreign exchange rates. These instruments are initially recognised at fair value and are subsequently remeasured at their fair value on the trade date. The method of recognising the resulting gain or loss is dependent on whether the derivative is designated as a hedging instrument and the nature of the item being hedged. The Group designates derivatives as either:

- a hedge of a highly probable forecast transaction or change in the cash flows of a recognised asset or liability (a cash flow hedge); or
- a hedge of the exposure to change in the fair value of a recognised asset or liability (a fair value hedge).

Underlying the definition of fair value is the presumption that the Group is a going concern without any intention of materially curtailing the scale of its operations.

For a majority of the Group's derivative instruments, the fair value will be determined by the Group applying discounted cash flow analysis using quoted market rates as an input into the valuation model.

In determining the fair value of a derivative, the appropriate quoted market price for an asset held is the bid price, and for a liability issued is the offer price.

At inception of a hedging relationship, the hedging instrument and the hedged item are documented and prospective effectiveness testing is performed. During the life of the hedging relationship, effectiveness testing is continued to ensure the instrument remains an effective hedge of the transaction.

In order to qualify for hedge accounting, the following conditions must be met:

- formal designation and documentation at inception of the hedging relationship, detailing the risk management objective and strategy for undertaking the hedge;
- the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk;
- for a cash flow hedge, a forecast transaction that is the subject of the hedge must be highly probable;
- the effectiveness of the hedge can be reliably measured; and
- the hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout its life.

**Derivatives classified as cash flow hedges**
Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and any ineffective portion is recognised immediately in the income statement. If the firm commitment or forecasted transaction that is the subject of a cash flow hedge results in the recognition of an asset or a liability, then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had previously been recognised in equity are included in the initial measurement of the asset or liability. For hedges that do not result in the recognition of an asset or a liability, amounts deferred in equity are recognised in the income statement in the same period in which the hedged items affect net profit or loss.

**Derivatives classified as fair value hedges**
For an effective hedge of an exposure to changes in the fair value, the hedged item is adjusted for changes in fair value attributable to the risk being hedged with the corresponding entry in profit or loss. Gains or losses from remeasuring the derivative, or for non-derivatives the foreign currency component of its carrying amount, are recognised in profit or loss.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement as they arise.

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. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to net profit or loss for the period.

The Group does not use derivatives to hedge balance sheet and profit and loss account translation exposures. Where appropriate, borrowings are arranged in local currencies to provide a natural hedge against overseas assets.

### Critical accounting estimates and judgements
The preparation of consolidated financial statements under

## 1 ACCOUNTING POLICIES continued

IFRS requires the Group to make estimates and assumptions that affect the application of policies and reported amounts. Estimates and judgements are continually evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates. The estimates and assumptions which have a significant risk of causing a material adjustment to the carrying amount of assets and liabilities are discussed below:

**A Impairment of goodwill**
The Group is required to test, at least annually, whether goodwill has suffered any impairment. The recoverable amount is determined based on value in use calculations. The use of this method requires the estimation of future cash flows and the choice of a suitable discount rate in order to calculate the present value of these cash flows. Actual outcomes could vary.

**B Impairment of property, plant and equipment**
Property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate that the carrying amount may not be recoverable. When a review for impairment is conducted, the recoverable amount is determined based on value in use calculations prepared on the basis of management's assumptions and estimates.

**C Depreciation of property, plant and equipment**
Depreciation is provided so as to write down the assets to their residual values over their estimated useful lives as set out above. The selection of these estimated lives requires the exercise of management judgement.

**D Post retirement benefits**
The determination of the pension cost and defined benefit obligation of the Group's defined benefit pension schemes depends on the selection of certain assumptions which include the discount rate, inflation rate, salary growth, mortality and expected return on scheme assets. Differences arising from actual experiences or future changes in assumptions will be reflected in subsequent periods. See note 11 for further details.

**E Refunds and loyalty provisions**
Provisions for sales returns and loyalty scheme redemption are estimated on the basis of historical returns and redemptions and these are recorded so as to allocate them to the same period as the original revenue is recorded. Actual returns and redemptions could vary from these estimates.

### Non-GAAP performance measures

The Directors believe that the 'adjusted' profit and earnings per share measures provide additional useful information for shareholders on underlying performance of the business. These measures are consistent with how business performance is measured internally and with how the Group previously reported under UK GAAP. The adjusted profit before tax measure is not a recognised profit measure under IFRS and may not be directly comparable with 'adjusted' profit measures used by other companies. The adjustments made to reported profit before tax are to exclude the following:

- Exceptional income and charges. These are largely one-off in nature and therefore create volatility in reported earnings; and
- Profits and losses on the disposal of properties. These were previously reported below operating profit under UK GAAP and while they do represent a profit or loss to the business, they can vary significantly from year to year again creating volatility in reported earnings.

### Policies relating to UK GAAP comparatives

**Derivative financial instruments**
The Group uses derivative financial instruments to manage its exposures to fluctuations in foreign currency exchange rates and interest rates. Derivative instruments utilised by the Group include interest rate and currency swaps, and forward currency contracts. Amounts payable or receivable in respect of interest rate swaps are recognised as adjustments to net interest income over the period of the contract. Forward currency contracts are entered into as hedges with the instrument's impact on profit deferred until the underlying transaction is recognised in the profit and loss account.

### Policies relating to discontinued operations in comparatives

**A Loans and advances to customers**
Loans and advances are classified as impaired when an instalment is in excess of 30 days overdue. Specific provisions are made against all advances identified as impaired at the balance sheet date to the extent that, in the opinion of the directors, recovery is doubtful. Specific provisions against such exposures are calculated using a bad debt provision model, which uses the last two years' credit history to produce estimates of the likely level of asset impairment. General provisions relate to latent bad and doubtful debts which are present in any lending portfolio but have not been specifically identified. General provisions are calculated using the same bad debt provision model and an evaluation of current economic and political factors.

Loans and advances are written off when there is no realistic prospect of recovery, based on a predetermined set of criteria. Account balances written off include those where no payment has been received for a period of 12 months since the account was identified as doubtful, and in other situations such as bankruptcy, insolvency or fraud.

**B Long-term assurance business**
The value of the long-term assurance business consists of the present value of surpluses expected to emerge in the future from business currently in force, and this value is included in prepayments and accrued income. In determining their value, these surpluses are discounted at a risk-adjusted, post-tax rate. Changes in the value are included in the income statement grossed up at the standard rate of corporation tax applicable to insurance companies.

# Notes to the financial statements continued

## 2 SEGMENTAL INFORMATION

The Group's primary reporting segments are geographic, with the Group operating in two geographic areas being the UK and International. The geographic segments disclose revenue, operating profit and operating assets and liabilities by destination and reflect management responsibility. Within each geographic segment the Group sells both Food and General Merchandise and secondary segment disclosure is given for revenue. Given that both Food and General Merchandise are sold from the same locations it is not practical to provide segmental information on operating assets and capital expenditure at this level.

The Group's geographical segments are United Kingdom and International Retail. The International segment consists of the Marks & Spencer owned businesses in the Republic of Ireland and Hong Kong, together with franchise operations.

The geographic segment results are as follows:

| | Revenue | | Operating profit | | Operating assets | | Operating liabilities | |
|---|---|---|---|---|---|---|---|---|
| | **2006 £m** | 2005 £m | **2006 £m** | 2005 £m | **2006 £m** | 2005 £m | **2006 £m** | 2005 £m |
| **United Kingdom** | | | | | | | | |
| Before exceptional operating charges | **7,275.0** | 7,034.7 | **784.5** | 588.3 | | | | |
| Exceptional operating charges | **–** | – | **–** | (60.3) | | | | |
| | **7,275.0** | 7,034.7 | **784.5** | 528.0 | **4,431.2** | 4,443.2 | **(1,630.7)** | (1,084.7) |
| **International Retail** | | | | | | | | |
| Before exceptional operating charges | **522.7** | 455.8 | **65.6** | 60.4 | | | | |
| Exceptional operating charges | **–** | – | **–** | 9.7 | | | | |
| | **522.7** | 455.8 | **65.6** | 70.1 | **214.5** | 215.2 | **(81.5)** | (60.0) |
| Total | **7,797.7** | 7,490.5 | **850.1** | 598.1 | **4,645.7** | 4,658.4 | **(1,712.2)** | (1,144.7) |
| Assets/(liabilities) from discontinued operation[1] | | | | | **69.5** | 59.3 | **(20.5)** | (17.1) |
| Total non-operating assets/(liabilities) | | | | | **495.3** | 149.6 | **(2,322.5)** | (2,796.3) |
| **Total assets/(liabilities)** | | | | | **5,210.5** | 4,867.3 | **(4,055.2)** | (3,958.1) |

[1] The assets and liabilities in the comparative period relate only to Kings Super Markets.

Revenue originates in the following geographical segments: United Kingdom £7,473.3m (last year £7,208.9m) and International £324.4m (last year £281.6m). The value of goods exported from the UK, including shipments to international subsidiaries, amounted to £367.6m (last year £319.9m).

The Group completed the sale of Marks and Spencer Retail Financial Services Holdings Limited to HSBC Holdings plc on 9 November 2004. At the same time, the Group and HSBC entered into a relationship under which the Group continues to share in the success of the business. Under this relationship, the Group receives income in the form of fees representing an amount equivalent to costs incurred, 50% of the profits of M&S Money (after a notional tax charge and after deducting agreed operating and capital costs) together with an amount relating to sales growth. In the current year, a net operating profit of £9.6m has been recorded and is included within the results for UK Retail.

Other segment items:

| | | | **2006** | | | 2005 |
|---|---|---|---|---|---|---|
| | **United Kingdom £m** | **International £m** | **Total £m** | United Kingdom £m | International £m | Total £m |
| **Revenue** | | | | | | |
| General Merchandise | **3,644.4** | **366.0** | **4,010.4** | 3,641.6 | 331.1 | 3,972.7 |
| Food | **3,630.6** | **156.7** | **3,787.3** | 3,393.1 | 124.7 | 3,517.8 |
| | **7,275.0** | **522.7** | **7,797.7** | 7,034.7 | 455.8 | 7,490.5 |
| Expenditure on property, plant and equipment | **307.3** | **14.1** | **321.4** | 184.0 | 29.9 | 213.9 |
| Expenditure on intangible assets | **10.7** | **0.2** | **10.9** | 159.6 | – | 159.6 |
| Depreciation | **252.5** | **8.8** | **261.3** | 253.3 | 5.4 | 258.7 |
| Amortisation | **12.7** | **–** | **12.7** | 11.4 | – | 11.4 |

## 3 EXPENSE ANALYSIS

| | 2006 | | | 2005 | | |
|---|---|---|---|---|---|---|
| | **Before exceptional items £m** | **Exceptional items £m** | **Total £m** | Before exceptional items £m | Exceptional items £m | Total £m |
| **Revenue** | **7,797.7** | **–** | **7,797.7** | 7,490.5 | – | 7,490.5 |
| Cost of sales | **(4,812.1)** | **–** | **(4,812.1)** | (4,884.3) | (3.3) | (4,887.6) |
| **Gross profit** | **2,985.6** | **–** | **2,985.6** | 2,606.2 | (3.3) | 2,602.9 |
| Selling and marketing expenses | **(1,625.7)** | **–** | **(1,625.7)** | (1,493.0) | (26.0) | (1,519.0) |
| Administrative expenses | **(522.7)** | **–** | **(522.7)** | (476.8) | (52.4) | (529.2) |
| Other operating income | **18.6** | **–** | **18.6** | 12.7 | – | 12.7 |
| Loss on property disposals | **(5.7)** | **–** | **(5.7)** | (0.4) | 31.1 | 30.7 |
| **Operating profit after exceptional items** | **850.1** | **–** | **850.1** | 648.7 | (50.6) | 598.1 |

The pre-exceptional selling and marketing expenses and administrative expenses in the table above are further analysed in the table below:

| | **Selling and marketing expenses £m** | **Admini-strative expenses £m** | **Total £m** | Selling and marketing expenses £m | Admini-strative expenses £m | Total £m |
|---|---|---|---|---|---|---|
| Employee costs (see note 10A) | **844.9** | **228.3** | **1,073.2** | 773.6 | 195.8 | 969.4 |
| Occupancy costs | **276.2** | **49.2** | **325.4** | 265.8 | 42.5 | 308.3 |
| Repairs, renewals and maintenance of property | **73.0** | **17.2** | **90.2** | 60.9 | 12.9 | 73.8 |
| Depreciation and amortisation | **243.5** | **30.5** | **274.0** | 226.0 | 29.0 | 255.0 |
| Other costs | **188.1** | **197.5** | **385.6** | 166.7 | 196.6 | 363.3 |
| **Operating expenses before exceptional items** | **1,625.7** | **522.7** | **2,148.4** | 1,493.0 | 476.8 | 1,969.8 |

Exceptional items are comprised of:

| | **2006 £m** | 2005 £m |
|---|---|---|
| Head office relocation | **–** | (8.8) |
| Head office change programme | **–** | (6.3) |
| Board restructure | **–** | (8.4) |
| Closure of Lifestore | **–** | (29.3) |
| Defence costs | **–** | (38.6) |
| Sale of head office premises | **–** | 31.1 |
| Release of provision held against European closure | **–** | 9.7 |
| **Exceptional items** | **–** | (50.6) |

# Notes to the financial statements continued

## 4 PROFIT BEFORE TAXATION

| | 2006 £m | 2005 £m |
|---|---|---|
| The following items have been included in arriving at profit before taxation: | | |
| Depreciation of property, plant, and equipment: | | |
| – Owned assets | **259.2** | 256.6 |
| – Under finance leases | **2.1** | 2.1 |
| Amortisation of intangibles (included in administrative expenses) | **12.7** | 11.4 |
| Loss/(profit) on property disposals | **5.7** | (30.7) |
| Operating lease rentals payable | | |
| – Property | **127.1** | 135.7 |
| – Fixtures, fittings and equipment | **8.5** | 7.5 |

Included in administrative expenses is the auditors' remuneration, including expenses for audit and non-audit services, as follows:

| | 2006 £m | 2005 £m |
|---|---|---|
| **Statutory audit services** | | |
| Annual audit | **1.1** | 1.2 |
| **Non-audit related services** | | |
| Further assurance services | **–** | 0.3 |
| Corporate finance transactions | **–** | 1.8 |
| Tax advisory services | **0.3** | 0.2 |
| Other services | **0.2** | 0.2 |
| | **0.5** | 2.5 |

Included in the comparatives for Corporate finance transactions are fees paid to the Group's auditors in the UK in relation to the provision of assurance services relating to the Tender Offer of £0.4m, the sale of Financial Services of £0.5m, the acquisition of per una of £0.1m and Defence of £0.8m.

## 5 FINANCE COSTS

| | 2006 £m | 2005 £m |
|---|---|---|
| **Interest payable:** | | |
| Interest payable on bank borrowings | **4.2** | 43.3 |
| Amortisation of issue costs of bank loan | **2.3** | 1.5 |
| Interest payable on syndicated bank facility | **7.7** | 7.8 |
| Interest payable on medium term notes | **96.2** | 110.8 |
| Interest payable on securitised loan notes | **20.3** | 20.2 |
| Interest payable on finance leases | **2.3** | 2.3 |
| Dividend on non-equity B shares | **2.3** | – |
| | **135.3** | 185.9 |
| Less: amounts included in profit from discontinued operations[1] | **(0.4)** | (65.0) |
| **Interest payable and similar charges** | **134.9** | 120.9 |
| **Interest receivable:** | | |
| Bank and other interest receivable | **13.4** | 169.9 |
| Pension finance income (net) (see note 11E) | **17.5** | 11.4 |
| Fair value hedges[2] | **0.2** | – |
| | **31.1** | 181.3 |
| Less: amounts included in profit from discontinued operations[1] | **(0.6)** | (153.4) |
| **Interest receivable** | **30.5** | 27.9 |
| **Net finance costs** | **104.4** | 93.0 |

[1] Interest payable and receivable last year of £64.6m and £153.2m respectively relate to Financial Services. These were included within cost of sales and turnover respectively and are therefore excluded from net interest within note 7.

[2] Represents a fair value gain on hedging instruments of £67.2m and a corresponding fair value loss on underlying medium term notes of £67.0m, which have been designated into a hedging relationship.

Where applicable, interest payable amounts are shown net of their assigned interest rate derivative. The fair values of these derivatives have been reported as a net figure under interest income.

## 6 INCOME TAX EXPENSE

### A Taxation charge

| | 2006 £m | 2005 £m |
|---|---|---|
| Current tax | | |
| UK corporation tax at 30% (last year 30%) | | |
| – current year | **150.3** | 115.7 |
| – prior years | **(2.0)** | (17.5) |
| | **148.3** | 98.2 |
| Overseas current taxation | **5.3** | 5.5 |
| Total current taxation | **153.6** | 103.7 |
| Deferred tax (note 25) | | |
| – current year | **71.8** | 36.0 |
| – prior years | **(0.3)** | 10.4 |
| Total deferred taxation | **71.5** | 46.4 |
| | **225.1** | 150.1 |

# Notes to the financial statements continued

## 6 INCOME TAX EXPENSE continued

### B Taxation reconciliation

| | 2006 £m | 2005 £m |
|---|---|---|
| Profit before tax | **745.7** | 505.1 |
| Taxation at the standard UK corporation tax rate of 30% (last year 30%) | **223.7** | 151.5 |
| Depreciation and charges on non-qualifying fixed assets | **10.2** | 10.8 |
| Share schemes | **–** | (4.9) |
| Other income and expenses not taxable or deductible | **(2.7)** | 10.8 |
| Overseas profits taxed at lower rates | **(3.8)** | (7.3) |
| Exceptional items | **–** | (3.7) |
| Adjustments to tax charge in respect of prior periods | **(2.3)** | (7.1) |
| Total taxation charge | **225.1** | 150.1 |

The effective tax rate was 30.2% (last year 29.7%). Included in the tax charge for last year is a credit of £19.1m which is attributable to exceptional operating charges.

## 7 DISCONTINUED OPERATIONS

On 31 March 2006, the Group announced the sale of Kings Super Markets Inc to a US investor group for $61.5m excluding cash in the business at the date of disposal.

The profit after tax in the current year is entirely attributable to Kings Super Markets Inc (last year £3.9m). The balance of profit after tax last year, together with the net gain on disposal is entirely attributable to the sale of Marks and Spencer Retail Financial Services Holdings to HSBC Holdings plc completed on 9 November 2004.

### A Profit from discontinued operations

| | 2006 £m | 2005 £m |
|---|---|---|
| Revenue | **228.2** | 451.8 |
| Cost of sales | **(144.7)** | (235.7) |
| Gross profit | **83.5** | 216.1 |
| Net operating expenses | **(80.5)** | (180.4) |
| Net interest receivable/(payable) | **0.2** | (0.2) |
| Profit before tax | **3.2** | 35.5 |
| Taxation on results | **(0.7)** | (2.4) |
| Profit after tax | **2.5** | 33.1 |
| Gain on disposal of subsidiary net assets | **–** | 199.0 |
| Taxation | **–** | (0.9) |
| Net gain on disposal | **–** | 198.1 |
| **Profit from discontinued operations** | **2.5** | 231.2 |

### B Expenditure, depreciation and amortisation

The following items have been excluded from the segmental disclosures in note 2.

| | 2006 £m | 2005 £m |
|---|---|---|
| Expenditure on property, plant and equipment | **5.4** | 4.6 |
| Expenditure on intangible assets | **–** | 0.8 |
| Depreciation | **6.3** | 7.8 |
| Amortisation | **–** | 1.9 |

## 7 DISCONTINUED OPERATIONS continued

Analysed below are the net assets of Kings Super Markets Inc as at 1 April 2006:

### C Net assets of discontinued operations

| | 2006 £m |
|---|---|
| Fixed assets | 33.8 |
| Trade and other receivables | 2.8 |
| Inventories | 9.2 |
| Cash and cash equivalents | 4.8 |
| Other financial assets | 18.9 |
| Assets held in discontinued operation | **69.5** |
| Liabilities of discontinued operation[1] | **(20.5)** |
| Net assets of discontinued operation | **49.0** |

[1] Includes £2.0m of finance leases included within financial liabilities of discontinued operations.

## 8 EARNINGS PER SHARE

The calculation of earnings per ordinary share is based on earnings after tax (last year earnings after tax and non-equity dividends), and the weighted average number of ordinary shares in issue during the year.

The adjusted earnings per share figures have been calculated in addition to the earnings per share required by IAS 33 – 'Earnings per Share' and is based on earnings excluding the effect of exceptional items and asset disposals. These have been calculated to allow the shareholders to gain an understanding of the underlying trading performance of the Group.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Group has only one class of dilutive potential ordinary shares being those share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the year.

Details of the adjusted earnings per share are set out below:

| | 2006 £m | 2005 £m |
|---|---|---|
| **Earnings after tax and non-equity dividends** | **523.1** | 583.4 |
| Profit from discontinued operations | **(2.5)** | (231.2) |
| **Earnings after tax and non-equity dividends – continuing** | **520.6** | 352.2 |
| Exceptional operating charges and asset disposals (net of taxation) | **2.0** | 31.5 |
| **Adjusted earnings after tax and non-equity dividends – continuing** | **522.6** | 383.7 |
| Weighted average number of ordinary shares in issue (millions) | **1,667.0** | 2,006.2 |
| Potentially dilutive share options under Group's share option schemes (millions) | **14.5** | 12.1 |
| | **1,681.5** | 2,018.3 |

### A Basic earnings per share

| | 2006 | 2005 |
|---|---|---|
| Weighted average number of ordinary shares in issue (millions) | **1,667.0** | 2,006.2 |
| **Basic earnings per share (pence)** | **31.4** | 29.1 |
| Profit from discontinued operations per share (pence) | **(0.1)** | (11.5) |
| **Basic earnings per share – continuing (pence)** | **31.3** | 17.6 |
| Exceptional operating charges and asset disposals per share (pence) | **0.1** | 1.6 |
| **Adjusted basic earnings per share – continuing (pence)** | **31.4** | 19.2 |

# Notes to the financial statements continued

## 8 EARNINGS PER SHARE continued

### B Diluted earnings per share

| | 2006 | 2005 |
|---|---|---|
| Weighted average number of ordinary shares in issue (millions) | 1,681.5 | 2,018.3 |
| **Diluted earnings per share (pence)** | 31.1 | 28.9 |
| Profit from discontinued operations per share (pence) | (0.1) | (11.5) |
| **Diluted earnings per share – continuing (pence)** | 31.0 | 17.4 |
| Exceptional operating charges and asset disposals per share (pence) | 0.1 | 1.6 |
| **Diluted adjusted basic earnings per share – continuing (pence)** | 31.1 | 19.0 |

## 9 DIVIDENDS

| | 2006 per share | 2005 per share | 2006 £m | 2005 £m |
|---|---|---|---|---|
| **Dividends on equity ordinary shares:** | | | | |
| Paid final dividend | 7.5p | 7.1p | 124.3 | 161.3 |
| Paid interim dividend | 4.8p | 4.6p | 79.8 | 75.6 |
| | 12.3p | 11.7p | 204.1 | 236.9 |
| **Dividends on non-equity B shares:**[1] | | | | |
| Interim dividend | – | 3.36% | – | 1.4 |
| Final dividend | – | 3.78% | – | 1.4 |
| | | | – | 2.8 |
| | | | 204.1 | 239.7 |

[1] Under IAS 32 – 'Financial Instruments' dividends on non-equity shares are now treated as part of interest (see note 5).

In addition the directors have proposed a final dividend in respect of the financial year ended 1 April 2006 of 9.2p per share amounting to a dividend of £154.8m. It will be paid on 14 July 2006 to shareholders who are on the Register of Members on 2 June 2006. In line with the requirements of IAS 10 – 'Events after the Balance Sheet Date', this dividend has not been recognised within these results.

## 10 EMPLOYEES

### A Aggregate remuneration

The aggregate remuneration and associated costs of Group employees were:

| | 2006 | | | 2005 | | |
|---|---|---|---|---|---|---|
| | Continuing operations £m | Discontinued operations £m | Total £m | Continuing operations[1] £m | Discontinued operations £m | Total £m |
| Wages and salaries | 856.3 | 36.2 | 892.5 | 781.3 | 61.8 | 843.1 |
| Social security costs | 64.3 | 3.3 | 67.6 | 52.6 | 5.2 | 57.8 |
| Other pension costs | 96.9 | 1.3 | 98.2 | 99.8 | 3.4 | 103.2 |
| Share-based payments | 24.7 | – | 24.7 | 22.2 | – | 22.2 |
| Employee welfare and other personnel costs | 33.1 | 2.3 | 35.4 | 22.7 | 10.8 | 33.5 |
| Capitalised staffing costs | (2.1) | – | (2.1) | (2.0) | – | (2.0) |
| | 1,073.2 | 43.1 | 1,116.3 | 976.6 | 81.2 | 1,057.8 |

[1] Includes exceptional operating charges of £7.2m.

Details of key management compensation is given in note 32E.

## 10 EMPLOYEES continued

### B Average number of employees

| | 2006 | 2005 |
|---|---|---|
| **UK stores** | | |
| Management and supervisory categories | **4,601** | 4,863 |
| Other | **57,687** | 56,269 |
| **UK head office** | | |
| Management and supervisory categories | **2,325** | 2,537 |
| Other | **732** | 968 |
| Overseas | **2,959** | 2,110 |
| Discontinued operations | **2,006** | 3,803 |
| | **70,310** | 70,550 |

If the number of hours worked was converted on the basis of a normal working week, the equivalent average number of full-time employees for continuing operations would have been 46,989 (last year 45,297) and for discontinued operations 1,592 (last year 3,005).

### C Directors' emoluments

Emoluments of directors of the Company are summarised below. Further details are given in the Remuneration report on pages 40 to 48.

| | 2006 £000 | 2005 £000 |
|---|---|---|
| Aggregate emoluments | **4,249** | 6,016 |
| Termination payments | **622** | 3,651 |

## 11 RETIREMENT BENEFITS

The Group provides pension arrangements for the benefit of its UK employees through the Marks & Spencer UK Pension Scheme. This has a defined benefit section, which was closed to new entrants with effect from 1 April 2002, and a defined contribution section which has been open to new members with effect from 1 April 2003.

The defined benefit section operates on a Final Salary basis and at the year end had some 31,000 active members (last year 35,000), 57,000 deferred members (last year 56,000) and 38,000 pensioners (last year 36,000). At the year end, the defined contribution section had some 5,000 active members (last year 4,000).

The Group also operates small defined benefit pension schemes in the Republic of Ireland and at Kings Super Markets in the USA. Retirement benefits also include a UK post-retirement healthcare scheme and unfunded pension plans.

Within the total Group retirement benefit cost of £80.7m (last year £84.8m), £69.1m (last year £74.0m) relates to the UK defined benefit section, £5.6m (last year £4.6m) to the UK defined contribution section and £6.0m (last year £6.2m) to other retirement benefit schemes.

The Group's accounting policy for recognising actuarial gains and losses is to recognise these immediately through the statement of recognised income and expense.

### A Pensions and other post-retirement liabilities

| | 2006 £m | 2005 £m |
|---|---|---|
| Total market value of assets | **4,606.2** | 3,956.8 |
| Present value of scheme liabilities | **(5,381.3)** | (4,611.0) |
| Pension scheme deficit | **(775.1)** | (654.2) |
| Unfunded pension plans | **(1.7)** | (2.5) |
| Post-retirement healthcare | **(18.1)** | (19.3) |
| Retirement benefit obligations | **(794.9)** | (676.0) |

# Notes to the financial statements continued

## 11 RETIREMENT BENEFITS continued

### B Financial assumptions

A full actuarial valuation of the UK defined benefit pension scheme was carried out at 31 March 2003 and showed a deficit of £585m. The financial assumptions for the UK scheme and the most recent actuarial valuations of the other post-retirement schemes have been updated by independent qualified actuaries to take account of the requirements of IAS 19 in order to assess the liabilities of the schemes at 1 April 2006:

| | **2006 %** | 2005 % |
|---|---|---|
| Rate of increase in salaries | **3.7** | 3.7 |
| Rate of increase in pensions in payment for service: | | |
| – pre April 1997 | **2.4** | 2.5 |
| – between April 1997 and July 2005 | **2.9** | 2.9 |
| – post July 2005 | **2.1** | 2.4 |
| Discount rate | **4.9** | 5.5 |
| Inflation rate | **2.9** | 2.9 |
| Long-term healthcare cost increases | **7.9** | 7.9 |

### C Demographic assumptions

The demographic assumptions are in line with those adopted for the last formal actuarial valuation of the Scheme. One of the most significant demographic assumptions underlying the valuation is mortality. The post-retirement mortality assumptions are based on an analysis of the pensioner mortality trends under the Scheme for the period to 2003 updated to allow for anticipated longevity improvements over the subsequent three years. The specific mortality rates used are based on the PMA92 and PFA92 tables, adjusted to allow for the experience of scheme pensioners. The life expectancies underlying the valuation are as follows:

| | **2006 Years** | 2005 Years |
|---|---|---|
| Current pensioners (at age 65) – males | **18.8** | 18.6 |
| Current pensioners (at age 65) – females | **22.6** | 22.4 |
| Future pensioners (at age 65) – males | **19.8** | 19.6 |
| Future pensioners (at age 65) – females | **23.6** | 23.4 |

The next funding valuation for the UK Scheme is due to be carried out as at 31 March 2006, when the mortality trends under the Scheme will be reviewed and the demographic assumptions updated if appropriate.

### D Analysis of assets and expected rates of return

The major categories of assets as a percentage of total plan assets are:

| | **2006 %** | 2005 % |
|---|---|---|
| UK equities | **17** | 26 |
| Overseas equities | **30** | 27 |
| Government bonds | **16** | 31 |
| Corporate bonds (Triple B or above) | **27** | 13 |
| Other | **10** | 3 |
| | **100** | 100 |

The expected long-term rates of return at 1 April 2006 were:

| | **2006 %** | 2005 % |
|---|---|---|
| UK equities | **8.0** | 8.1 |
| Overseas equities | **8.0** | 8.4 |
| Government bonds | **4.3** | 4.8 |
| Corporate bonds (Triple B or above) | **4.9** | 5.5 |
| Other | **4.5** | 3.8 |
| | **6.2** | 6.7 |

## 11 RETIREMENT BENEFITS continued

The overall expected return on assets assumption is derived as the weighted average of the expected returns from each of the main asset classes. The expected return for each asset class reflects a combination of historical performance analysis, the forward looking views of financial markets (as suggested by the yields available) and the views of investment organisations. Consideration is also given to the rate of return expected to be available for reinvestment.

As at 1 April 2006 the UK scheme indirectly held 394,672 (last year 746,868) ordinary shares in Marks and Spencer Group plc through its investment in an Aquila Life UK Equity Index Fund.

### E Analysis of amount charged against profits

| | 2006 £m | 2005 £m |
|---|---|---|
| **Operating cost** | | |
| Current service cost[1] | **109.9** | 113.8 |
| Curtailment gain | **(13.0)** | (14.0) |
| | **96.9** | 99.8 |
| **Finance cost** | | |
| Expected return on plan assets | **(265.5)** | (248.3) |
| Interest on scheme liabilities | **248.0** | 236.9 |
| Net finance income | **(17.5)** | (11.4) |
| **Discontinued operations** | | |
| Service cost and finance income of discontinued operation | **1.3** | 3.4 |
| Curtailment gain on disposal of Financial Services | **–** | (7.0) |
| Total cost of retirement benefits | **80.7** | 84.8 |

[1] Includes defined contributions of £6.3m (last year £6.5m).

### F Scheme assets

Changes in the fair value of the scheme assets are as follows:

| | 2006 £m | 2005 £m |
|---|---|---|
| Fair value of scheme assets at start of year | **3,956.8** | 3,634.2 |
| Expected return on scheme assets[1,2] | **265.9** | 248.9 |
| Employer contributions[3,4] | **130.2** | 156.4 |
| Benefits paid | **(164.2)** | (160.1) |
| Transfer on disposal of Financial Services | **(32.0)** | – |
| Actuarial gain | **454.3** | 77.4 |
| Exchange | **1.4** | – |
| Discontinued operation | **(6.2)** | – |
| Fair value of scheme assets at end of year | **4,606.2** | 3,956.8 |

[1] The expected return on scheme assets includes £0.4m (last year £0.6m) in respect of discontinued operations.

[2] The actual return on scheme assets was £720.2m (last year £325.7m).

[3] The cash contribution for 2005/06 includes an additional contribution of £51m paid into the UK defined benefit pension scheme in April 2005 (last year an additional contribution of £64m was paid in March 2005).

[4] Future contributions to the UK scheme will be made at the rate of 15.8% of pensionable salaries up to the next full actuarial valuation. The Group expects to contribute £60m to defined benefit schemes for the year ended 31 March 2007.

# Notes to the financial statements continued

## 11 RETIREMENT BENEFITS continued

### G Retirement benefit obligations

Changes in the present value of retirement benefit obligations are as follows:

| | 2006 £m | 2005 £m |
|---|---|---|
| Present value of obligation at start of year | **4,632.8** | 4,303.7 |
| Current service cost | **111.2** | 117.2 |
| Curtailment gain | **(13.0)** | (21.0) |
| Interest cost[1] | **248.4** | 237.5 |
| Benefits paid | **(164.2)** | (160.1) |
| Transfer on disposal of Financial Services | **(32.0)** | – |
| Actuarial loss | **623.6** | 155.5 |
| Exchange | **1.3** | – |
| Discontinued operation | **(7.0)** | – |
| Present value of obligation at end of year | **5,401.1** | 4,632.8 |
| Analysed as: | | |
| Present value of pension scheme liabilities | **5,381.3** | 4,611.0 |
| Unfunded pension plans | **1.7** | 2.5 |
| Post-retirement healthcare | **18.1** | 19.3 |
| Present value of obligation at end of year | **5,401.1** | 4,632.8 |

[1] Interest cost includes £0.4m (last year £0.6m) in respect of discontinued operations.

### H Cumulative actuarial gains and losses recognised in equity

| | 2006 £m | 2005 £m |
|---|---|---|
| Loss at start of year | **(757.7)** | (679.6) |
| Net actuarial losses recognised in the year | **(169.3)** | (78.1) |
| Loss at end of year | **(927.0)** | (757.7) |

### I History of experience gains and losses

| | 2006 £m | 2005 £m | 2004 £m | 2003 £m |
|---|---|---|---|---|
| Experience adjustments arising on scheme assets | **454.3** | 77.4 | 401.9 | (713.3) |
| Experience gains/(losses) arising on scheme liabilities | **20.0** | (24.0) | (30.3) | 16.0 |
| Changes in assumptions underlying the present value of scheme liabilities | **(643.6)** | (131.5) | (157.8) | (196.1) |
| Actuarial (losses)/gains recognised in equity | **(169.3)** | (78.1) | 213.8 | (893.4) |
| Fair value of scheme assets | **4,606.2** | 3,956.8 | 3,634.2 | 2,638.5 |
| Present value of scheme liabilities | **(5,381.3)** | (4,611.0) | (4,280.1) | (3,888.1) |
| Pension scheme deficit | **(775.1)** | (654.2) | (645.9) | (1,249.6) |

## 12 SHARE-BASED PAYMENTS

The charge for share-based payments under IFRS arises across the following schemes:

| | Notes | 2006 £m | 2005 £m |
|---|---|---|---|
| Save As You Earn Share Option Scheme | 12A | **10.2** | 10.8 |
| Executive Share Option Scheme | 12B | **6.5** | 8.7 |
| Performance Share Plan | 12C | **2.5** | – |
| Deferred Bonus Plan | 12D | **2.0** | – |
| Restricted Share Plan | 12E | **1.8** | 0.8 |
| Executive Share Matching Plan | 12F | **0.4** | 0.6 |
| Share Incentive Plan | 12G | **1.3** | 1.3 |
| | | **24.7** | 22.2 |

Details of the option and share schemes that the Group operates are provided in the Remuneration report on pages 40 to 48.

### A Save As You Earn Share Option Scheme

Under the terms of the Scheme, the Board may offer options to purchase ordinary shares in the Company once in each financial year to those employees who enter into an Inland Revenue approved Save As You Earn (SAYE) savings contract. Inland Revenue rules limit the maximum amount saved to £250 per month. The price at which options may be offered is 80% of the market price for three consecutive dealing days preceding the offer date. The options may normally be exercised during the period of six months after the completion of the SAYE contract, either three, five or seven years after entering the Scheme.

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | **Number of options** | **Weighted average exercise price** | Number of options | Weighted average exercise price |
| Outstanding at beginning of the period | **52,188,263** | **235.0p** | 64,873,219 | 234.4p |
| Granted | **8,528,770** | **349.0p** | 8,241,836 | 280.0p |
| Exercised | **(14,658,839)** | **206.9p** | (11,329,689) | 225.2p |
| Forfeited | **(4,270,037)** | **253.6p** | (6,474,910) | 252.5p |
| Expired | **(1,384,532)** | **397.7p** | (3,122,193) | 339.4p |
| Outstanding at end of the period | **40,403,625** | **261.6p** | 52,188,263 | 235.0p |
| Exercisable at end of period | **3,897,065** | **226.7p** | 2,476,297 | 220.5p |

For SAYE share options exercised during the period, the weighted average share price at the date of exercise was 472.5p (last year 345.5p).

The fair values of the options granted during the year have been calculated using the Black-Scholes model assuming the inputs shown below:

| | 2006 | | 2005 | |
|---|---|---|---|---|
| | **3 year plan** | **5 year plan** | 3 year plan | 5 year plan |
| Grant date | **Nov 05** | **Nov 05** | Nov 04 | Nov 04 |
| Share price at grant date | **436p** | **436p** | 350p | 350p |
| Exercise price | **349p** | **349p** | 280p | 280p |
| Option life in years | **3 years** | **5 years** | 3 years | 5 years |
| Risk free rate | **4.3%** | **4.2%** | 4.6% | 4.6% |
| Expected volatility | **25.8%** | **29.8%** | 31.3% | 37.3% |
| Expected dividend yield | **2.7%** | **2.7%** | 3.3% | 3.3% |
| Fair value of option | **120.6p** | **143.6p** | 103.0p | 125.7p |

Volatility has been estimated by taking the historic volatility in the Company's share price over a three or five-year period.

The resulting fair value is expensed over the service period of three or five years on the assumption that 15% of three-year options and 20% of five-year options will lapse over the service period as employees leave the Company.

# Notes to the financial statements continued

## 12 SHARE-BASED PAYMENTS continued

Outstanding options granted under the United Kingdom Employees' Save As You Earn Option Scheme are as follows:

| | Number of options | | Weighted average remaining contractual life (years) | | |
|---|---|---|---|---|---|
| Options granted | **2006** | 2005 | **2006** | 2005 | Option price |
| January 1998 | **Expired** | 1,038,090 | **–** | 0.2 | 467p |
| January 1999 | **164,580** | 1,594,114 | **0.3** | 1.2 | 324p |
| January 2000 | **3,295,357** | 4,398,817 | **1.3** | 1.9 | 223p |
| January 2001 | **4,485,640** | 13,572,339 | **2.1** | 1.9 | 156p |
| January 2002 | **3,775,553** | 4,702,766 | **1.3** | 2.1 | 250p |
| January 2003 | **3,923,986** | 7,988,919 | **2.1** | 2.3 | 283p |
| January 2004 | **9,238,136** | 10,812,290 | **2.2** | 3.2 | 228p |
| January 2005 | **7,199,193** | 8,080,928 | **3.3** | 4.2 | 280p |
| January 2006 | **8,321,180** | – | **4.1** | – | 349p |
| | **40,403,625** | 52,188,263 | **2.6** | 2.6 | 262p |

### B Executive Share Option Scheme

Under the terms of the Executive Share Option Scheme, approved by shareholders in 2005, the Board may offer options to purchase ordinary shares in the Company to executive directors and senior employees at the market price on a date to be determined prior to the date of the offer. No further options may be granted under any schemes other than the 2005 scheme. No awards have been made under the 2005 scheme. Further details are set out in the Remuneration report on page 42.

Performance targets are assessed over a three-year period from the date of grant with no ability to re-test any grants. Once options have vested they can be exercised during the period up to ten years from grant date.

| | **2006** | | 2005 | |
|---|---|---|---|---|
| | **Number of options** | **Weighted average exercise price** | Number of options | Weighted average exercise price |
| Outstanding at beginning of the period | **31,690,916** | **335.2p** | 47,165,764 | 308.9p |
| Granted | **1,491,046** | **352.0p** | 12,709,897 | 346.3p |
| Exercised | **(9,683,033)** | **324.8p** | (16,979,635) | 252.9p |
| Forfeited | **(4,338,398)** | **352.2p** | (8,867,917) | 333.3p |
| Expired | **(1,025,065)** | **414.0p** | (2,337,193) | 469.8p |
| Outstanding at end of the period | **18,135,466** | **333.5p** | 31,690,916 | 335.2p |
| Exercisable at end of period | **2,841,565** | **374.4p** | 7,005,133 | 355.2p |

For executive share options exercised during the period, the weighted average share price at the date of exercise was 423.4p (last year 358.8p).

## 12 SHARE-BASED PAYMENTS continued

The fair value of executive share options granted during the year is calculated based on a Black-Scholes model assuming the inputs shown below:

| | **2006** | 2005 | 2005 |
|---|---|---|---|
| Grant date | **Jun 05** | Nov 04 | Jul 04 |
| Share price at grant date | **352p** | 337p | 347p |
| Exercise price | **352p** | 337p | 347p |
| Expected life | **5 years** | 5 years | 5 years |
| Contractual life | **10 years** | 10 years | 10 years |
| Risk free rate | **4.2%** | 4.6% | 5.0% |
| Expected volatility | **31.9%** | 37.3% | 38.7% |
| Expected dividend yield | **3.4%** | 3.3% | 3.3% |
| Fair value of option | **87.0p** | 98.8p | 106.8p |

Volatility has been estimated by taking the historic volatility in the Company's share price over a five-year period to match the expected option life.

The resulting fair value is expensed over the five-year service period on the assumption that 30% of options will lapse over the service period as employees leave the Company.

Outstanding options granted under all executive share option schemes are as follows:

| | Number of options | | Weighted average remaining contractual life (years) | | |
|---|---|---|---|---|---|
| Options granted | **2006** | 2005 | **2006** | 2005 | Option price |
| **(1984 Scheme)** | | | | | |
| May 1995 | **–** | 1,025,065 | **–** | 0.1 | 414p |
| May 1996 | **13,100** | 39,376 | **0.1** | 1.1 | 458p |
| November 1996 | **–** | 6,172 | **–** | 1.6 | 486p |
| June 1997 | **5,692** | 11,384 | **1.2** | 2.2 | 527p |
| **(1997 Scheme)** | | | | | |
| June 1998 | **486,551** | 847,693 | **2.2** | 3.2 | 557p |
| November 1998 | **7,425** | 41,088 | **2.6** | 3.6 | 404p |
| June 1999 | **217,279** | 1,015,906 | **3.2** | 4.2 | 358p |
| November 1999 | **–** | 21,583 | **–** | 4.6 | 278p |
| **(2000 Scheme)** | | | | | |
| September 2000 | **6,945** | 329,342 | **4.4** | 5.4 | 215p |
| June 2001 | **358,488** | 1,873,894 | **5.2** | 6.2 | 256p |
| December 2001 | **110,170** | 1,793,630 | **5.7** | 6.7 | 350p |
| **(2002 Scheme)** | | | | | |
| June 2002 | **1,500,272** | 5,603,693 | **6.2** | 7.2 | 350p |
| November 2002 | **102,905** | 704,148 | **6.6** | 7.6 | 353p |
| January 2003 | **32,738** | 212,121 | **6.8** | 7.8 | 297p |
| March 2003 | **–** | 112,612 | **–** | 7.9 | 296p |
| June 2003 | **5,355,784** | 7,394,132 | **7.2** | 8.2 | 297p |
| November 2003 | **522,773** | 600,292 | **7.6** | 8.6 | 270p |
| January 2004 | **96,884** | 96,884 | **7.8** | 8.8 | 289p |
| February 2004 | **85,185** | 85,185 | **7.8** | 8.8 | 270p |
| July 2004 | **6,950,820** | 8,985,830 | **8.3** | 9.3 | 347p |
| November 2004 | **868,599** | 890,886 | **8.6** | 9.6 | 337p |
| June 2005 | **1,413,856** | – | **9.2** | – | 352p |
| | **18,135,466** | 31,690,916 | **7.5** | 7.6 | 335p |

# Notes to the financial statements continued

## 12 SHARE-BASED PAYMENTS continued

### C Performance Share Plan

The Performance Share Plan is the primary long-term incentive plan for approximately 100 of the most senior executives and was approved by shareholders in 2005. Under the plan, annual awards, based on a percentage of salary, may be offered. The extent to which the awards vest is based on earnings per share growth over three years. Further details are set out in the Remuneration report on page 41. The first award under this scheme was made in July 2005.

During the year, 3,694,559 shares were awarded under the plan. The weighted average fair value of the shares issued was 365.7p.

### D Deferred Bonus Plan

The Deferred Bonus Plan was introduced in 2005 as part of the annual bonus scheme for approximately 400 of the most senior managers. As part of the bonus scheme, the managers are required to defer a proportion of any bonus paid into shares which will be held for three years. There are no further performance conditions on these shares, other than continued employment, and the value of any dividends earned during the deferred period will be paid at the end of the period. Further details are set out in the Remuneration report on page 41.

It is anticipated that shares with a value of £11.9m will be awarded under the scheme in June 2006.

### E Restricted Share Plan

A Restricted Share Plan was established in 2000 as part of the reward strategy for retention of senior employees who are vital to the success of the business recovery and growth. The Plan operates for senior executives below Executive Director level. Awards under the plan are made as part of ongoing reviews of reward packages, and recruitment tools for new employees. The shares are held in trust for a period of between one and three years, at which point they are released to the employee, subject to them still being in employment.

During the year, 564,336 shares (last year 795,428) have been awarded under the Restricted Share Plan. The weighted average fair value of the shares issued was 331.1p (last year 332.8p).

### F Executive Share Matching Plan

The Executive Share Matching Plan for senior management was introduced in 2002, since when there have been annual awards in 2002, 2003 and 2004. The plan currently operates for four members of senior management, and it is intended that no further awards are made under this plan. Participants were required to invest one-third of any annual bonus earned in shares of the Company. The pre-tax value of the invested bonus would be matched by an award of shares, with the extent of the match determined by the Total Shareholder Return performance measure. Further details are set out in the Remuneration report on page 42.

No shares have been awarded under the Executive Share Matching Plan during the year. Last year, 46,293 shares were issued with a weighted average fair value of 376.2p.

### G United Kingdom Share Incentive Plan

The Share Incentive Plan is a discretionary, all-employee plan, approved by the Inland Revenue, under which Freeshares may be allocated by the Company. The last award was made in July 2003.

## 13 INTANGIBLE ASSETS

| | Goodwill £m | Brands £m | Computer software £m | Computer software under development £m | Total £m |
|---|---|---|---|---|---|
| **At 3 April 2004** | | | | | |
| Cost or valuation | – | – | 44.5 | 2.5 | 47.0 |
| Accumulated amortisation | – | – | (14.6) | – | (14.6) |
| Net book value | – | – | 29.9 | 2.5 | 32.4 |
| **Year ended 2 April 2005** | | | | | |
| Opening net book value | – | – | 29.9 | 2.5 | 32.4 |
| Additions[1, 2] | 69.5 | 80.0 | 0.8 | 10.1 | 160.4 |
| Transfers | – | – | 7.0 | (7.0) | – |
| Disposal of subsidiary | – | – | (14.1) | – | (14.1) |
| Amortisation charge[3] | – | (2.7) | (10.6) | – | (13.3) |
| Closing net book value | 69.5 | 77.3 | 13.0 | 5.6 | 165.4 |
| **At 2 April 2005** | | | | | |
| Cost or valuation | 69.5 | 80.0 | 32.8 | 5.6 | 187.9 |
| Accumulated amortisation | – | (2.7) | (19.8) | – | (22.5) |
| Net book value | 69.5 | 77.3 | 13.0 | 5.6 | 165.4 |
| **Year ended 1 April 2006** | | | | | |
| Opening net book value | 69.5 | 77.3 | 13.0 | 5.6 | 165.4 |
| Additions | – | – | 0.2 | 10.7 | 10.9 |
| Transfers | – | – | 9.5 | (9.5) | – |
| Disposals | – | – | – | (0.1) | (0.1) |
| Amortisation charge | – | (5.3) | (7.4) | – | (12.7) |
| **Closing net book value** | **69.5** | **72.0** | **15.3** | **6.7** | **163.5** |
| **At 1 April 2006** | | | | | |
| Cost or valuation | 69.5 | 80.0 | 42.3 | 6.7 | 198.5 |
| Accumulated amortisation | – | (8.0) | (27.0) | – | (35.0) |
| **Net book value** | **69.5** | **72.0** | **15.3** | **6.7** | **163.5** |

[1] On 4 October 2004, the Group acquired the per una group of companies for a total consideration of £125.9m. The net assets acquired included £1.4m of assets offset by £1.0m of liabilities. There were no fair value adjustments. The Group adopted acquisition accounting for the acquisition of the per una group of companies.

Per Una Group Limited was a newly formed entity into which the net assets and liabilities acquired were transferred immediately prior to the acquisition date. As separate accounts were not maintained for this entity in the period prior to the acquisition date, separate figures for profit after tax were not available. Based on the available information, the profit before tax attributable to the acquired business in the year to 31 March 2004 and in the six months prior to acquisition was approximately £17m and £15m respectively. These pre-acquisition figures for the acquired business have been adjusted to reflect the post-acquisition structure for the per una group. In the six months prior to acquisition, the value of goods purchased from the acquired business was £85.2m.

[2] 'Additions' includes £0.8m in respect of discontinued operations.

[3] 'Amortisation charge' includes £1.9m in respect of discontinued operations.

Computer software and software under development are internally generated. Computer software is amortised on a straight-line basis over a period of three to five years.

Brands consist of the per una brand which was acquired in October 2004 and which is being amortised on a straight-line basis over a period of 15 years.

Goodwill is not amortised but the Group tests goodwill annually for impairment with the recoverable amount being determined from value in use calculations. The key assumptions for the value in use calculations are those regarding the discount rate, growth rates and changes in income and costs.

The Group prepares discounted cash flow forecasts based on financial forecasts approved by management covering a three-year period, which takes account of both past performance and expectations for future market developments. Cash flows beyond this three-year period are extrapolated using a growth rate of 2.0%, which does not exceed the long-term average growth rate for retail businesses in the UK. Management estimates the discount rate using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to retail businesses. A pre-tax discount rate of 9.5% has been used.

# Notes to the financial statements continued

## 14 PROPERTY, PLANT AND EQUIPMENT

| | Land and buildings £m | Fixtures, fittings & equipment £m | Assets in the course of construction £m | Total £m |
|---|---|---|---|---|
| **At 3 April 2004** | | | | |
| Cost | 2,448.1 | 3,156.8 | 50.4 | 5,655.3 |
| Accumulated depreciation | (73.9) | (1,861.5) | – | (1,935.4) |
| Net book value | 2,374.2 | 1,295.3 | 50.4 | 3,719.9 |
| **Year ended 2 April 2005** | | | | |
| Opening net book value | 2,374.2 | 1,295.3 | 50.4 | 3,719.9 |
| Exchange difference | 1.8 | 0.3 | 0.2 | 2.3 |
| Additions[1] | 25.5 | 177.8 | 15.2 | 218.5 |
| Transfers | 14.3 | 29.9 | (44.2) | – |
| Disposals | – | (1.9) | – | (1.9) |
| Disposal of subsidiaries | (73.6) | (12.5) | – | (86.1) |
| Depreciation charge[2] | (12.9) | (253.6) | – | (266.5) |
| Closing net book value | 2,329.3 | 1,235.3 | 21.6 | 3,586.2 |
| **At 2 April 2005** | | | | |
| Cost | 2,412.0 | 3,162.1 | 21.6 | 5,595.7 |
| Accumulated depreciation | (82.7) | (1,926.8) | – | (2,009.5) |
| Net book value | 2,329.3 | 1,235.3 | 21.6 | 3,586.2 |
| **Year ended 1 April 2006** | | | | |
| Opening net book value | 2,329.3 | 1,235.3 | 21.6 | 3,586.2 |
| Exchange difference | 2.2 | 2.0 | 0.3 | 4.5 |
| Additions[1] | 34.7 | 251.8 | 40.3 | 326.8 |
| Transfers | – | 20.3 | (20.3) | – |
| Disposals | (34.1) | (6.2) | – | (40.3) |
| Assets of discontinued operations | (11.4) | (21.0) | (1.4) | (33.8) |
| Depreciation charge[2] | (10.7) | (256.9) | – | (267.6) |
| **Closing net book value** | **2,310.0** | **1,225.3** | **40.5** | **3,575.8** |
| **At 1 April 2006** | | | | |
| Cost | 2,392.2 | 3,287.1 | 40.5 | 5,719.8 |
| Accumulated depreciation | (82.2) | (2,061.8) | – | (2,144.0) |
| **Net book value** | **2,310.0** | **1,225.3** | **40.5** | **3,575.8** |

[1] 'Additions' includes £5.4m (last year £4.6m) in respect of discontinued operations.

[2] 'Depreciation charge' includes £6.3m (last year £7.8m) in respect of discontinued operations.

The net book values included in the tables above include land and buildings of £44.9m (last year £50.9m) and equipment of £5.0m (last year £5.5m) where the Group is a lessee under a finance lease.

In accordance with IFRS 1 – 'First time adoption of International Financial Reporting Standards' and IAS 17 – 'Leases' the Group reviewed the classification of all leases at the transition balance sheet date of 4 April 2004. Under IAS 17, the land and building elements of a lease need to be considered separately and the land element is normally deemed to be an operating lease. As a result, the buildings element of a number of properties, previously treated as operating leases, have been reclassified as finance leases. In addition, the revaluation element held in respect of leasehold land previously held as a fixed asset has been derecognised and the payments made to acquire such land have been reclassified as leasehold prepayments.

Under the provisions of IFRS 1, the Group adopted a valuation as deemed cost on transition for freehold land and buildings. A property valuation was prepared on an existing use basis by external valuers DTZ Debenham Tie Leung as at 2 April 2004. The Group elected under IFRS 1 to reflect this valuation, in so far as it related to freehold land and buildings, as deemed cost on transition at 4 April 2004. This gave rise to an uplift of £530.9m against the previous carrying value.

## 15 INVESTMENT PROPERTY

| | 2006 £m | 2005 £m |
|---|---|---|
| **Cost** | | |
| At start of year | **38.6** | 37.8 |
| Additions | **–** | 0.8 |
| At end of year | **38.6** | 38.6 |
| **Depreciation** | | |
| At start of year | **–** | – |
| Depreciation charge | **0.1** | – |
| At end of year | **0.1** | – |
| **Net book value** | **38.5** | 38.6 |

The investment properties were valued at £55.5m (last year £42.6m) as at 1 April 2006 by qualified professional valuers working for DTZ Debenham Tie Leung, Chartered Surveyors, acting in the capacity of External Valuers. All such valuers are Chartered Surveyors, being members of the Royal Institution of Chartered Surveyors (RICS). The properties were valued on the basis of Market Value. All valuations were carried out in accordance with the RICS Appraisal and Valuation Standards. As the investment properties are held at depreciated historical cost, this valuation has not been reflected in the carrying value of the assets.

The Group received rental income of £1.5m (last year £1.4m) in respect of these investment properties.

## 16 INVESTMENT IN JOINT VENTURE

| | 2006 £m | 2005 £m |
|---|---|---|
| At start of year | **8.7** | 8.5 |
| Share of profit | **0.3** | 0.2 |
| At end of year | **9.0** | 8.7 |

The joint venture represents a 50% equity interest in Hedge End Park Ltd, a property investment company incorporated in Great Britain. The partner in the joint venture is J Sainsbury plc.

In relation to the Group's interest in joint ventures, the assets and liabilities are shown below:

| | 2006 £m | 2005 £m |
|---|---|---|
| Non-current assets | **2.5** | 2.5 |
| Current assets | **6.7** | 6.4 |
| Current liabilities | **(0.2)** | (0.2) |
| Net assets | **9.0** | 8.7 |

# Notes to the financial statements continued

## 17 OTHER FINANCIAL ASSETS

| | 2006 £m | 2005 £m |
|---|---|---|
| **Non-current** | | |
| Unlisted investments | **3.3** | 0.3 |
| **Current** | | |
| Listed securities: | | |
| – Listed in the United Kingdom | **43.6** | 51.0 |
| – Listed overseas | **–** | 11.4 |
| Unlisted investments | **5.2** | 4.6 |
| | **48.8** | 67.0 |

## 18 TRADE AND OTHER RECEIVABLES

| | 2006 £m | 2005 £m |
|---|---|---|
| **Non-current** | | |
| Other receivables[1] | **5.3** | 6.2 |
| Prepaid leasehold premiums | **235.8** | 204.9 |
| Other prepayments and accrued income | **1.7** | 0.1 |
| | **242.8** | 211.2 |
| **Current** | | |
| Trade receivables | **45.2** | 29.3 |
| Less: Provision for impairment of receivables | **(3.2)** | (1.5) |
| Trade receivables – net | **42.0** | 27.8 |
| Other receivables | **27.4** | 44.8 |
| Prepaid pension contributions | **57.7** | 65.6 |
| Prepaid leasehold premiums | **7.6** | 1.8 |
| Other prepayments and accrued income | **75.8** | 73.8 |
| | **210.5** | 213.8 |

[1] Amounts receivable after more than one year in 2005 included £2.0m of non-financial assets which were excluded from the analysis in note 23.

## 19 CASH AND CASH EQUIVALENTS

Cash at bank includes short-term deposits with banks and other financial institutions, with an initial maturity of three months or less and credit card debtors receivable within 48 hours. The carrying amount of these assets approximates their fair value.

The effective interest rate on short-term bank deposits is 4.5% (last year 4.8%); these deposits have an average maturity of eight days (last year two days).

## 20 TRADE & OTHER PAYABLES

| | 2006 £m | 2005 £m |
|---|---|---|
| **Current** | | |
| Trade payables | **242.6** | 195.3 |
| Other payables | **196.6** | 176.4 |
| Social security and other taxes | **40.7** | 40.4 |
| Accruals and deferred income | **387.9** | 305.8 |
| | **867.8** | 717.9 |
| **Non-current** | | |
| Accruals and deferred income | **74.8** | 71.8 |
| | **74.8** | 71.8 |

## 21 BORROWINGS AND OTHER FINANCIAL LIABILITIES

| | 2006 £m | 2005[1] £m |
|---|---|---|
| **Current** | | |
| Bank loans, overdrafts and commercial paper[2] | **90.0** | 212.9 |
| Syndicated bank facility | **–** | 200.0 |
| Medium term notes[3] | **901.0** | 58.3 |
| Securitised loan notes[4] | **4.4** | 3.2 |
| Finance lease liabilities | **2.7** | 4.4 |
| Non-equity B shares[5] | **54.7** | – |
| | **1,052.8** | 478.8 |
| **Non-current** | | |
| Medium term notes[6] | **779.0** | 1,588.6 |
| Securitised loan notes[4] | **307.3** | 310.4 |
| Finance lease liabilities | **47.5** | 49.5 |
| | **1,133.8** | 1,948.5 |
| Total financial liabilities | **2,186.6** | 2,427.3 |

[1] Last year comparatives have been prepared under UK GAAP.

[2] Bank loans, overdrafts and commercial paper includes a £5.0m (last year £5.0m) loan from the Hedge End Park Ltd joint venture.

[3] Relates to a number of floating rate medium term notes set to mature throughout the 2006/07 financial year linked to sterling and euro LIBOR for periods ranging from one to six months.

[4] Relates to three separate bonds securitised against 45 of the Group's properties. Two are repayable in instalments. The gross amounts before finance costs are £48.7m and £131m respectively. The first is a floating rate bond which has been swapped into a fixed rate of 6.34%, amortised on a quarterly basis from 12 March 2002, with final payment due on 12 September 2015. The second is a floating rate bond which has been swapped into a fixed rate of 6.344%, amortised on a quarterly basis from 12 September 2015, with final payment due on 12 December 2026. The gross amount of the remaining bond is £140m before finance costs. It relates to a fixed rate bond at a rate of 6.282% and is repayable in full on 12 December 2026.

[5] Under the IFRS 1 exemption not to apply IAS 32 retrospectively, non-equity B shares are classified as share capital in the comparative year (see note 27).

[6] Relates to fixed rate bonds of £375m at a rate of 6.375% repayable on 7 November 2011 and £400m at a rate of 5.625% repayable on 24 March 2014.

# Notes to the financial statements continued

## 21 BORROWINGS AND OTHER FINANCIAL LIABILITIES continued

### Non-equity B shares

| | 2006 Shares | £m | 2005 Shares | £m |
|---|---|---|---|---|
| Authorised non-equity B shares of 70p each | **3,200,000,000** | **2,240.0** | 3,200,000,000 | 2,240.0 |
| **Allotted, called up and fully paid non-equity shares of 70p each:** | | | | |
| At start of year | **93,822,916** | **65.7** | 121,244,763 | 84.9 |
| Redemption of B shares | **(15,638,602)** | **(11.0)** | (27,421,847) | (19.2) |
| | **78,184,314** | **54.7** | 93,822,916 | 65.7 |

On 27 March 2006, Marks and Spencer Group plc gave notice to redeem all of the B shares in issue. The redemption was on the basis of 70p per share. The decision by the Company to redeem all outstanding B shares was consistent with the rights and restrictions attached to the B shares contained in the circular sent to shareholders in February 2002 prior to approval at the Extraordinary General Meeting of the Company on 28 February 2002. Prior to redemption, holders of B shares were entitled to receive a sub-LIBOR dividend in respect of their B shares for the period 26 March to 4 May 2006. The B shares were redeemed at par on 5 May 2006.

### Maturity of borrowings

The maturity of borrowings is as follows:

| | 2006 £m | 2005 £m |
|---|---|---|
| **Repayable within one year or on demand:** | | |
| Bank loans, overdrafts and commercial paper | **90.0** | 212.9 |
| Syndicated bank facility | **–** | 200.0 |
| Medium term notes | **901.0** | 58.3 |
| Securitised loan notes | **4.4** | 3.2 |
| Finance leases | **2.7** | 4.4 |
| Non-equity B shares | **54.7** | 65.7 |
| | **1,052.8** | 544.5 |
| **Repayable between one and two years:** | | |
| Medium term notes | **–** | 820.7 |
| Securitised loan notes | **3.8** | 3.5 |
| Finance leases | **1.3** | 2.2 |
| | **5.1** | 826.4 |
| **Repayable between two and five years:** | | |
| Securitised loan notes | **13.6** | 12.5 |
| Finance leases | **0.3** | 0.7 |
| | **13.9** | 13.2 |
| **Repayable in five years or more:** | | |
| Medium term notes | **779.0** | 767.9 |
| Securitised loan notes | **289.9** | 294.4 |
| Finance leases | **45.9** | 46.6 |
| | **1,114.8** | 1,108.9 |
| | | |
| | **2,186.6** | 2,493.0 |

## 21 BORROWINGS AND OTHER FINANCIAL LIABILITIES continued

### Borrowing facilities

At 1 April 2006, the Group had a five-year committed syndicated bank facility of £1.2bn set to mature on 27 March 2011, which contains only one financial covenant being earnings before interest, tax, depreciation, amortisation and rents payable to fixed charge cover. The Group also has a number of undrawn uncommitted facilities available to it. At 1 April 2006, these amounted to £175m (last year £190m), all of which are due to be reviewed within a year. All committed and uncommitted bank facilities were undrawn as at the balance sheet date.

### Financial liabilities

After taking into account the various interest rate swaps entered into by the Group, the currency and interest rate exposure of the Groups' financial liabilities is as set out below. There are no financial liabilities other than short term payables excluded from this analysis:

| | | | 2006 |
|---|---|---|---|
| Currency | Fixed rate £m | Floating rate £m | Total £m |
| Sterling | **1,137.7** | **1,045.5** | **2,183.2** |
| Euro | **3.2** | **0.2** | **3.4** |
| | **1,140.9** | **1,045.7** | **2,186.6** |

Included within floating rate liabilities is £54.7m of unredeemed B shares.

The floating rate sterling and euro borrowings are linked to interest rates related to LIBOR. These rates are for periods ranging from one month to six months. Excluding finance leases, the fixed rate Sterling borrowings are at an average rate of 6.1% and the weighted average time for which the rate is fixed is 10.4 years.

### Interest rate analysis

The effective interest rates at the balance sheet date were as follows:

| | 2006 % |
|---|---|
| Medium term notes | **5.7** |
| Securitised loan notes | **6.3** |
| Non-equity B shares | **3.5** |
| Finance leases | **4.4** |

### Finance leases

The minimum lease payments under finance leases fall due as follows:

| | 2006 £m | 2005 £m |
|---|---|---|
| Not later than one year | **4.8** | 5.5 |
| Later than one year but not more than five | **9.8** | 13.6 |
| More than five years | **197.7** | 201.2 |
| | **212.3** | 220.3 |
| Future finance charges on finance leases | **(162.1)** | (166.4) |
| Present value of lease obligations | **50.2** | 53.9 |

It is the Group's policy to lease certain of its properties and equipment under finance leases. The average lease term for equipment is four years and 125 years for property. Interest rates are fixed at the contract rate. All leases are on a fixed repayment basis and no arrangements have been entered into for contingent payments. The Group's obligations under finance leases are secured by the lessors' charges over the leased assets.

# Notes to the financial statements continued

## 22 FINANCIAL INSTRUMENTS

The Group has taken advantage of the exemption under IFRS 1 from the requirement to restate comparatives in accordance with IAS 32 and IAS 39. The comparative figures have therefore been measured and presented in accordance with previously adopted UK GAAP. The main adjustments that would be required to make the comparative information comply with IAS 32 and IAS 39 are the inclusion of derivative assets and liabilities on the balance sheet and the reclassification of non-equity B shares from share capital to debt.

**Treasury Policy and Financial Risk Management**

Marks and Spencer operates a centralised treasury function to manage the Group's external/internal funding requirements and financial risks in line with the Board approved treasury policies and procedures, and delegated authorities therein given.

The Group's financial instruments, other than derivatives, comprise borrowings, cash and liquid resources and various items, such as trade debtors and trade creditors, that arise directly from its operations. The main purpose of these financial instruments is to raise finance for the Group's operations.

Group Treasury also enters into derivative transactions, principally interest rate and currency swaps and forward currency contracts. The purpose of these transactions is to manage the interest rate and currency risks arising from the Group's operations and financing.

It remains Group policy not to hold or issue financial instruments for trading purposes, except where financial constraints necessitate the need to liquidate any outstanding investments. The treasury function is managed as a cost centre and does not engage in speculative trading.

The principal financial risks to which the Group is exposed relate to liquidity/funding, interest rates, foreign exchange rates and counterparty risk. The policies and strategies for managing these risks are summarised as follows:

**(a) Liquidity/funding risk**

The Group's funding strategy is to ensure a mix of financing methods offering flexibility and cost effectiveness to match the requirements of the Group. Operating subsidiaries are financed by a combination of retained profits, bank borrowings, medium-term note issuance and securitised loan notes. In addition to the existing borrowings, the Group has a Euro Medium Term Note programme of £3 billion, of which £1.7 billion was in issuance as at the balance sheet date. Furthermore, short-term borrowings are backed by a £1.2 billion five-year committed syndicated bank facility, which was undrawn at the balance sheet date.

**(b) Interest rate risk**

Interest rate risk primarily occurs with the movement of sterling interest rates in relation to the Group's floating rate financial assets and liabilities. Group policy for interest rate management is to maintain a mix of fixed and floating rate borrowings. Interest rate risk in respect of debt on the balance sheet is reviewed on a regular basis against forecast interest costs and covenants. A number of interest rate swaps have been entered into to redesignate fixed and floating debt. The structure and maturity of these swaps correspond to the underlying borrowings and are accounted for as fair value or cash flow hedges as appropriate.

At the balance sheet date fixed rate borrowings amounted to £1,137.7m representing the property securitisation, two public bond issues and finance leases. Based on the financial liabilities and assets as at the balance sheet date a one percentage point movement in average sterling interest rates will have a £6.2m impact on the Group's net interest charge.

**(c) Foreign currency risk**

Transactional foreign currency exposures arise from both the export of goods from the UK to overseas subsidiaries, also from the import of materials and goods directly sourced from overseas suppliers. Group Treasury hedge these exposures principally using forward foreign exchange contracts covering between 80% and 100% out to 15 months.

As at the balance sheet date the gross value in Sterling terms of forward foreign exchange sell or buy contracts amounted to £270m with a weighted average maturity date of six months.

The Group does not use derivatives to hedge balance sheet and profit and loss translation exposures. Where appropriate, borrowings are arranged in local currencies to provide a natural hedge against overseas assets.

Where funding has been sourced in currencies other than sterling, the Group has swapped these exposures back into sterling debt through cross currency swaps matching the underlying terms. The gross notional value of cross currency swaps as at the balance sheet date was £610.8m with a weighted average maturity of 0.6 years.

The Group also hedges foreign currency intercompany loans where these exist. As at the balance sheet date, the gross notional value of intercompany loan hedges was £109m.

## 22 FINANCIAL INSTRUMENTS continued

### (d) Counterparty risk

Counterparty risk exists where the Group has the potential to experience loss through default or non-performance by financial institutions in relation to outstanding financial instruments. Counterparty exposures for these instruments are managed through Board approved Group Treasury policy that limits the value that can be placed with each approved counterparty to minimise the risk of loss. These limits are based on a combination of short-term credit ratings of A-1/P-1 and long-term credit ratings of AA-/Aa3 or better. The monetary limit will apply to the aggregate of investments and the mark to market value of foreign exchange and interest rate derivatives. Limits are reviewed regularly by senior management. Dealing mandates and derivative agreements are entered into with counterparty banks prior to deals being arranged.

The maximum exposure to credit risk at 1 April 2006 was as follows: trade receivables £42m, other receivables £33m, cash and cash equivalents £363m and derivatives £76m. The Group does not have any material exposures to concentrations of credit risk with any one counterparty.

### Derivative financial instruments

| | | 2006 |
|---|---|---|
| | Assets | Liabilities |
| **Current** | | |
| Interest rate swaps – fair value hedges | **1.6** | **–** |
| Cross currency – fair value hedges | **71.9** | **(5.3)** |
| Forward foreign exchange contracts – cash flow hedges | **1.2** | **(2.7)** |
| Forward foreign exchange contracts – held for trading | **1.7** | **–** |
| | **76.4** | **(8.0)** |
| **Non-current** | | |
| Interest rate swaps – cash flow hedges | **–** | **(9.5)** |

The Group has entered into a number of interest rate and currency swaps to redesignate both fixed and floating rate debt to the Group's desired interest rate profile. The attributes of these derivatives match the characteristics of the underlying debt hedged. Derivatives moving floating debt to fixed have been designated as cash flow hedges, and derivatives moving fixed debt to floating have been designated as fair value hedges in accordance with IAS 39.

As at the balance sheet date gross outstanding interest rate swaps amounted to £754.3m with a weighted average maturity of 3.6 years. The weighted average effective interest rate for floating to fixed interest rate derivatives was 6.3% as at the balance sheet date. The gross notional outstanding interest rate swaps converting fixed debt to floating was £574.6m with rate fixings being set using the published one, three, or six month LIBOR, where appropriate.

Forward foreign exchange contracts in relation to the Group's forecast currency requirements are designated as cash flow hedges with fair value movements recognised directly in equity. To the extent that these hedges cover actual currency payables or receivables then associated fair value movements previously recognised in equity are recorded in the income statement in conjunction with the corresponding asset or liability.

Forward foreign exchange contracts in relation to the hedging of the Group's foreign currency intercompany loans are designated as held for trading with fair value movements being recognised in the income statement. The corresponding fair value movement of the intercompany loan balance results in an overall nil impact on the income statement.

Gains and losses in equity on forward foreign exchange contracts as of 1 April 2006 will be released to the income statement at various dates over the following 15 months from the balance sheet date.

With the exception of the Group's fixed rate bond debt, there were no material differences between the carrying value of non-derivative financial assets and financial liabilities and their fair values as at the balance sheet date.

The carrying value of the Group's fixed rate bond debt was £915.0m, the fair value of this debt was £940.8m.

# Notes to the financial statements continued

## 23 FINANCIAL INSTRUMENTS – DISCLOSURES IN RESPECT OF COMPARATIVES

The Group has taken advantage of the exemption permitted under IFRS 1 not to retrospectively apply IAS 32 and 39. In accordance with IFRS 1 the disclosures in respect of the comparative period are presented in this note in accordance with FRS 13 – 'Financial Instruments'.

### A Financial assets

After taking into account the various interest rate swaps entered into by the Group, the currency and interest rate exposure of the Group's financial assets is set out below. There are no financial assets other than short-term debtors excluded from this analysis:

| | | | | 2005 |
|---|---|---|---|---|
| Currency | Fixed rate £m | Floating rate £m | Non-interest bearing £m | Total £m |
| Sterling | 38.8 | 118.5 | 74.5 | 231.8 |
| US dollar | – | 12.9 | 7.2 | 20.1 |
| Euro | – | 5.2 | 12.3 | 17.5 |
| Other | – | 9.3 | 5.4 | 14.7 |
| | 38.8 | 145.9 | 99.4 | 284.1 |

The floating rate sterling, US dollar and euro assets are at interest rates linked to LIBID. The non-interest bearing financial assets are predominantly cash in tills and uncleared deposits.

The weighted average interest rate of fixed interest assets, which were all denominated in sterling, was 4.8%. These assets were fixed for a weighed average period of 0.3 years.

Financial assets are analysed as follows:

| | 2005 £m |
|---|---|
| Current asset investments | 67.0 |
| Cash at bank and in hand | 212.6 |
| Fixed asset investments | 0.3 |
| Other amounts receivable after more than one year | 4.2 |
| Financial assets as defined by FRS 13 | 284.1 |

### B Financial liabilities

After taking into account the various interest rate and currency swaps entered into by the Group, the currency and interest rate exposure of the Group's financial liabilities is as set out below. There are no financial liabilities other than short-term creditors excluded from this analysis:

| | | | 2005 |
|---|---|---|---|
| Currency | Fixed rate £m | Floating rate £m | Total £m |
| Sterling[1] | 1,086.7 | 1,349.1 | 2,435.8 |
| US dollar | – | 8.3 | 8.3 |
| Euro | – | 0.2 | 0.2 |
| | 1,086.7 | 1,357.6 | 2,444.3 |

[1] Included within floating rate liabilities is £65.7m of unredeemed B shares.

## 23 FINANCIAL INSTRUMENTS – DISCLOSURES IN RESPECT OF COMPARATIVES continued

The floating rate sterling, US dollar and euro borrowings are linked to interest rates related to LIBOR. These rates are for periods ranging from one month to six months. The fixed rate sterling borrowings are at a weighted average rate of 6.1% and the weighted average time for which the rate is fixed is 11.4 years.

### C Fair values of non-derivative financial assets and financial liabilities

Set out below is a comparison of fair and book values of all the Group's financial instruments by category. Where market prices are not available for a particular instrument, fair values have been calculated by discounting cash flows at prevailing interest rates and exchange rates.

| | | 2005 |
|---|---|---|
| | Book value | Fair value |
| **Assets/(liabilities)** | | |
| Current asset investments[1] | 67.0 | 67.0 |
| Fixed asset investments | 0.3 | 0.3 |
| Cash at bank and in hand[1] | 212.6 | 212.6 |
| Other financial assets due after more than one year | 4.2 | 4.2 |
| Borrowings due within one year[2] | (476.7) | (476.4) |
| B shares | (65.7) | (65.7) |
| Financial liabilities due after more than one year[2] | (1,901.9) | (1,935.8) |
| Cross currency swaps[2] | – | 56.3 |
| Interest rate swaps[2] | – | 3.7 |
| Forward foreign currency contracts[2] | – | (0.4) |

[1] Current asset investments and cash at bank are predominantly short-term deposits placed with banks, financial institutions and on money markets, and investments in short-term securities. Therefore, these fair values closely approximate book values.

[2] Interest rate, cross currency swaps and forward currency contracts have been marked to market to produce a fair value figure.

### Hedges of future transactions

Unrecognised gains and losses on instruments used for hedging and those recognised in the period ended 2 April 2005 are as follows:

| | | | 2005 |
|---|---|---|---|
| | Gains £m | Losses £m | Net total £m |
| Unrecognised gains/(losses) on hedges at beginning of the period | 74.3 | (34.1) | 40.2 |
| (Gains)/losses arising in previous years recognised in the period | (12.7) | 25.8 | 13.1 |
| Gains/(losses) arising in previous years not recognised in the period | 61.6 | (8.3) | 53.3 |
| Gains/(losses) arising in the period | 12.8 | (6.5) | 6.3 |
| Unrecognised gains/(losses) on hedges at end of the period | 74.4 | (14.8) | 59.6 |
| Of which: | | | |
| Gains/(losses) expected to be recognised within one year | 2.9 | (3.6) | (0.7) |
| Gains/(losses) expected to be recognised after one year | 71.5 | (11.2) | 60.3 |

### Currency risk

The effect of currency exposures arising from the translation of overseas investments is mitigated by Group borrowings in local currencies as appropriate. Gains and losses arising on net investments in overseas subsidiaries were recognised in the consolidated statement of total recognised income and expenses.

After taking into account the effect of any hedging transactions that manage transactional currency exposures, no Group company had any material monetary assets or liabilities in currencies other than their functional currencies at the balance sheet date.

# Notes to the financial statements continued

## 24 PROVISIONS

| | UK restructuring £m | Overseas restructuring £m | Total £m |
|---|---|---|---|
| **At 4 April 2004** | 32.2 | 17.1 | 49.3 |
| Provided in the period | 30.4 | – | 30.4 |
| Released in the period | (1.4) | (9.7) | (11.1) |
| Utilised during the period | (26.0) | – | (26.0) |
| Net closure profit in Continental Europe | – | 1.2 | 1.2 |
| Exchange differences | – | 1.1 | 1.1 |
| At 2 April 2005 | 35.2 | 9.7 | 44.9 |
| **At 2 April 2005** | 35.2 | 9.7 | 44.9 |
| Provided in the period | 5.8 | – | 5.8 |
| Released in the period | (3.5) | – | (3.5) |
| Utilised during the period | (18.2) | (0.8) | (19.0) |
| Exchange differences | – | 0.1 | 0.1 |
| **At 1 April 2006** | **19.3** | **9.0** | **28.3** |

Analysis of total provisions:

| | **2006 £m** | 2005 £m |
|---|---|---|
| Current | **9.2** | 25.2 |
| Non-current | **19.1** | 19.7 |
| | **28.3** | 44.9 |

The provision for UK restructuring primarily relates to costs of closing Lifestore, restructuring of the Direct operation and head office restructuring.

The provision for overseas restructuring costs primarily relates to future closure costs in respect of the Group's discontinued operations in Continental Europe.

The non-current provisions relate to closure costs of discontinued operations in Continental Europe, the closure of Lifestore operations and the restructuring of Direct operations and are expected to be utilised over a period of 15 years.

## 25 DEFERRED INCOME TAX

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 30% (last year 30%) for UK differences and the local tax rates for overseas differences.

The movements in deferred tax assets and liabilities (after the offsetting of balances within the same jurisdiction as permitted by IAS 12) during the period are shown below. Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net.

**Deferred tax asset/(liabilities):**

| | Fixed assets temporary differences £m | Accelerated capital allowances £m | Pension temporary differences £m | Other short-term temporary differences £m | Total deferred tax assets £m | Deferred tax liabilities[2] £m | Total £m |
|---|---|---|---|---|---|---|---|
| **At 4 April 2004** | (151.8) | (70.2) | 267.0 | 30.3 | 75.3 | (5.3) | 70.0 |
| (Charged)/credited to the income statement[1] | 1.9 | 0.8 | (48.3) | (4.1) | (49.7) | 0.3 | (49.4) |
| Acquisition of subsidiary | – | – | – | (24.0) | (24.0) | – | (24.0) |
| Disposal of subsidiary | 4.2 | (4.9) | (0.2) | (0.7) | (1.6) | – | (1.6) |
| Credited to equity | – | – | 22.7 | 1.9 | 24.6 | 0.3 | 24.9 |
| At 2 April 2005 | (145.7) | (74.3) | 241.2 | 3.4 | 24.6 | (4.7) | 19.9 |
| **At 2 April 2005** | (145.7) | (74.3) | 241.2 | 3.4 | 24.6 | (4.7) | 19.9 |
| Charged to the income statement | (2.7) | (10.7) | (42.4) | (14.9) | (70.7) | (0.8) | (71.5) |
| Credited/(charged) to equity | 5.0 | – | 52.7 | 24.7 | 82.4 | (0.6) | 81.8 |
| Transferred to discontinued operations | – | – | – | (0.8) | (0.8) | – | (0.8) |
| **At 1 April 2006** | **(143.4)** | **(85.0)** | **251.5** | **12.4** | **35.5** | **(6.1)** | **29.4** |

[1] The £49.4m charge to the income statement in the year to 2 April 2005 includes £3.0m charge in respect of discontinued operations.

[2] Deferred tax liabilities relate primarily to overseas fixed assets revaluations and accelerated capital allowances.

In arriving at the deferred tax on fixed asset revaluations, credit has been taken for capital losses with a tax value of £56.1m (last year £56.1m).

No deferred tax is recognised on the unremitted earnings of overseas subsidiaries. As the earnings are continually reinvested by the Group, no tax is expected to be payable on them in the foreseeable future. Undistributed profits of overseas subsidiaries amount to £187.0m (last year £150.0m).

The Group is claiming UK tax relief for losses incurred by some of its current and former European subsidiaries. In the light of continuing litigation, no asset has been recognised in respect of these claims.

## 26 SHARE CAPITAL

| | **2006 Shares** | **£m** | 2005 Shares | £m |
|---|---|---|---|---|
| Authorised ordinary shares of 25p each | **3,200,000,000** | **800.0** | 3,200,000,000 | 800.0 |
| **Allotted, called up and fully paid ordinary shares of 25p each:** | | | | |
| At start of year | **1,658,095,142** | **414.5** | 2,265,144,934 | 566.3 |
| Purchase of own shares | **–** | **–** | (635,359,116) | (158.8) |
| Shares issued on exercise of share options | **24,341,872** | **6.1** | 28,309,324 | 7.0 |
| At end of year | **1,682,437,014** | **420.6** | 1,658,095,142 | 414.5 |

**Issue of new shares:**
24,341,872 (last year 28,309,324) ordinary shares having a nominal value of £6.1m (last year £7.0m) were allotted during the year under the terms of the Company's schemes which are described in note 12. The aggregate consideration received was £61.8m (last year £68.4m).

# Notes to the financial statements continued

## 27 STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

| | Share capital | | Share premium account £m | Capital redemption reserve £m | Hedging reserve £m | Other reserve[1] £m | Retained earnings[2,3] £m | Total £m |
|---|---|---|---|---|---|---|---|---|
| | Ordinary shares £m | Non-equity B shares £m | | | | | | |
| **At 4 April 2004** | 566.3 | 84.9 | 45.2 | 1,924.8 | – | (6,542.2) | 6,780.1 | 2,859.1 |
| Profit for the year attributable to shareholders | – | – | – | – | – | – | 586.2 | 586.2 |
| Dividends | – | – | – | – | – | – | (239.7) | (239.7) |
| Shares issued on exercise of share options | 7.0 | – | 61.4 | – | – | – | – | 68.4 |
| Redemption of B shares | – | (19.2) | – | 19.2 | – | – | (19.2) | (19.2) |
| Purchase of own shares | (158.8) | – | – | 158.8 | – | – | (2,300.0) | (2,300.0) |
| Tender Offer expenses | – | – | – | – | – | – | (14.9) | (14.9) |
| Sale of shares held by employee trusts[4] | – | – | – | – | – | – | 0.3 | 0.3 |
| Actuarial loss on post-retirement liability | – | – | – | – | – | – | (78.1) | (78.1) |
| Deferred tax on post-retirement liability | – | – | – | – | – | – | 23.0 | 23.0 |
| Deferred tax on share schemes | – | – | – | – | – | – | 1.9 | 1.9 |
| Charge for share-based payments | – | – | – | – | – | – | 22.2 | 22.2 |
| At 2 April 2005 | 414.5 | 65.7 | 106.6 | 2,102.8 | – | (6,542.2) | 4,761.8 | 909.2 |
| **At 3 April 2005** | 414.5 | 65.7 | 106.6 | 2,102.8 | – | (6,542.2) | 4,761.8 | 909.2 |
| First time adoption of IAS 32 and IAS 39 | – | (65.7) | – | – | (1.6) | – | (0.3) | (67.6) |
| | **414.5** | **–** | **106.6** | **2,102.8** | **(1.6)** | **(6,542.2)** | **4,761.5** | **841.6** |
| Profit for the year attributable to shareholders | – | – | – | – | – | – | 523.1 | 523.1 |
| Dividends | – | – | – | – | – | – | (204.1) | (204.1) |
| Foreign currency translation | – | – | – | – | – | – | 11.1 | 11.1 |
| Shares issued on exercise of share options | 6.1 | – | 55.7 | – | – | – | – | 61.8 |
| Redemption of B shares | – | – | – | 11.0 | – | – | (11.0) | – |
| Purchase of shares held by employee trusts[4] | – | – | – | – | – | – | (6.0) | (6.0) |
| Actuarial loss on post-retirement liability | – | – | – | – | – | – | (169.3) | (169.3) |
| Deferred tax on post-retirement liability | – | – | – | – | – | – | 52.0 | 52.0 |
| Deferred tax on share schemes | – | – | – | – | – | – | 21.8 | 21.8 |
| Deferred tax on revalued properties | – | – | – | – | – | – | 5.0 | 5.0 |
| Charge for share-based payments | – | – | – | – | – | – | 24.7 | 24.7 |
| Cash flow hedges | | | | | | | | |
| – fair value movement | – | – | – | – | (3.1) | – | – | (3.1) |
| – recycled and reported in net profit | – | – | – | – | (1.4) | – | – | (1.4) |
| – amount recognised in inventories | – | – | – | – | (3.8) | – | – | (3.8) |
| – tax on fair value gains | – | – | – | – | 1.9 | – | – | 1.9 |
| **At 1 April 2006** | **420.6** | **–** | **162.3** | **2,113.8** | **(8.0)** | **(6,542.2)** | **5,008.8** | **1,155.3** |

[1] The 'Other reserve' was created as part of the capital restructuring that took place in 2002. It represents the difference between the nominal value of the shares issued prior to the capital reduction by Marks and Spencer Group plc (being the carrying value of the investment in Marks & Spencer plc) and the share capital, share premium and capital redemption reserve of Marks and Spencer plc at the date of the transaction.

[2] Cumulative goodwill of £62.0m (last year £62.0m) arising on the acquisition of subsidiaries has been written off against retained earnings.

[3] Includes a currency reserve of £11.1m (last year £nil).

[4] The Marks and Spencer ESOP Trust ('the Trust') holds 2,820,688 (last year 1,526,270) shares with a book value of £9.7m (last year £3.7m) and a market value of £15.7m (last year £5.3m). These shares were acquired by the Trust in the market. The Trust used funds provided by Marks and Spencer plc to meet the Group's obligations. Awards are granted to employees at the discretion of Marks and Spencer plc and shares are awarded to employees by the Trust in accordance with the wishes of Marks and Spencer plc under senior executive share schemes, the Share Matching Plan and Restricted Share Plan.

## 28 CONTINGENCIES AND COMMITMENTS

### A Capital commitments

| | 2006 £m | 2005 £m |
|---|---|---|
| Commitments in respect of properties in the course of construction | **60.5** | 34.5 |

### B Other material contracts:

In the event of a material change in the trading arrangements with certain warehouse operators, the Group has a commitment to purchase fixed assets, at values ranging from historical net book value to market value, which are currently owned and operated by them on the Group's behalf.

### C Commitments under operating leases:

The Group leases various stores, offices, warehouses and equipment under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

| | 2006 £m | 2005 £m |
|---|---|---|
| Total commitments under non-cancellable operating leases expiring: | | |
| Not later than one year | **10.2** | 13.3 |
| Later than one year and not later than five years | **49.9** | 62.1 |
| Later than five years and not later than 25 years | **1,724.4** | 1,658.1 |
| Later than 25 years | **1,515.4** | 1,554.7 |
| | **3,299.9** | 3,288.2 |

The total future sublease payments to be received are £58.9m (last year £47.1m).

# Notes to the financial statements continued

## 29 ANALYSIS OF CASH FLOWS GIVEN IN THE CASH FLOW STATEMENT

| | 52 weeks ended 1 April 2006 £m | 52 weeks ended 2 April 2005 £m |
|---|---|---|
| **A Cash flows from operating activities – continuing** | | |
| Profit on ordinary activities after taxation | **520.6** | 355.0 |
| Income tax expense | **225.1** | 150.1 |
| Interest payable and similar charges | **134.9** | 120.9 |
| Interest receivable | **(30.5)** | (27.9) |
| Exceptional operating charges | **–** | 50.6 |
| **Operating profit before exceptional operating charges** | **850.1** | 648.7 |
| (Increase)/decrease in inventories | **(42.2)** | 55.0 |
| Increase in receivables | **(4.1)** | (1.0) |
| Payments to acquire leasehold properties | **(38.0)** | (0.1) |
| Increase/(decrease) in payables | **128.0** | (31.2) |
| Exceptional operating cash outflow (see note 29F) | **(14.6)** | (74.6) |
| Depreciation and amortisation | **274.0** | 255.0 |
| Share-based payments | **24.7** | 22.2 |
| Loss on property disposals | **5.7** | 0.4 |
| **Cash generated from operations – continuing** | **1,183.6** | 874.4 |
| **B Cash flows from operating activities – discontinued** | | |
| Profit on ordinary activities after taxation | **2.5** | 231.2 |
| Profit on sale | **–** | (199.0) |
| Income tax expense | **0.7** | 3.3 |
| Interest payable and similar charges | **0.4** | 0.2 |
| Interest receivable | **(0.6)** | – |
| **Operating profit** | **3.0** | 35.7 |
| (Increase)/decrease in inventories | **(1.1)** | 0.5 |
| Decrease in receivables | **0.4** | 6.3 |
| Increase in customer advances | **–** | (19.6) |
| Increase in customer deposits | **–** | 697.3 |
| Increase/(decrease) in payables | **4.2** | (2.5) |
| Depreciation and amortisation | **6.3** | 9.7 |
| Loss on property disposals | **1.1** | – |
| **Cash generated from operations – discontinued[1]** | **13.9** | 727.4 |

[1] Discontinued operations in the current period relate to Kings Super Markets Inc, and include those results of M&S Money for the comparative period. For Kings Super Markets Inc, there was a cash outflow of £5.2m (last year £3.5m outflow) in relation to investing activities, £0.1m inflow (last year £0.1m inflow) in relation to financing activities and £0.6m outflow (last year £0.5m outflow) for taxation.

| | 52 weeks ended 1 April 2006 £m | 52 weeks ended 2 April 2005 £m |
|---|---|---|
| **C Capital expenditure and financial investment** | | |
| Purchase of property, plant and equipment | **(298.5)** | (232.2) |
| Proceeds from sale of property, plant and equipment | **45.1** | 117.8 |
| Purchase of intangible fixed assets | **(10.9)** | (10.9) |
| (Purchase)/sale of non-current financial assets | **(3.0)** | 0.8 |
| Sale of current available for sale investments | **1.0** | 11.0 |
| | **(266.3)** | (113.5) |
| **D Other debt financing** | | |
| Cash (outflow)/inflow from borrowings | **(144.6)** | 649.0 |
| (Repayment)/drawdown of syndicated bank facility | **(200.0)** | 200.0 |
| Redemption of securitised loan notes | **(3.1)** | (2.8) |
| Redemption of medium term notes | **(58.3)** | (95.2) |
| Decrease in obligations under finance leases | **(3.0)** | (1.6) |
| Redemption of B shares | **(11.0)** | – |
| Movement in other creditors treated as financing | **–** | 7.7 |
| | **(420.0)** | 757.1 |

## 29 ANALYSIS OF CASH FLOWS GIVEN IN THE CASH FLOW STATEMENT continued

| | **52 weeks ended 1 April 2006 £m** | 52 weeks ended 2 April 2005 £m |
|---|---|---|
| **E Other equity financing** | | |
| Shares issued under employee share schemes | **61.8** | 68.4 |
| Redemption of B shares | **–** | (19.2) |
| Net (purchase)/sale of own shares held in employee trusts | **(6.0)** | 0.6 |
| Purchase of own shares | **–** | (2,300.0) |
| Tender Offer expenses | **–** | (14.9) |
| | **55.8** | (2,265.1) |

| | **52 weeks ended 1 April 2006 £m** | 52 weeks ended 2 April 2005 £m |
|---|---|---|
| **F Exceptional operating cash flows** | | |
| UK restructuring costs | **(7.0)** | (27.0) |
| Closure of Lifestore | **(6.7)** | (3.1) |
| Defence costs | **(0.2)** | (36.2) |
| Board restructure | **–** | (7.7) |
| Head office relocation | **–** | (12.6) |
| Restructuring of general merchandise logistics operations | **–** | (0.7) |
| Closure of European operations | **(0.7)** | 12.7 |
| | **(14.6)** | (74.6) |

Additions to property, plant and equipment during the year amounting to £1.3m were financed by new finance leases.

## 30 ANALYSIS OF NET DEBT

### A Reconciliation of movement in net debt

| | At 3 April 2005 £m | Adoption of IAS 32 and IAS 39 £m | Cash flow £m | Exchange and other movements £m | **At 1 April 2006 £m** |
|---|---|---|---|---|---|
| **Net cash:** | | | | | |
| Bank loans (see note 21) | (212.9) | – | 122.9 | – | **(90.0)** |
| Less: amounts treated as financing (see below) | 149.6 | – | (144.6) | – | **5.0** |
| | (63.3) | – | (21.7) | – | **(85.0)** |
| Cash and cash equivalents (see note 19) | 212.6 | – | 153.2 | 1.6 | **367.4** |
| **Net cash per cash flow statement** | 149.3 | – | 131.5 | 1.6 | **282.4** |
| **Available for sale investments (see note 17)** | 67.0 | – | (1.0) | 1.7 | **67.7** |
| **Debt financing:** | | | | | |
| Bank loans, overdrafts and commercial paper treated as financing (see above) | (149.6) | – | 144.6 | – | **(5.0)** |
| Syndicated bank facility (see note 21) | (200.0) | – | 200.0 | – | **–** |
| Medium term notes (see note 21) | (1,646.9) | (63.8) | 58.3 | (4.3) | **(1,656.7)** |
| Securitised loan notes (see note 21) | (313.6) | – | 3.1 | (0.3) | **(310.8)** |
| Finance lease liabilities (see note 21) | (53.9) | – | 3.0 | (1.3) | **(52.2)** |
| Non-equity B shares (see note 21) | – | (65.7) | 11.0 | – | **(54.7)** |
| **Debt financing** | (2,364.0) | (129.5) | 420.0 | (5.9) | **(2,079.4)** |
| **Net debt** | (2,147.7) | (129.5) | 550.5 | (2.6) | **(1,729.3)** |

# Notes to the financial statements continued

## 30 ANALYSIS OF NET DEBT continued

### B Reconciliation of net debt to balance sheet

| | 2006 £m | 2005 £m |
|---|---|---|
| **Balance sheet and related notes** | | |
| Cash and cash equivalents | **362.6** | 212.6 |
| Current financial assets (see note 17) | **48.8** | 67.0 |
| Bank loans, overdrafts and commercial paper (see note 21) | **(90.0)** | (212.9) |
| Syndicated bank facility (see note 21) | **–** | (200.0) |
| Medium term notes (see note 21) | **(1,680.0)** | (1,646.9) |
| Securitised loan notes (see note 21) | **(311.7)** | (313.6) |
| Finance lease liabilities (see note 21) | **(50.2)** | (53.9) |
| Non-equity B shares (see note 21) | **(54.7)** | – |
| | **(1,775.2)** | (2,147.7) |
| Financial assets included within assets of discontinued operation (see note 7C) | **21.7** | – |
| Interest payable included within related borrowing | **24.2** | – |
| | **(1,729.3)** | (2,147.7) |

## 31 FOREIGN EXCHANGE RATES

| | Weighted average sales rate | | Weighted average profit rate | | Balance sheet rate | |
|---|---|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 | **2006** | 2005 |
| Euro | **1.47** | 1.46 | **1.47** | 1.46 | **1.43** | 1.46 |
| US dollar | **1.78** | 1.85 | **1.79** | 1.86 | **1.74** | 1.89 |
| Hong Kong dollar | **13.85** | 14.41 | **13.89** | 14.47 | **13.48** | 14.73 |

## 32 RELATED PARTY TRANSACTIONS

### A Subsidiaries

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Company and its subsidiaries are disclosed in the Company's separate financial statements (on page 99).

### B M&S Money

The Group sold Marks and Spencer Retail Financial Services Holdings Limited to HSBC Holdings plc on 9 November 2004. At the same time the Group and HSBC entered into a relationship under which the Group receives income in the form of fees representing an amount equivalent to costs incurred, 50% of the profits of M&S Money (after a notional tax charge and after deducting agreed operating and capital costs) together with an amount relating to sales growth. The fees received in the period from 10 November 2004 to 2 April 2005 were £16.4m.

In addition the Group also received in the same period £1.1m for rent and £15.1m for costs incurred as part of the transition of M&S Money to HSBC. The Group also conducted settlement transactions with M&S Money in the normal course of business. At 2 April 2005, the amount owed by M&S Money was £16.2m.

### C Hedge End joint venture

A loan of £5.0m was received from the joint venture on 9 October 2002. It is repayable on five business days' notice and was renewed on 31 December 2005. Interest was charged on the loan at 3% from 1 January 2004 to 31 December 2004 and at 5% thereafter.

### D Marks & Spencer Pension Scheme

Details of other transactions and balances held with the Marks and Spencer Pension Scheme are set out in note 11.

### E Key management compensation

| | **2006 £m** | 2005 £m |
|---|---|---|
| Salaries and short-term benefits | **12.0** | 12.5 |
| Post-employment benefits | **0.7** | 0.9 |
| Termination benefits | **1.6** | 7.0 |
| Share-based payments | **4.7** | 4.0 |
| | **19.0** | 24.4 |

The key management figures given above include directors. Further information about the remuneration of individual directors is provided in the Remuneration report.

During the year, key management have purchased goods at the Group's usual prices, less a 20% discount. This discount is available to all staff employed directly by the Group in the UK.

Interest-free loans outstanding to key management, which includes no directors, at 1 April 2006 were £13,678 (last year £50,561). The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provision has been made for doubtful debts in respect of the amounts owed by related parties.

# Notes to the financial statements continued

## 33 ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

| | | As at 2 Apr 2005 £m | As at 3 Apr 2004 £m |
|---|---|---|---|
| **Net assets and equity under UK GAAP** | | 521.4 | 2,454.0 |
| Adjustments (after taxation) | | | |
| IFRS 1 – 'Property Revaluation' | a | 376.2 | 378.5 |
| IFRS 2 – 'Share Schemes' | b | 9.8 | 6.2 |
| IAS 10 – 'Dividend Recognition' | c | 124.3 | 160.7 |
| IAS 17 – 'Leases' | | | |
| Treatment of leasehold land | d | (72.4) | (102.4) |
| Finance leases | e | (1.8) | (1.7) |
| Lease incentives | f | (21.0) | (17.2) |
| Fixed rental uplifts | g | (13.5) | (10.3) |
| IAS 19 – 'Employee Benefits' | h | (27.2) | (30.7) |
| IAS 38 – 'Intangible Assets' | | | |
| Software assets | i | 13.0 | 22.7 |
| Goodwill and brands | j | 1.3 | – |
| Other | | (0.9) | (0.7) |
| **Net assets and equity under IFRS** | | 909.2 | 2,859.1 |

| | | Year ended 2 Apr 2005 £m |
|---|---|---|
| **Net income under UK GAAP** | | 587.0 |
| Adjustments (before taxation) | | |
| IFRS 1 – 'Property Revaluation' | a | 1.1 |
| IFRS 2 – 'Share Schemes' | b | (23.0) |
| IAS 17 – 'Leases' | | |
| Treatment of leasehold land | d | 29.9 |
| Finance leases | e | (0.2) |
| Lease incentives | f | (5.1) |
| Fixed rental uplifts | g | (4.5) |
| IAS 19 – 'Employee Benefits' | h | 5.3 |
| IAS 38 – 'Intangible Assets' | | |
| Software assets | i | 1.4 |
| Goodwill and brands | j | 0.5 |
| Other | | (0.1) |
| | | 5.3 |
| Taxation | | 4.6 |
| Discontinued operations – software assets | | (10.7) |
| **Net income under IFRS** | | 586.2 |

**a) IFRS 1 – 'Property Revaluation'**
Under UK GAAP, property was stated at historical cost, subject to certain properties having been revalued as at 31 March 1988. A property revaluation was prepared on an existing use basis by external valuers DTZ Debenham Tie Leung as at 2 April 2004. The Group has elected under IFRS 1 to reflect this valuation, in so far as it relates to freehold land and buildings, as deemed cost on transition at 4 April 2004.

**b) IFRS 2 – 'Share Schemes'**
The Group operates a range of share-based incentive schemes. Under UK GAAP, where shares (or rights to shares) were awarded to employees, UITF 17 required that the charge to the profit and loss account should be based on the difference between the market value of shares at the date of grant and the exercise price (i.e. an intrinsic value basis) spread over the performance period. Save As You Earn (SAYE) schemes were exempt from this requirement and no charge was made. IFRS 2 requires that all shares or options (including SAYE) awarded to employees as remuneration should be measured at fair value at grant date, using an option pricing model, and charged against profits over the period between grant date and vesting date, being the vesting period. This treatment has been applied to all awards granted but not fully vested at the date of transition.

## 33 ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS continued

**c) IAS 10 – 'Events after the Balance Sheet Date'**
Under UK GAAP, dividends are recognised in the period to which they relate. IAS 10 requires that dividends declared after the balance sheet date should not be recognised as a liability at that balance sheet date as the liability does not represent a present obligation as defined by IAS 37 – 'Provisions, Contingent Liabilities, and Contingent Assets'. Accordingly the final dividends for 2003/04 (£160.7m) and 2004/05 (£124.3m) are derecognised in the balance sheets for April 2004 and April 2005 respectively.

**d) IAS 17 – 'Leases – Treatment of Leasehold Land'**
The Group previously recognised finance leases under the recognition criteria set out in SSAP 21. IAS 17 requires the land and building elements of property leases to be considered separately, with leasehold land normally being treated as an operating lease. As a consequence, payments made to acquire leasehold land, previously treated as fixed assets, have been recategorised as prepaid leases and amortised over the life of the lease. In addition, the revaluation previously attributed to the land element has been derecognised.

**e) IAS 17 – 'Leases – Finance Leases'**
Also under the provisions of IAS 17, the building elements of certain property leases, classified as operating leases under UK GAAP, have been reclassified as finance leases. The adjustments are to include the fair value of these leased buildings within fixed assets and to set up the related obligation, net of finance charges, in respect of future periods, within creditors.

**f) IAS 17 'Leases – Lease Incentives'**
Under UK GAAP, leasehold incentives received on entering into property leases were recognised as deferred income on the balance sheet and amortised to the profit and loss account over the period to the first rent review. Under IAS 17, these incentives have to be amortised over the term of the lease. Consequently, as the term of the lease is longer than the period to the first rent review, amounts previously amortised to the profit and loss account are reinstated on the balance sheet as deferred income and released over the term of the lease.

**g) IAS 17 – 'Leases – Fixed Rental Uplifts'**
The Group has a number of leases that contain predetermined, fixed rental uplifts. Under IAS 17, it is necessary to account for these leases such that the predetermined, fixed rental payments are recognised on a straight-line basis over the life of the lease. Under UK GAAP, the Group accounted for these property lease rentals such that the increases were charged in the year that they arose.

**h) IAS 19 – 'Employee Benefits'**
Previously no provision was made for holiday pay. Under IAS 19 – 'Employee Benefits' the expected cost of compensated short-term absences (e.g. holidays) should be recognised when employees render the service that increases their entitlement. As a result, an accrual has been made for holidays earned but not taken.

**i) IAS 38 – 'Software Assets'**
The cost of developing software used to be written off as incurred. Under IAS 38 – 'Intangible Assets' there is a requirement to capitalise internally generated intangible assets provided certain recognition criteria are met. Results have been adjusted to reflect the capitalisation and subsequent amortisation of costs that meet the criteria. As a result expenses previously charged to the profit and loss account have been brought onto the balance sheet as intangible software assets and amortised over their estimated useful lives.

**j) IAS 38 – 'Goodwill'**
Goodwill used to be capitalised and amortised over its useful economic life. Under IAS 38 – 'Intangible Assets' there is a requirement to separately identify brands and other intangibles acquired rather than include these as part of goodwill. Intangible assets, other than goodwill, are amortised over their useful lives. Goodwill, which is considered to have an indefinite life, is subject to an annual impairment review. As a result, the goodwill recognised under UK GAAP on the acquisition of per una of £125.5m has been split between brand (£80m) and goodwill (£45.5m). The goodwill amortisation under UK GAAP has been reversed but the brand has been amortised as required under IFRS.

**Cash flow statement**
The cash flows reported under IFRS relate to movements in cash and cash equivalents (defined as short-term highly liquid investments that are readily convertible into known amounts of cash and subject to insignificant risk of changes in value). Under UK GAAP, only the movement in cash (defined as cash in hand and deposits repayable on demand, less overdrafts) were reported in the cash flow statement. As a result of adopting IFRS, a £55.7m movement in cash equivalents in the year to 2 April 2005 is now reported as a cash flow movement rather than as movement in financial investment.

# Notes to the financial statements continued

## 34 FIRST TIME ADOPTION OF IAS 32 AND IAS 39

The adoption of IAS 32 – 'Financial Instruments: Disclosure and Presentation' and IAS 39 – 'Financial Instruments: Recognition and Measurement' with effect from 3 April 2005 results in a change in the Group's accounting policy for financial instruments. The impact of these standards on the Group's opening balance sheet is shown below.

The principal impacts of IAS 32 and IAS 39 on the Group's financial statements relate to the recognition of derivative financial instruments at fair value and the reclassification of non-equity B shares as debt. Any derivatives that do not qualify for hedge accounting are held on the balance sheet at fair value with the changes in value reflected through the income statement. The accounting treatment of derivatives that qualify for hedge accounting depends on how they are designated, as follows:

**Fair value hedges**
The Group uses interest rate swaps to hedge the exposure to interest rates of its issued debt. Under UK GAAP, derivative financial instruments were not recognised at fair value in the balance sheet.

Under IAS 39, derivative financial instruments that meet the 'fair value' hedging requirements are recognised in the balance sheet at fair value with corresponding fair value movements recognised in the income statement. For an effective fair value hedge, the hedged item is adjusted for changes in fair value attributable to the risk being hedged with the corresponding entry in the income statement. To the extent that the designated hedge relationship is fully effective, the amounts in the income statement offset each other. As a result, only the ineffective element of any designated hedging relationship impacts the financing line in the income statement.

**Cash flow hedges**
Under IAS 39, derivative financial instruments that qualify for cash flow hedging are recognised on the balance sheet at fair value with corresponding fair value changes deferred in equity. In addition, the Group hedges the foreign currency exposure on inventory purchases. Under UK GAAP, foreign currency derivatives were held off balance sheet and these are now treated as cash flow hedges.

The adjustments to the opening balance sheet as at 3 April 2005 are as follows:

| | Opening balance sheet under IFRS £m | Effect of IAS 32 and IAS 39 £m | Restated opening position at 3 Apr 2005 £m |
|---|---|---|---|
| **Non-current assets** | | | |
| Derivative financial instruments | – | 71.1 | 71.1 |
| Deferred tax asset | 24.6 | 1.3 | 25.9 |
| **Current assets** | | | |
| Derivative financial instruments | – | 2.8 | 2.8 |
| Inventories | 338.9 | 0.4 | 339.3 |
| **Current liabilities** | | | |
| Derivative financial instruments | – | (1.9) | (1.9) |
| Borrowings | (478.8) | (66.2) | (545.0) |
| Trade and other payables | (717.9) | 24.7 | (693.2) |
| **Non-current liabilities** | | | |
| Derivative financial instruments | – | (12.0) | (12.0) |
| Borrowings | (1,948.5) | (87.8) | (2,036.3) |
| **Impact on net assets** | | (67.6) | |
| Non-equity B shares | | (65.7) | |
| Hedging reserve | | (1.6) | |
| Retained earnings | | (0.3) | |
| **Impact on shareholders' funds** | | (67.6) | |

# Company income statement

| | Notes | **52 weeks ended 1 April 2006 £m** | 52 weeks ended 2 April 2005 £m |
|---|---|---|---|
| **Operating profit** | C2, C3 | **–** | – |
| Income from shares in Group undertakings | | **205.2** | 946.7 |
| Interest receivable | C4 | **–** | 1.7 |
| Interest payable and similar charges | C4 | **(2.5)** | – |
| **Profit on ordinary activities before taxation** | | **202.7** | 948.4 |
| Income tax expense | | **–** | (0.5) |
| **Profit for the year attributable to shareholders** | | **202.7** | 947.9 |

# Company balance sheet

| | Notes | **2006 £m** | 2005 £m |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Investments in Group undertakings | C6 | **9,046.1** | 9,046.0 |
| **Current assets** | | | |
| Trade and other receivables | | **0.4** | 0.1 |
| **Total assets** | | **9,046.5** | 9,046.1 |
| **LIABILITIES** | | | |
| **Current liabilities** | | | |
| Amounts owed to Group undertakings | | **2,051.7** | 2,100.1 |
| Current tax liabilities | | **–** | 0.5 |
| Trade and other payables | | **0.3** | 0.4 |
| Non-equity B shares | | **54.7** | – |
| **Total liabilities** | | **2,106.7** | 2,101.0 |
| **Net assets** | | **6,939.8** | 6,945.1 |
| **EQUITY** | | | |
| Called up share capital – equity | | **420.6** | 414.5 |
| Called up share capital – non-equity | | **–** | 65.7 |
| Share premium account | C7 | **162.3** | 106.6 |
| Capital redemption reserve | C7 | **2,113.8** | 2,102.8 |
| Merger reserve | C7 | **1,397.3** | 1,397.3 |
| Retained earnings | C7 | **2,845.8** | 2,858.2 |
| **Total equity** | | **6,939.8** | 6,945.1 |

Approved by the Board
26 May 2006

**Stuart Rose**, Chief Executive
**Ian Dyson**, Group Finance Director

# Company statement of changes in shareholders' equity

| | 52 weeks ended 1 April 2006 £m | 52 weeks ended 2 April 2005 £m |
|---|---|---|
| Profit attributable to shareholders | **202.7** | 947.9 |
| Dividends | **(204.1)** | (239.7) |
| | **(1.4)** | 708.2 |
| Shares issued on the exercise of share options | **61.8** | 68.4 |
| Purchase of own shares | **–** | (2,300.0) |
| Tender Offer expenses | **–** | (14.9) |
| Redemption of B shares | **–** | (19.2) |
| Change in shareholders' equity | **60.4** | (1,557.5) |
| Opening shareholders' equity | **6,945.1** | 8,502.6 |
| First time adoption of IAS 32 and 39 | **(65.7)** | – |
| Closing shareholders' equity | **6,939.8** | 6,945.1 |

# Company cash flow statement

| | 52 weeks ended 1 April 2006 £m | 52 weeks ended 2 April 2005 £m |
|---|---|---|
| **Cash flows from operating activities** | | |
| Cash generated from operations | **(0.4)** | 0.7 |
| Tax paid | **(0.5)** | – |
| **Net cash (outflow)/inflow from operating activities** | **(0.9)** | 0.7 |
| **Cash flows from investing activities** | | |
| Dividends received | **205.2** | 946.7 |
| Pre-acquisition dividend received | **–** | 1,626.7 |
| Investment in subsidiary | **(0.1)** | (5.5) |
| Interest received | **–** | 1.7 |
| **Net cash inflow from investing activities** | **205.1** | 2,569.6 |
| **Cash flows from financing activities** | | |
| Interest paid | **(2.5)** | – |
| Non-equity dividends paid | **–** | (2.8) |
| Purchase of own shares | **–** | (2,300.0) |
| Redemption of non-equity B shares | **(11.0)** | (19.2) |
| Shares issued under employee share schemes | **61.8** | 68.4 |
| Repayment of intercompany loan | **(48.4)** | (64.9) |
| Tender Offer expenses | **–** | (14.9) |
| Equity dividends paid | **(204.1)** | (236.9) |
| **Net cash outflow from financing activities** | **(204.2)** | (2,570.3) |
| **Net cash inflow from activities** | **–** | – |
| **Cash and cash equivalents at beginning and end of period** | **–** | – |

# Company notes to the financial statements

## C1 ACCOUNTING POLICIES

The Company's accounting policies are given in note 1 of the Group financial statements.

## C2 EMPLOYEES

The Company had no employees during the current or prior period. Directors received emoluments in respect of their services to the Company during the period of £502,000 (last year £401,000). The Company did not operate any pension schemes during the current or preceding financial year.

## C3 AUDITORS' REMUNERATION

Auditors' remuneration of £0.3m (last year £0.2m) in respect of the Company's annual audit has been borne by its subsidiary Marks and Spencer plc.

## C4 INTEREST

| | **2006 £m** | 2005 £m |
|---|---|---|
| Bank and other interest receivable | **–** | 1.7 |
| Dividends on non-equity B shares[1] | **(2.5)** | – |
| Net interest (payable)/receivable | **(2.5)** | 1.7 |

[1] Under IAS 32 – 'Financial Instruments' dividends on non-equity shares, previously shown as dividends, are now treated as interest payable.

## C5 DIVIDENDS

| | **2006 per share** | 2005 per share | **2006 £m** | 2005 £m |
|---|---|---|---|---|
| **Dividends on equity ordinary shares:** | | | | |
| Paid final dividend | **7.5p** | 7.1p | **124.3** | 161.3 |
| Paid interim dividend | **4.8p** | 4.6p | **79.8** | 75.6 |
| | **12.3p** | 11.7p | **204.1** | 236.9 |
| **Dividends on non-equity B shares[1]:** | | | | |
| Interim dividend | **–** | 3.36% | **–** | 1.4 |
| Final dividend | **–** | 3.78% | **–** | 1.4 |
| | | | **–** | 2.8 |
| | | | **204.1** | 239.7 |

[1] Under IAS 32 – 'Financial Instruments' dividends on non-equity shares are now treated as part of interest.

In addition, the directors have proposed a final dividend in respect of the financial year ended 1 April 2006 of 9.2p per share amounting to a dividend of £154.8m. It will be paid on 14 July 2006 to shareholders who are on the Register of Members on 2 June 2006. In line with the requirements of IAS 10 – 'Events after the Balance Sheet date', the dividend has not been recognised in these results.

# Company notes to the financial statements continued

## C6 PRE-ACQUISITION PROFITS

### A Investments in Group undertakings

| | 2006 £m | 2005 £m |
|---|---|---|
| Beginning of the year | **9,046.0** | 10,667.2 |
| Additional investment in subsidiary | **0.1** | 5.5 |
| Dividends paid out of pre-acquisition profits | **–** | (1,626.7) |
| End of year | **9,046.1** | 9,046.0 |

Shares in Group undertakings represents the Company's investment in Marks and Spencer plc.

### B Principal subsidiary undertakings

The Company's principal subsidiary undertakings are set out below. A schedule of interests in all undertakings is filed with the Annual Return.

| | Principal activity | Country of incorporation and operation | Proportion of voting rights and shares held by: | |
|---|---|---|---|---|
| | | | Company | A subsidiary |
| Marks and Spencer plc | Retailing | Great Britain | 100% | – |
| Marks and Spencer International Holdings Limited | Holding Company | Great Britain | – | 100% |
| Marks and Spencer (Nederland) BV | Holding Company | The Nederlands | – | 100% |
| Marks and Spencer Finance Inc | Holding Company | United States | – | 100% |
| Marks and Spencer (Ireland) Limited | Retailing | Republic of Ireland | – | 100% |
| Kings Super Markets Inc | Retailing | United States | – | 100% |
| Marks and Spencer (Asia Pacific) Limited | Retailing | Hong Kong | – | 100% |
| Marks and Spencer Simply Foods Limited | Retailing | Great Britain | – | 100% |
| M.S. Insurance L.P. | Financial Services | Guernsey | – | 100% |
| Marks and Spencer Investments Limited | Finance | Great Britain | – | 100% |
| St Michael Finance plc | Finance | Great Britain | – | 100% |
| Marks and Spencer Finance plc | Finance | Great Britain | – | 100% |
| Amethyst Leasing (Properties) Limited | Finance | Great Britain | – | 100% |
| Amethyst Finance plc | Finance | Great Britain | – | –[1] |
| Marks and Spencer Chester Limited | Property Investment | Great Britain | – | 100% |
| Marks and Spencer SCM Limited | Procurement | Great Britain | – | 100% |
| Per Una Group Limited | Procurement | Great Britain | – | 100% |
| The Zip Project Limited | Procurement | Great Britain | – | 100% |

[1] Amethyst Finance plc is a wholly-owned subsidiary of a non-group company but has been consolidated in these accounts under SIC 12 – 'Consolidation – Special Purpose Entities', as it meets the definition of a special purpose entity.

The Company has taken advantage of the exemption under Section 231(5) of the Companies Act 1985 by providing information only in relation to subsidiary undertakings whose results or financial position, in the opinion of the directors, principally affected the financial statements.

## C7 STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

| | Share capital | | | | | | |
|---|---|---|---|---|---|---|---|
| | Ordinary shares £m | Non-equity B shares £m | Share premium account £m | Capital redemption reserve £m | Merger reserve £m | Profit and loss account £m | Total £m |
| **At 4 April 2004** | 566.3 | 84.9 | 45.2 | 1,924.8 | 3,024.0 | 2,857.4 | 8,502.6 |
| Profit for the year attributable to shareholders | – | – | – | – | – | 947.9 | 947.9 |
| Dividends | – | – | – | – | – | (239.7) | (239.7) |
| Shares issued on exercise of share options | 7.0 | – | 61.4 | – | – | – | 68.4 |
| Redemption of B shares | – | (19.2) | – | 19.2 | – | (19.2) | (19.2) |
| Purchase of own shares | (158.8) | – | – | 158.8 | – | (2,300.0) | (2,300.0) |
| Tender Offer expenses | – | – | – | – | – | (14.9) | (14.9) |
| Realisation of merger reserve for dividends paid out of pre-acquisition profits | – | – | – | – | (1,626.7) | 1,626.7 | – |
| **At 2 April 2005** | 414.5 | 65.7 | 106.6 | 2,102.8 | 1,397.3 | 2,858.2 | 6,945.1 |

## C7 STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY continued

| | Share capital | | Share premium account | Capital redemption reserve | Merger reserve | Profit and loss account | Total |
|---|---|---|---|---|---|---|---|
| | Ordinary shares £m | Non-equity B shares £m | £m | £m | £m | £m | £m |
| **At 3 April 2005** | 414.5 | 65.7 | 106.6 | 2,102.8 | 1,397.3 | 2,858.2 | 6,945.1 |
| First time adoption of IAS 32 and IAS 39 | – | (65.7) | – | – | – | – | (65.7) |
| | 414.5 | – | 106.6 | 2,102.8 | 1,397.3 | 2,858.2 | 6,879.4 |
| Profit for the year attributable to shareholders | – | – | – | – | – | 202.7 | 202.7 |
| Dividends | – | – | – | – | – | (204.1) | (204.1) |
| Shares issued on exercise of share options | 6.1 | – | 55.7 | – | – | – | 61.8 |
| Redemption of B shares | – | – | – | 11.0 | – | (11.0) | – |
| **At 1 April 2006** | **420.6** | **–** | **162.3** | **2,113.8** | **1,397.3** | **2,845.8** | **6,939.8** |

## C8 RELATED PARTY TRANSACTIONS

During the year, the Company has received dividends from Marks and Spencer plc of £205.2m (last year £2,573.4m) and has made loan repayments of £48.4m (last year £64.9m). There were no other related party transactions.

## C9 ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

| | | As at 2 April 2005 £m | As at 3 April 2004 £m |
|---|---|---|---|
| **Net assets and equity under UK GAAP** | | 5,628.8 | 5,580.0 |
| Adjustments (after taxation) | | | |
| IAS 10 – 'Dividend Recognition' | a | (81.0) | (101.4) |
| IAS 27 – 'Consolidated and Separate Financial Statements' | b | 1,397.3 | 3,024.0 |
| **Net assets and equity under IFRS** | | 6,945.1 | 8,502.6 |

| | | Year ended 2 April 2005 £m |
|---|---|---|
| **Net income under UK GAAP** | | 2,516.6 |
| Adjustments (before taxation) | | |
| IAS 10 – 'Dividend Recognition' | a | 58.0 |
| IAS 27 – 'Consolidated and Separate Financial Statements' | b | (1,626.7) |
| **Net income under IFRS** | | 947.9 |

**a) IAS 10 – 'Events after the Balance Sheet Date'**
Under UK GAAP, dividends are recognised in the period to which they relate. IAS 10 requires that dividends declared after the balance sheet date should not be recognised as a liability at that balance sheet date as the liability does not represent a present obligation as defined by IAS 37 – 'Provisions, Contingent Liabilities, and Contingent Assets'.

**b) IAS 27 – 'Consolidated and Separate Financial Statements'**
Under UK GAAP, the Company's investment in Marks and Spencer plc was measured at the nominal value of the shares issued. In accordance with IAS 27 - 'Consolidated and Separate Financial Statements', the Company's investment was restated to the fair value of shares issued with a corresponding entry being made to a merger reserve. During the year ended 2 April 2005 dividends of £1,626.7m were paid out of pre-acquisition profits. Under IAS 27 this payment is treated as a reduction in the cost of investment and a transfer was made between the profit and loss account and the merger reserve.

# Group financial record

The figures for 2006 and 2005 are prepared under IFRS. The figures for 2004, 2003 and 2002 are UK GAAP figures presented in the same format as the 2005 and 2006 figures. The principal differences between UK GAAP and IFRS are described in notes 33 and 34 to the financial statements which provides an explanation of the transition to IFRS.

Comparatives for 2002 were not restated following the adoption of FRS17 – 'Retirement Benefits', Application Note G of FRS 5 – 'Revenue Recognition' and UITF 38 – 'Accounting for ESOP Trusts' in 2004.

| | **IFRS 2006 52 weeks £m** | IFRS 2005 52 weeks £m | UK GAAP 2004 53 weeks £m | UK GAAP 2003 52 weeks £m | UK GAAP 2002 52 weeks £m |
|---|---|---|---|---|---|
| **Income statement** | | | | | |
| Revenue (excluding sales taxes) | **7,797.7** | 7,490.5 | 7,728.1 | 7,399.0 | 6,939.9 |
| **Operating profit** | | | | | |
| United Kingdom | **784.5** | 528.0 | 738.6 | 601.5 | 550.4 |
| Overseas | **65.6** | 70.1 | 45.0 | 34.9 | 16.9 |
| Excess interest charged to cost of sales of financial services | **–** | – | – | – | 6.4 |
| **Total operating profit** | **850.1** | 598.1 | 783.6 | 636.4 | 573.7 |
| **Analysed as** | | | | | |
| Before exceptional operating charges | **850.1** | 648.7 | 825.7 | 680.3 | 523.5 |
| Exceptional operating charges | **–** | (50.6) | (42.1) | (43.9) | 50.0 |
| Net interest (payable)/receivable | **(121.9)** | (104.4) | (45.7) | (40.6) | 16.8 |
| Other finance income/(charge) | **17.5** | 11.4 | (15.2) | 27.0 | – |
| **Profit before taxation** | **745.7** | 505.1 | 722.7 | 622.8 | 590.5 |
| Taxation on ordinary activities | **(225.1)** | (150.1) | (225.1) | (182.1) | (158.2) |
| Minority interests | **–** | – | – | 0.4 | (0.4) |
| **Profit after taxation and minority interests** | **520.6** | 355.0 | 497.6 | 441.1 | 431.9 |
| Profit from discontinued operations | **2.5** | 231.2 | 54.7 | 66.2 | (278.9) |
| **Profit attributable to shareholders** | **523.1** | 586.2 | 552.3 | 507.3 | 153.0 |

| | IFRS 2006 £m | IFRS 2005 £m | UK GAAP 2004 £m | UK GAAP 2003 £m | UK GAAP 2002 £m |
|---|---|---|---|---|---|
| **Balance sheet** | | | | | |
| **Non-current assets** | | | | | |
| Intangible non-current assets | **163.5** | 165.4 | – | – | – |
| Property, plant and equipment (including investment properties) | **3,614.3** | 3,624.8 | 3,497.6 | 3,435.1 | 3,381.2 |
| Trade and other receivables | **242.8** | 211.2 | 1,779.3 | 1,559.5 | 1,667.2 |
| Joint ventures and other financial assets | **12.3** | 9.0 | 10.0 | 29.7 | 50.3 |
| Deferred tax asset | **35.5** | 24.6 | 203.5 | 277.1 | – |
| **Non-current assets** | **4,068.4** | 4,035.0 | 5,490.4 | 5,301.4 | 5,098.7 |
| **Current assets** | **1,142.1** | 832.3 | 2,086.7 | 1,686.8 | 2,093.5 |
| **Total assets** | **5,210.5** | 4,867.3 | 7,577.1 | 6,988.2 | 7,192.2 |
| **Current liabilities** | **(2,017.0)** | (1,237.4) | (1,919.9) | (1,769.4) | (1,881.6) |
| **Non-current liabilities** | | | | | |
| Net post retirement liability | **(794.9)** | (676.0) | (669.5) | (1,278.2) | (25.3) |
| Other non-current liabilities | **(1,243.3)** | (2,044.7) | (2,533.7) | (1,832.3) | (2,204.0) |
| **Total liabilities** | **(4,055.2)** | (3,958.1) | (5,123.1) | (4,879.9) | (4,110.9) |
| **Net assets** | **1,155.3** | 909.2 | 2,454.0 | 2,108.3 | 3,081.3 |

| | IFRS 2006 52 weeks £m | IFRS 2005 52 weeks £m | UK GAAP 2004 53 weeks £m | UK GAAP 2003 52 weeks £m | UK GAAP 2002 52 weeks £m |
|---|---|---|---|---|---|
| **Cash flow** | | | | | |
| **Cash flows from operating activities** | | | | | |
| Generating from operating activities | **1,197.5** | 1,601.8 | 666.5 | 1,168.7 | 1,093.7 |
| Taxation paid | **(101.5)** | (166.7) | (220.4) | (216.9) | (179.4) |
| **Cash flows from operating activities** | **1,096.0** | 1,435.1 | 446.1 | 951.8 | 914.3 |
| **Cash flows from investing activities** | | | | | |
| Capital expenditure and financial investment | **(266.3)** | (113.5) | (317.4) | (326.7) | 163.2 |
| Acquisitions and disposals | **–** | 351.1 | 51.3 | (38.8) | 261.6 |
| Dividends received from joint venture | **–** | – | – | 8.0 | – |
| Interest received | **12.9** | 15.4 | 14.4 | 11.9 | 38.8 |
| **Cash flows from investing activities** | **(253.4)** | 253.0 | (251.7) | (345.6) | 463.6 |
| **Cash flows from financing activities** | | | | | |
| Interest paid | **(142.8)** | (116.5) | (61.2) | (51.3) | (2.0) |
| Non-equity dividend paid | **–** | (2.8) | (3.0) | (6.8) | – |
| Other debt financing | **(420.0)** | 757.1 | 413.6 | (431.4) | 1,031.7 |
| Equity dividends paid | **(204.1)** | (236.9) | (247.1) | (225.4) | (256.7) |
| Other equity financing | **55.8** | (2,265.1) | (66.6) | (280.9) | (1,761.9) |
| **Cash flows from financing activities** | **(711.1)** | (1,864.2) | 35.7 | (995.8) | (988.9) |
| **Net cash inflow from activities** | **131.5** | (176.1) | 230.1 | (389.6) | 389.0 |

# Group financial record continued

## Key performance measures

| | | IFRS 2006 52 weeks | IFRS 2005 52 weeks | UK GAAP 2004 53 weeks | UK GAAP 2003 52 weeks | UK GAAP 2002 52 weeks |
|---|---|---|---|---|---|---|
| Gross margin[1] | Gross profit / Revenue | **38.3%** | 34.7% | 35.4% | 34.8% | 34.4% |
| Net margin[1] | Operating profit / Revenue | **10.9%** | 8.0% | 9.9% | 8.6% | 7.7% |
| Net margin excluding exceptional items and asset disposals | | **11.0%** | 8.7% | 10.2% | 9.2% | 7.1% |
| Profitability[1] | Profit before tax / Revenue | **9.6%** | 6.7% | 9.4% | 8.4% | 8.5% |
| Profitability excluding exceptional items and asset disposals | | **9.6%** | 7.4% | 9.7% | 9.0% | 7.9% |
| Earnings per share | Standard earnings / Weighted average ordinary shares in issue | **31.4p** | 29.1p | 24.2p | 21.8p | 5.4p |
| Earnings per share adjusted for exceptional items and asset disposals | | **31.5p** | 20.8p | 24.7p | 23.3p | 16.3p |
| Dividends per share declared in respect of the year | | **14.0p** | 12.1p | 11.5p | 10.5p | 9.5p |
| Dividend cover[2] | Profit attributable to shareholders / Dividend payable | **2.2x** | 2.9x | 2.1x | 2.1x | 2.2x |
| Return on equity[2] | Profit attributable to shareholders / Average equity shareholders' funds | **52.3%** | 35.0% | 25.2% | 22.4% | 11.5% |
| Retail gearing | Retail debt + net post retirement liability / Retail debt + net post retirement liability + retail shareholders' funds | **69.7%** | 75.8% | 44.7% | 53.0% | 27.0% |
| Retail fixed charge cover | Operating profit before depreciation and operating lease charges / Fixed charges[3] | **4.9x** | 4.1x | 7.3x | 6.9x | 12.6x |
| Net debt (£m) | | **1,729.3** | 2,147.7 | 1,994.7 | 1,831.4 | 1,907.0 |
| Capital expenditure (£m) | | **326.8** | 218.5 | 433.5 | 311.0 | 290.5 |

NOTE: Comparatives for 2003 have been restated following the adoption of FRS 17 – 'Retirement Benefits', Application Note G of FRS 5 – 'Revenue Recognition' and UITF 38 – 'Accounting for ESOP Trusts'.

[1] Based on continuing operations.

[2] Stated before goodwill written off of £368.2m in 2002, dividend cover and return on equity are 0.6 times and 3.4% after the write-off of goodwill.

[3] Fixed charges are defined as interest and operating leases.

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# Shareholder information

## FINANCIAL CALENDAR

Record date to be eligible for the final dividend
**2 JUNE 2006**

Annual General Meeting – The ICC, Birmingham
**2pm on 11 JULY 2006**

Final ordinary dividend for the year to 1 April 2006 to be paid
**14 JULY 2006**

Interim results to be announced
**7 NOVEMBER 2006***

Record date to be eligible for interim dividend
**17 NOVEMBER 2006***

Interim ordinary dividend to be paid
**12 JANUARY 2007***

* Provisional dates

## Ordinary shares

As at 1 April 2006 there are 246,525 holders of ordinary shares whose shareholdings are analysed as follows

| Size of shareholding | Number of shareholders | Percentage of total number of shareholders | Number of ordinary shares 000's | Percentage of ordinary shares |
|---|---|---|---|---|
| Over 1,000,000 | 216 | 0.09 | 1,178,733,765 | 70.06 |
| 100,001 – 1,000,000 | 534 | 0.22 | 191,205,420 | 11.36 |
| 10,001 – 100,000 | 3,226 | 1.31 | 74,739,881 | 4.44 |
| 5,001 – 10,000 | 6,492 | 2.63 | 44,924,348 | 2.67 |
| 2,001 – 5,000 | 25,358 | 10.29 | 77,374,988 | 4.60 |
| 1,001 – 2,000 | 37,278 | 15.12 | 53,194,784 | 3.16 |
| 501 – 1,000 | 50,272 | 20.39 | 37,463,328 | 2.23 |
| 1 – 500 | 123,149 | 49.95 | 24,800,500 | 1.48 |
| | 246,525 | 100.0 | 1,682,437,014 | 100.0 |

Shareholders are further analysed as follows

| Type of owner | Number of shareholders | Percentage of total number of shareholders | Number of ordinary shares 000's | Percentage of ordinary shares |
|---|---|---|---|---|
| Private holders | 238,252 | 97.0 | 342,895,295 | 20.38 |
| Institutional and corporate holders | 8,273 | 3.0 | 1,339,541,719 | 79.62 |
| | 246,525 | 100.0 | 1,682,437,014 | 100.0 |

## B shares

As at 1 April 2006 there were 63,926 holders of B shares holding a total of 78,184,314 shares. All of these remaining B shares were purchased by the Company on 5 May 2006 and cancelled. If you have any queries regarding the B shares please call Lloyds TSB Registrars.

## Shareholder vouchers

We sent Café Revive and Spend & Save vouchers to our shareholders in 2005 to reward them as valued customers in our stores. We also extended the offer to nominee companies and their beneficial owners, which included a further 100,000 investors. We will be repeating the programme in 2006, mailing the vouchers in July. For further information, please telephone Lloyds TSB Registrars.

## Company website

Visit www.marksandspencer.com/thecompany to find out more about your Company. You can catch up on the latest news in the press release section, read the latest Annual report and review, as well as watch recordings of past AGMs and our financial results presentations. Our 2006 AGM is being broadcast live on the internet and details of how you can view this are included in your Notice of Meeting. We welcome feedback on the site. Please e-mail your comments to chairman@marks-and-spencer.com.

## Electronic shareholder communication

Shareview is an electronic communication service for shareholders run by Lloyds TSB Registrars, who maintain the share register on our behalf. Registering for Shareview is easy, secure and free – just go to www.shareview.co.uk, click on "Register now" and follow the on-screen process. Features of the service allow you to:

- elect to be alerted by email when the Annual report, Annual review and Notice of Meeting are available on our website. You can then read these online instead of receiving copies in the post;
- check your Marks & Spencer shareholding;
- access information about your dividends;
- value your portfolio;
- change your registered address details;
- set up a new dividend mandate or change your existing details; and
- send your AGM proxy voting instructions electronically.

When you register with Shareview you can select your preferred communication method, post or email. The information you receive electronically will be the same as the paper version, only you will receive it sooner. This will help us save your Company money and help conserve environmental resources.

## REGISTERED OFFICE AND HEAD OFFICE

Waterside House, 35 North Wharf Road, London W2 1NW
Telephone +44 (0) 20 7935 4422

## REGISTERED NUMBER

4256886

## GROUP SECRETARY AND HEAD OF CORPORATE GOVERNANCE

Graham Oakley

## REGISTRARS

Lloyds TSB Registrars,
The Causeway, Worthing,
West Sussex BN99 6DA
Telephone 0845 609 0810
and outside the UK
+44 121 415 7071
www.lloydstsb-registrars.co.uk

### Dividend Reinvestment Plan

You can elect to receive future dividends as shares rather than cash by participating in the Dividend Reinvestment Plan. For further information, and to apply online, visit www.Shareview.co.uk and view the feature "reinvest your dividends". Alternatively, telephone Lloyds TSB Registrars.

### Dividends direct to your bank account

Having your dividend paid directly into your bank or building society account gives the following benefits:

- avoid the risk of cheques being lost in the post;
- no need to present cheques for payment; and
- dividend credited to your account on payment date.

Your tax voucher will be sent to your registered address as usual.

To set up a dividend mandate or change your existing mandated details, please either log on to www.Shareview.co.uk and follow the instructions or telephone Lloyds TSB Registrars.

### ShareGift

Shareholders generously donated to ShareGift following the final redemption of the B shares in May 2006. ShareGift is a registered charity administered by The Orr Mackintosh Foundation. Set up in 1996, ShareGift has donated the proceeds of unwanted shareholdings to support a wide range of UK charities.

Shareholders with a small number of shares, the value of which makes it uneconomical to sell, may wish to consider donating them to charity through ShareGift.

Find out more at www.ShareGift.org or by telephoning ShareGift on 020 7337 0501.

### Capital gains tax

For the purposes of Capital Gains Tax, the price of an ordinary share on 31 March 1982 was 153.5p, which, when adjusted for the 1 for 1 scrip issue in 1984, gives a figure of 76.75p. Following the capital reorganisation in March 2002, the Inland Revenue has confirmed the base cost for CGT purposes was 372.35p (81.43%) for an ordinary share and 68.75p (18.57%) for a B share.

### American Depositary Receipts (ADRs)

The Company has a level 1 ADR programme sponsored by JP Morgan Chase Bank NA to enable US investors to purchase Marks & Spencer American Depository Shares (ADS's) in US Dollars 'over the counter'. Each ADS represents six ordinary shares. For further information, please contact:

JP Morgan Chase Bank, NA P.O. Box 43013, Providence, RI 02940-3013, USA

Email: adr@jpmorgan.com
Website: www.adr.com
Toll-free for callers within the US: (800) 990 1135
For those calling outside the US: +1 (781) 575 4328

### Half year results

This year, we will advertise our half year results in selected national newspapers rather than publishing a booklet and posting it to shareholders. The full statement will be available on our website.

### Corporate social responsibility

A copy of our Corporate Social Responsibility Report is available online at www.marksandspencer.com/csrreport2006

### Unsolicited mail

The Company is obliged by law to make its share register publicly available and, as a consequence, some shareholders may receive unsolicited mail. If you wish to limit the amount of unsolicited mail you receive, please contact:

The Mailing Preference Service (MPS)
DMA House
70 Margaret Street
London W1W 8SS

Alternatively register online at www.mpsonline.org.uk or call the MPS Registration line on 0845 703 4599.

The Mailing Preference Service is an independent organisation which offers a free service to the public. Registering with them will help stop most unsolicited consumer advertising material.

The use of a nominee company can also help protect your privacy. You can transfer your shares into our corporate nominee company by contacting Lloyds TSB Registrars. Alternatively, contact your broker for information on their nominee services.

## CONTACT US

**We welcome your comments as we endeavour to develop our products and services.**

**e-mail us at**
chairman@marks-and-spencer.com

**Customer Queries**
0845 302 1234

**Lloyds TSB Registrars**
**For shareholder queries please telephone**
0845 609 0810
+44 (0) 121 415 7071 (outside the UK)

## FURTHER INFORMATION

For additional copies of the Annual report or Annual review and summary financial statements go to:

**www.marksandspencer.com/thecompany**

**Alternatively call 0800 591 697.**

Audio files can be downloaded from our website.

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