



Tim Steiner, OBE
Chief Executive Officer

9. Chief Executive Officer's Review

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Robust progress in a challenging market

Our 2016 performance highlights the strength of our core retail business model. In a grocery market with limited growth we delivered double digit sales growth through the year, consistently ahead of both the UK online grocery segment and the grocery market as a whole. We commenced operations at our latest CFC in Andover, Hampshire, which has the first installation of our next generation physical infrastructure solution. We progressed with the building of our largest ever CFC in Erith, South East London. We also extended the scope of our agreement of services to Morrisons.com, and advanced discussions with multiple potential international partners to utilise Ocado Smart Platform.

We continued to deliver on our strategic objectives, namely, to drive growth, maximise efficiency and utilise our proprietary knowledge. These objectives are shared among both our retail and platform businesses and enable us to ideally position ourselves for the continuing shift to online that is taking place in the grocery industry, both in the UK and globally.

This progress has been made in a UK grocery market that has faced significant challenges throughout 2016. Intense competition, influenced by continued changing trends in customer behaviour with ongoing shifts to using discount and smaller format stores and online, has driven sustained price deflationary pressures across the grocery industry. Input cost inflation, largely fuelled by labour cost rises, and more latterly the impact of currency devaluation following the EU referendum, has added to the challenging environment and resulted in margin pressure and uncertainty across the industry. Our continued focus on improving our proposition to customers and driving the efficiency of our business through technology helps to protect us in these conditions.

Progress against our strategic objectives

We have a number of core complementary actions, which form a framework to achieve our strategic objectives for our retail and corporate customers, intended to deliver long-term shareholder value. These actions are to:

- Constantly improve the proposition to customers;
- Strengthen our brand;
- Develop more capital and operationally efficient infrastructure solutions;
- Constantly enhance our end-to-end technology systems; and
- Enable Morrisons' and future partners' online businesses.



Constantly improve the proposition to customers

Our core focus remains on offering the best possible proposition to our customers, which we believe is central to driving growth for both our retail and partner businesses.

From a retail perspective, we continued to focus on improving each of the core elements of our customer proposition - providing excellent service and user experience, an extensive range of products, and offering competitive prices. Our efforts in improving the proposition to customers have been evidenced by the award of the Best Online Supermarket for the second consecutive year at The Grocer Gold Awards 2016.

Providing a compelling proposition to consumers is critical to attracting new customers to Ocado, and to encourage loyalty and retention for future shops. We constantly analyse and review our offering against the wider market and focus on innovation in order to seek to stay ahead of our peers. A consistently positive user experience is at the heart of our service and we always strive to improve the customer experience through enhancements to the speed, convenience and ease of using our service. This provides our customers with the freedom and flexibility to navigate easily and complete their weekly shop wherever and whenever they please.

Mobile has continued to grow in significance with over 55% of all orders at Ocado being checked out using our latest apps and browsers on mobile devices. Given the importance of mobile, and the constant development and improvement of underlying mobile device technologies, it is critical we continually improve our capabilities to enable easy to use shopping.

We strive to be at the forefront of innovation and new developments and have continued to focus on improving functionality and personalisation for our customers to enhance their shopping experience, with features such as customised gifts based on prior shopping habits, calorie saver suggestions and personalised online coupons. We have introduced additional 'shop-in-shops' including our Picard shop specialising in high end frozen food and the Discovery Shop in partnership with the Grocery Accelerator to help food and drink start-ups trial concepts and get to market, further assisting customers to find more of their requirements in easily and carefully curated areas of our shop.

In June 2016 we launched a 'Supply Ocado' entrepreneurship portal, which allows potential suppliers from businesses of all sizes, from across the globe, the opportunity to access our buying team and apply to supply Ocado – with feedback provided to all applicants.

We further extended our delivery choices in some catchments with the earliest slot now starting at 5:30am to cater for the very early risers among our customers. Order accuracy was 99.0% (2015: 99.3%), with delivery punctuality (orders delivered on time or early) standing at 94.9% (2015: 95.3%). We believe our order accuracy and delivery punctuality continue to be market leading, both critical elements in providing a high quality, reliable and consistent service for our customers.

With what we believe to be the broadest range of products in the industry, our customers were able to choose from over 50,000 SKUs by the end of 2016 (2015: 47,000 SKUs) when shopping at Ocado.com. Our diverse range includes basic everyday items, own label products from both Ocado and Waitrose, other favourite brands, specialist and international product ranges, as well as general merchandise items ranging from basic clothes to standard electrical appliances.

Our Low Price Promise ("LPP") basket matching scheme ensures that we are price competitive against the market leader. This transparent pricing strategy gives confidence to our customers in the prices they are paying for their shopping. Despite price reductions and broader food price deflation in the market, nearly three quarters of our customers' baskets were already cheaper at Ocado when checking for LPP. The cost of LPP to Ocado in the form of vouchers used during the period slightly increased but remained low, reflecting our competitiveness in prices and sustained promotional activity.

Our bundled customer benefit membership scheme, Ocado Smart Pass, continued to be popular this year, with over half of regular sales conducted with Smart Pass customers. Smart Pass offers customers multiple benefits including free deliveries whilst enabling us to drive customer loyalty, shopping frequency and ultimately increase total spend per customer.

Our general merchandise product sales, including those from our destination sites, notably Fetch.co.uk, our dedicated pet store, have grown at over 40% year-on-year, and now constitute almost 7% of Ocado retail sales. In August 2016, we launched our latest destination site, Fabled, our premium beauty store in partnership with Marie Claire. The online shop is complemented by a flagship store in Tottenham Court Road, London, offering a physical showcase opportunity to the many premium brands we now work with. The early performance of Fabled is encouraging and we look forward to further developing this and our other destination sites. These destination sites are complementary to our Ocado.com offerings giving our customers access to significant additional assortments across everyday general merchandise categories.

Any improvements and innovations added to our retail proposition enhance the key features we can apply to the technology embedded in our platform, allowing our existing and future corporate customers to benefit from our continued development.



Strengthen our brands

We continued to reinforce our retail brand equity and values to our wide range of stakeholders including our existing customers who have recognised the quality of our proposition, evidenced by winning a number of awards including Best Online Retailer at the Best of Organic Market Awards and Best Online Retailer at the Loved By Parents Awards.

Our Ocado own-label continues to grow, further reinforcing our brand recognition. This year we have seen sales up over 10% against the equivalent period last year, with growth constrained by our contractual obligations with Waitrose. The average customer basket now contains over six Ocado own-label products, with over 90% of our customers having bought Ocado own-label products. The value of our brand and strength of these products is evidenced by multiple awards for our Ocado-own label products in 2016. These include the Gold award for the Ocado own-label Veg and Salad Box by Women's Fitness and several awards in organic food and baby product categories at the Loved by Parents Awards.

Our active customer base continued to expand to 580,000 (2015: 509,000), up 13.9% as we continued to grow in all of our existing catchment areas. Similarly our total order volumes have shown robust growth of 17.9% to an average of over 230,000 orders per week ("OPW") (2015: 195,000 OPW), with the highest OPW exceeding 270,000 during the period.

The average basket size at Ocado.com (excluding the impact of smaller standalone orders from our destination sites) declined by 2.7% to £108.10 (2015: £111.15), primarily due to price deflation across the industry. There was also some impact from the continued uptake of our Ocado Smart Pass offering which tends to drive increased customer frequency but with smaller basket sizes.

Our existing destination brands continue to strengthen. We anticipate Fabled, benefiting from the strong brand association of our partner, Marie Claire, will develop into an attractive destination retail brand for premium beauty products.

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We continue to work on our Ocado Smart Platform offering, utilising our Ocado Smart Platform branding to strengthen the marketing of the service to international commercial partners.

While not an external brand, we have been active in promoting the strength and values of Ocado Technology. Brand development has been focused on awareness activities largely through editorial and speaking opportunities, including participating in features with titles such as the Harvard Business Review, New Scientist and the technology section of wider publications such as the Wall Street Journal. This focus ensures we are able to recruit the best talent to develop the most innovative technology for use within our business.



Continuously develop more capital and operationally efficient infrastructure solutions

Our two mature Customer Fulfilment Centres in Hatfield and Dordon continued to operate to high levels of accuracy and with improved efficiency (we consider a CFC to be mature if it has been open for 12 months by the start of the half year reporting period). With limited investment we have increased capacity in both facilities to more than their designed maximum limits, and now expect to be able to operate at over 165,000 OPW from Hatfield CFC and at over 190,000 at Dordon CFC. This benefits not just Ocado but also Morrisons.com, as we have now taken the capacity of Dordon CFC above the anticipated capacity level at the time of our 2013 agreement. Using the units per labour hour efficiency measure ("UPH"), the average productivity for the period in these operations was 160 UPH (2015: 155 UPH).

We commenced operations at our new CFC in Andover, Hampshire, in November 2016, which will ramp up in future periods. This is particularly significant as Andover CFC houses the first installation of our new proprietary modular, scalable physical fulfilment solution. This solution will also offer many other benefits, such as the ability to pick an entire order in less than 5 minutes compared with an average of over two hours in our earlier CFCs. This will significantly reduce order processing lead times and give more flexibility to offer improved services for customers. At maturity Andover CFC will add approximately 65,000 OPW of capacity at an estimated capital cost of £45 million for the material handling equipment ("MHE").

We continued to develop our fourth CFC in Erith, South East London. The building is now complete and fit out works started during 2016. We plan to commence operations in FY2018. The MHE solution in this CFC is estimated to cost £135 million and will add over 200,000 OPW of capacity to our operations. Similar to our Andover CFC, this CFC will also use our proprietary modular, scalable fulfilment solution which will enable us to phase the investment over time in line with our capacity requirements. We expect this to be our most capital efficient CFC to date, and we anticipate it will enable us to efficiently expand our UK capacity. Approximately 30% of the Erith CFC capacity will be utilised for Morrisons.com under the extension agreement that was signed during 2016. In addition we plan to open a second general merchandise facility in 2018 to enable our general merchandise sales to continue to grow rapidly.

Enhancements to our routing system, increased availability of Sunday delivery slots and improved customer density led to an improvement in average deliveries achieved on a van route and has helped us increase deliveries per van per week across all shifts ("DPV") to 176 (2015: 166). We increased our delivery capacity within existing catchments by extending and rationalising our hub and spoke network. In 2016 we opened two new spoke sites in Peterborough and Crawley, while relocating operations from, and subsequently closing, our Southampton spoke to our Andover CFC.



Enhance our end-to-end technology systems

Core to our business and competitive advantage is our proprietary IP, knowledge and technology that supports our market leading proposition to customers and drives our operating efficiencies and to enable attractive economics. We continually strive to improve and develop our technology and believe that this innovation continues to create a competitive edge across our business. Our patent activities help to create a web of protection for our IP. As at the end of the period, we had filed patent applications covering over 50 separate innovations and the first few patents were granted during 2016.

Our focus on innovation has allowed us consistently to improve our own skills. Our innovation is enabled by our extensive and growing technology and engineering teams. By the end of the period our technology team comprised over 950 IT and software professionals operating from multiple technology centres in the UK, Poland, Spain and Bulgaria, taking advantage of the significant technological expertise found in these regions.

In addition to our technology team, we have a dedicated engineering team of over 200 qualified engineers deployed in current operations, CFC development and build, and platform business projects. This team, working closely with the technology team, are core to developing, building and commissioning our proprietary infrastructure equipment solution, now deployed in Andover CFC.



Enable Morrisons' and future partners' online businesses

We have built our retail business through developing and utilising proprietary solutions in technology, engineering and operations. As we continue to develop and innovate in our retail business we embed any improvements into our platform for existing and future partners, enhancing the opportunity to commercialise our IP. The commencement of operations at our Andover CFC will, we hope, provide further evidence of the capabilities and showcase to future Ocado Smart Platform customers the attractiveness of our proprietary solutions.

Morrisons.com launched as an online business in January 2014 using our broader platform offering. Our technology and service capabilities have enabled its strong growth, which continued through the 2016 period. To enable its further growth, in August 2016 we announced an extension of this agreement with Morrisons to include our Erith CFC. The renegotiated terms for additional capacity, which will come on stream in 2018, are more in line with the format of how we wish to operate with future platform partners. Among other things the agreement provides Morrisons with a 30% share of the capacity from our Erith CFC as well as the provision of a store pick module, which will allow Morrisons.com to service its customers from their store estate, alongside the CFC fulfilment Ocado provides, and also reach customers not served by our current CFCs.

During the period, we continued to engage and develop discussions with multiple international retailers about how we might assist them in launching or improving online businesses in their own markets using our technology and solutions collectively branded as Ocado Smart Platform. Ocado Smart Platform customers will benefit from our experience and from the latest technology and innovations we apply to our own retail business, offering flexible fulfilment (through CFC or store-based operations) and last mile options (home delivery and pick up services). We have recently appointed Luke Jensen, who has extensive experience in strategy, online and grocery retailing, to a new role as CEO - Ocado Smart Platform, to help accelerate our discussions. He will start in mid-February. We remain confident in the quality of our commercial proposition and expect to sign multiple deals in multiple territories in the medium term.

People, awards and CR initiatives

By the end of the period, we employed almost 12,000 people, a net addition of over 1,700 new employees year-on-year. Our employees support our retail business, our Morrisons.com platform business and the development of Ocado Smart Platform.

We will continue expanding our pool of talented staff in 2017, including plans to add over 100 technology and engineering professionals. The launch of the Andover CFC, and the continued growth in our business will continue to create new opportunities for existing and new employees in various roles throughout 2017.

The commitment and energy of our people is central to our success and I want to once again acknowledge their remarkable contribution throughout this very busy and exciting time. The efforts of our people were recognised during the year with a number of awards and we regularly receive feedback highlighting the outstanding service provided by our Customer Service Team members who make the Ocado.com and Morrisons.com deliveries.

Our Code for Life programme, which teaches children coding skills using a free resource, now has almost 70,000 users, including almost 1,400 schools, in the UK and from another 60 countries. We believe this scheme is vital to help equip the next generation with key skills from which they will benefit; we are proud of its widespread uptake across the globe.

We continuously strive to be the UK's greenest grocery supplier, operating at what we believe are the lowest waste levels in the industry. Working in partnership with Ecometrica we hope to publish centralised waste data during 2017. Throughout 2016 we have also seen the recycling of Ocado uniforms as part of an offenders retraining programme, enabling us to help offenders learn new skills as well as repurpose and sell new garments with all proceeds going to the Ocado Foundation.

Outlook statement

We reported robust gross sales (Retail) growth of 13.6% for the period and we anticipate continuing to grow ahead of the online market in the year ahead.

We anticipate that capital expenditure in 2017 will be approximately £175 million, including the development of further capacity in the Andover and Erith CFCs, and further development to our infrastructure and technology solutions. The capital expenditure requirements for any Ocado Smart Platform deals signed are not expected to be significant in 2017.

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