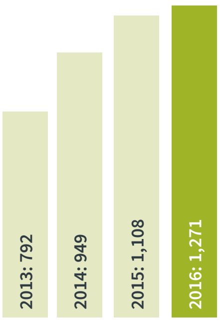
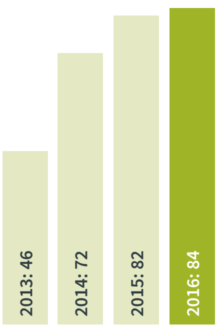
11. Chief Financial Officer's Review

Duncan Tatton-Brown
Chief Financial Officer

Revenue (£m)



EBITDA (£m)Ⓐ



For the period to 27 November 2016, we maintained solid sales growth in what has remained a challenging competitive environment. At Group level, sales increased driven principally by growth in our retail business with the balance coming from our agreement with Morrisons.

Solid growth in Retail sales, order volumes and the number of active customers in the period demonstrated the appeal of our retail proposition. Every year since we launched, we have seen over 10% growth in orders and in the period we grew total orders 17.9% year-on-year. Operating profitability in the period was adversely impacted by the continuing pressure on margins reflecting the competitiveness and deflationary pressures in the market, the impacts of the national living wage and our continued investment in a number of strategic initiatives to aid the future growth of the business. This was offset in part by more efficient operational fulfilment mainly at Dordon CFC and improvements in average deliveries per van per week.

	FY 2016 £m	FY 2015 £m	Variance
Revenue[1]	**1,271.0**	1,107.6	14.8%
Gross profit	**435.3**	375.1	16.0%
EBITDA before exceptional itemsⒶ	**84.3**	81.5	3.3%
Operating profit before share of result from JV and exceptional itemsⒶ	**21.9**	19.1	14.7%
Share of result from joint venture	**2.1**	2.3	(8.7)%
Profit before tax and exceptional items	**14.5**	11.9	21.8%
Exceptional items	**(2.4)**	-	-
Profit before tax	**12.1**	11.9	1.3%

1. Revenue is sales (net of returns) generated at Ocado.com, and the other retail banners - Fetch, Sizzle and Fabled, including charges for delivery but excluding relevant vouchers/offers and value added tax. The recharge of costs to Morrisons and fees charged to Morrisons are also included in revenue
2. Morrison MHE JVCo impact includes the income arising from the leasing arrangements with Morrisons for MHE assets and share of results from joint venture

Revenue

	FY 2016 £m	FY 2015 £m	Variance
Retail	**1,171.6**	1,033.7	13.3%
Morrisons recharges	**79.9**	55.1	44.9%
Morrisons fees	**19.5**	18.8	3.7%
Total revenue	**1,271.0**	1,107.6	14.8%

Revenue increased by 14.8% to £1,271.0 million for the period. Revenue from retail activities was £1,171.6 million, an increase of 13.3% which we believe continues to be ahead of the UK online grocery market. Revenue growth was driven by a 17.9% year-on-year increase in the full year average orders per week to 230,000. Product sales from the general merchandise destination sites grew by over 85% year-on-year driven by the increasing popularity of the Fetch pet store and the launch our new beauty destination site, Fabled, during the second half of the period.

The increase in order growth was partially offset by a reduction in average hypermarket order size, down 2.7% from £111.15 in 2015 to £108.10 in 2016, primarily due to deflation in the average item price as experienced across the grocery industry and a small reduction on the number of items partly due to the increased frequency of shop from our customers. Overall average basket size fell by 3.7% due to these effects and also the dilutive effect on the average order size from an increased mix of standalone destination site orders which are typically smaller average size.

The Morrisons arrangement contributed £99.4 million of revenue in 2016 (2015: £73.9 million). The growth was mainly driven by increased revenue from recharges for services provided to support the expansion of the Morrisons.com business. The fee income remained broadly in line with the prior year and comprised of the initial licence fees for the setup of technology services and annual fees relating to technology support, research and development and management services.

Ⓐ See Alternative Performance Measures on page 194

Gross profit

	FY 2016 £m	FY 2015 £m	Variance
Retail	335.9	301.4	11.4%
Morrisons recharges	79.9	54.9	45.4%
Morrisons fees	19.5	18.8	4.1%
Total gross profit	**435.3**	375.1	16.0%

Gross profit rose by 16.0% year-on-year to £435.3 million (2015: £375.1 million) and was 34.2% of revenue (2015: 33.9%), ahead of 2015 due to additional gross profit attributable to the Morrisons arrangement in the period, reflecting the sustained growth in the Morrisons.com business. Retail gross profit reduced to 28.7% of retail revenue (2015: 29.2%) primarily as a result of selling price deflation.

Other income increased to £52.9 million, up 7.9% year-on-year (2015: £49.0 million). Supplier income was 3.3% of retail revenue (2015: 3.1%). Supplier income grew year-on-year and continues to grow ahead of the rate of increase in revenue as we engage our suppliers in media opportunities on our customer interfaces (including website, mobile apps and mobile websites). Other income also included £2.5 million (2015: £2.5 million) of rental income relating to the lease of Dordon CFC and £11.7 million (2015: £11.2 million) of income arising from the leasing arrangements with Morrisons for MHE assets. This income, for the MHE assets, is generated from charging MHE lease costs to Morrisons and equates to the additional depreciation and lease interest costs that we incur for the share of the MHE assets effectively owned by Morrisons.

Operating profit

Operating profit before the share of result from the joint venture and exceptional items for the period was £21.9 million (2015: £19.1 million).

Distribution costs and administrative expenses included costs for both the Ocado and Morrisons fulfilment and delivery operations. Total distribution costs and administrative expenses including costs recharged to Morrisons grew by 15.2% year-on-year. Excluding Morrisons, costs grew by 10.4% year-on-year, below the growth in average orders per week of 17.9%. The costs relating to the Morrisons operations are recharged and included in revenue.

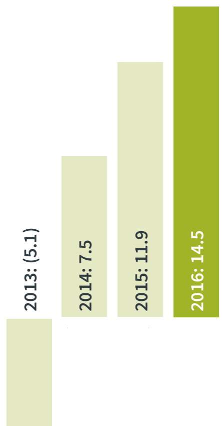
	FY 2016 £m	FY 2015 £m	Variance
Distribution costs[1]	247.5	216.6	14.3%
Administrative expenses[1]	78.8	73.4	7.4%
Costs recharged to Morrisons[2]	79.8	54.9	45.4%
Depreciation and amortisation[3]	60.3	60.1	0.4%
Total distribution costs and administrative expense	**466.4**	405.0	15.2%

1. Excluding chargeable Morrisons costs, depreciation, amortisation and impairment charges
2. Morrisons costs include both distribution and administrative costs
3. Depreciation and amortisation excludes exceptional items for the period which amounted to £0.7 million impairment charge (2015: £nil)

At £247.5 million, distribution costs increased by 14.3% compared to 2015. Overall mature CFC UPH (for Hatfield CFC and Dordon CFC combined) was 160 in 2016 compared with 155 in 2015. The improvement in mature CFC UPH for the period was driven mainly by the improved productivity at Dordon CFC which had grown by 5.6% year-on-year to 174 UPH in 2016 and had regularly exceeded 180 UPH by the end of the period. Deliveries per van per week have improved by 6.3% year-on-year to 176 (2015: 166) as customer density improved and we increased Sunday delivery slots. During the period we opened two new spokes in Crawley and Peterborough. As a result of these new spoke openings and the annualised impact of three spokes (Dagenham, Milton Keynes and West Drayton), the expansion of the Bristol spoke and additional fixed costs arising from the move of the London spoke at White City to Park Royal in 2015, spoke fixed costs as a percentage of sales increased in the period.

> *"We've maintained solid sales growth in what has remained a challenging competitive environment."*

Profit/(Loss) before Tax and Exceptional Items (£m)



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	FY 2016 £m	FY 2015 £m	Variance
Central costs – other [1]	63.0	55.1	14.3%
Central costs – share-based senior management incentive charges[2]	4.1	7.8	(47.3)%
Marketing costs (excluding vouchers)	11.7	10.5	11.6%
Total administrative expenses[1]	**78.8**	73.4	7.4%

1. Excluding chargeable Morrisons costs, depreciation, amortisation and impairment

Total administrative expenses excluding depreciation, amortisation and costs recharged to Morrisons increased to £78.8 million (2015: £73.4 million) and as a percentage of retail revenue this reduced to 6.7% (2015: 7.1%). The year-on-year cost increases were mainly due to additional costs to operate Morrisons.com which are not recharged to Morrisons but for which the Group earns fees, and continued investments in our strategic initiatives to support future growth in both our general merchandise business and for the Ocado Smart Platform. These cost increases were offset by lower share-based management incentive costs driven by the net effect of the maturity of the 2013 LTIP scheme.

Marketing costs excluding voucher spend were higher at £11.7 million (2015: £10.5 million) and in line with the prior year as a percentage of retail revenue at 1.0% (2015: 1.0%).

Total depreciation and amortisation costs excluding exceptional items were £60.3 million (2015: £60.1 million), broadly flat year-on-year and this includes impairment charges of £0.7 million (2015: £1.8 million). Higher depreciation and amortisation arose from increased investment in vehicles and new spokes to support our continued order growth offset by lower depreciation as a result of lower capex spend at our existing CFCs over the last few years. We commenced operations at Andover CFC at the end of the period. As a result the capital work in progress of Andover CFC and its associated software did not have a depreciation impact in the period.

The impairment charges in the period relate to our head office move, write offs related to the exit from the Southampton spoke site and from a detailed review of our legacy systems as we rewrite a number of key systems as part of our software replatforming.

Share of result from joint venture

MHE JVCo Limited ("MHE JVCo") was incorporated in 2013 on the completion of the Morrisons arrangement, with Ocado owning a 50% equity interest in this entity. MHE JVCo holds Dordon CFC assets which are leased to Ocado to service its and Morrisons' businesses. The income generated by MHE JVCo comprises interest income on finance leases granted to Ocado, offset by administrative expenses and depreciation on minor assets not subject to lease and administration charges. The Group share of MHE JVCo profit after tax in the period amounted to £2.1 million (2015: £2.3 million), the year-on-year decrease driven in main by a higher tax provision.

Exceptional items Ⓐ

Exceptional items in the period were £2.4 million (2015: £nil). Of this £1.7 million was recognised in EBITDA and related to our head office move and litigation against payment providers. The balance of £0.7 million is related to the accelerated depreciation charge as a result of our planned head office move.

Net finance costs

Net finance costs of £9.5 million (2015: £9.5 million) were in line with the prior year.

Profit before tax

Profit before tax and exceptional items for the period was £14.5 million (2015: £11.9 million).

Taxation

The Group provided for £0.1 million of corporation tax for one of its legal entities that does not have available prior year losses or capital allowances. Ocado had approximately £268.6 million (2015: £287.8 million) of unutilised carried forward tax losses at the end of the period. During 2016 Ocado incurred £43.4 million (2015: £36.2 million) in a range of taxes including fuel duty, PAYE and Employers' National Insurance and business rates.

Earnings per share

Basic earnings per share was 2.02p (2015: 2.01p) and diluted earnings per share was 1.96p (2015: 1.91p).

A See Alternative Performance Measures on page 194

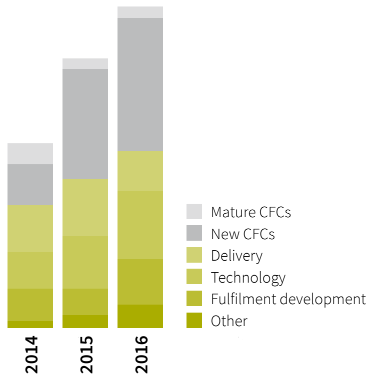
Capital expenditure

Capital expenditure for the period excluding share of MHE JVCo was £153.0 million (2015: £122.1 million) and comprised of the following:

	FY 2016 £m	FY 2015 £m
Mature CFCs	3.4	3.2
New CFCs	64.6	52.9
Delivery	20.6	25.3
Technology	34.3	23.0
Fulfilment Development	19.7	13.3
Other	10.5	4.4
Total capital expenditure[1,2] (excluding share of MHE JVCo)	**153.0**	122.1
Total capital expenditure[3] (including share of MHE JVCo)	**156.9**	126.5

1. Capital expenditure includes tangible and intangible assets
2. Capital expenditure excludes assets leased from MHE JVCo under finance lease arrangements
3. Capital expenditure includes Ocado share of the MHE JVCo of £3.9 million in 2016 and of £4.4 million in 2015

Capital Expenditure



Total investment in Mature CFCs was £3.4 million, which excludes the capital expenditure relating to MHE JVCo of £3.9 million. The investments at Hatfield CFC were primarily resiliency projects, for example installing additional chillers and crane and conveyor improvements. There have also been some capacity and productivity projects at the existing sites such as upgrading pick station scanners.

We incurred £64.6 million of costs in the period for the build and installation of our proprietary infrastructure at our new CFCs. At the end of the period, we commenced operations at our Andover CFC. This is the first of our CFCs to use our new proprietary infrastructure equipment solution and software, which will support the ongoing growth of our business. Andover CFC has an expected capacity of 65,000 OPW. Our fourth CFC located in Erith, South East London, will be larger than any of our existing CFCs with an expected capacity of over 200,000 OPW, and is planned to open in financial year 2018. We incurred £38.6 million of costs on this site in the period.

Delivery capital expenditure was £20.6 million (2015: £25.3 million). This included investment in new vehicles of £13.6 million (2015: £14.0 million) to support our business growth and replace vehicles at the end of their useful lives. These assets are typically on five year financing contracts. There was investment in new spokes of £2.0 million, which included the Crawley spoke which opened in April 2016 and the Peterborough spoke which opened in August 2016.

We continued to develop our own proprietary software and incurred £26.8 million (2015: £18.1 million) of internal development costs which were capitalised as intangible assets in the period, with a further £7.5 million (2015: £4.9 million) spent on computer hardware and software. Our technology headcount grew to over 950 staff at the end of the period (2015: over 700 staff) as increased investments were made to support our strategic initiatives, including major replatforming of Ocado's technology and migration of most of our systems to run on a public or private cloud. This will allow Ocado to achieve greater technical agility and enable the technology to support possible international expansion opportunities. In addition, we invested internal technology resources as part of developing capital projects for Dordon CFC and the further development of the Morrisons proposition.

Fulfilment development capital expenditure of £19.7 million (2015: £13.3 million) was incurred to further develop our next generation fulfilment solution which will be used in our new CFCs and for Ocado Smart Platform customers.

Other capital expenditure of £10.5 million, included £5.8 million of capital expenditure related mainly to our head office move. In addition to this we spent £3.5 million in our general merchandise business to support growth in capacity in our existing general merchandise facility and the fit out and costs associated with the development of our new Fabled flagship store and online offering.

At 27 November 2016, capital commitments contracted, but not provided for by the Group, amounted to £34.4 million (29 November 2015: £22.3 million), this increase is mainly driven by commitments in our new CFCs. We expect capital expenditure in 2017 to be approximately £175 million which mainly comprises the continuing investment in the next generation of fulfilment solutions, roll out of our new CFCs and additional investment in new vehicles to support business growth and the replacement of vehicles coming to the end of their five year financing contracts.

11. Chief Financial Officer's Review

"Operating cash flow increased by £14.6 million during the year."

Cash flow

During the year the Group generated improved operating cash flow after finance costs of £96.9 million, up from £82.8 million in 2015, as follows:

	FY 2016 £m	FY 2015 £m
EBITDA Ⓐ	**84.3**	81.5
Working capital movement	**18.5**	2.3
Exceptional items[3] Ⓐ	**(1.7)**	–
Other non-cash items[1]	**4.9**	8.7
Finance costs paid	**(9.1)**	(9.7)
Operating cash flow	**96.9**	82.8
Capital investment	**(123.9)**	(99.1)
Dividend from joint venture[2]	**8.4**	8.1
Increase/(decrease) in debt/finance obligations	**22.2**	(26.8)
Proceeds from share issues net of transaction costs	**1.1**	4.5
Other investing and financing activities	**0.4**	–
Increase in cash and cash equivalents	**5.1**	(30.5)

1. Other non-cash items include movements in provisions, share of income from MHE JVCo and share-based payment charges
2. Dividend received from MHE JVCo of £8.4 million (2015: £8.1 million)
3. Total exceptional items of £2.4 million (2015: £nil) includes a £0.7 million impairment charge to property, plant and equipment, which is a non-cash item

The operating cash flow increased by £14.1 million during the year as a result of an increase in EBITDA of £2.8 million and a positive working capital movement of £16.2 million. The positive working capital movement includes a £25.2 million increase in trade payables primarily due to increased trade accruals and trade payables attributable to inventory increases prior to year end.

We continue to reinvest our cash for future growth and as a result the cash outflows due to capital investment increased to £123.9 million comprising investments in Andover CFC and Erith CFC, development of our next generation fulfilment solution and expenditure on our delivery assets.

In the period there was a net increase in debt and finance obligations of £22.2 million (2015: net repayments of £26.8 million). This included a £52.5 million drawdown on the Revolving Credit Facility (2015: £nil).

Ⓐ See Alternative Performance Measures on page 194

Balance sheet

The Group had cash and cash equivalents of £50.9 million at the period end (2015: £45.8 million) with the increase mainly owing to a net cash inflow from financing activities in the period.

External gross debt at the period end, which excludes finance leases payable to MHE JVCo, was £107.1 million (2015: £53.3 million). The increase of £53.8 million was mainly driven by a drawdown of £52.5 million on the Revolving Credit Facility (excluding capitalised transaction fees of £1.2 million), currently used for funding capital investment in the new distribution centres. The balance was a result of £16.6 million of additional vehicle and property debt, offset by net repayments of £14.1 million of borrowings.

Gross debt at the period end of £215.8 million (2015: £172.8 million) and includes amounts owing to MHE JVCo of £108.7 million (2015: £119.5 million).

Net external debt at the period end was £56.2 million (2015: £7.5 million).

Bank facility

In the prior year, the 3 year £100 million revolving unsecured facility was extended by a further two years to July 2019 and the amount of the facility was increased to £210 million. At the end of the period we had drawn down £52.5 million of the facility.

Change of external auditors

Following a tender process of the external audit, Deloitte LLP is being recommended at the Annual General Meeting for appointment as the Group's external auditors for the 2017 financial year.