Duncan Tatton-Brown
Chief Financial Officer

9. Chief Financial Officer's Review

For the period to 29 November 2015, we maintained double-digit sales growth in a highly challenging and competitive grocery environment. At Group level, sales were driven primarily by growth in our retail business with the remainder from our agreement with Morrisons.

Continued growth in retail sales was supported by improvements to our proposition to customers and an increase in the number of active customers in the period. These factors drove strong order growth to the current average orders of 220,000 per week at the period end. Operating profitability continued to strengthen in comparison to the prior period due to more efficient operational fulfilment mainly at CFC Dordon. This was offset by lower margins reflecting the competitive and deflationary pressures in the market, our sustained investment in a number of strategic initiatives to support future growth of the business and higher depreciation and amortisation arising from CFC Dordon, vehicles and additional spokes to support current and future business growth.

> "We maintained double-digit sales growth in a highly challenging and competitive grocery environment."

	FY 2015 £m	FY 2014 £m	Variance
Revenue[1]	**1,107.6**	948.9	16.7%
Gross profit	**375.1**	312.9	19.9%
EBITDA	**81.5**	71.6	13.8%
Operating profit before share of result from JV and exceptional items	**19.1**	14.2	34.5%
Profit before tax	**11.9**	7.2	65.3%

	FY 2015 £m	FY 2014 £m	Variance
EBITDA	**81.5**	71.6	13.8%
Less Morrisons MHE JVCo impact[2]	**(13.5)**	(11.3)	21.2%
Add Share based management incentive charges	**7.8**	5.0	54.5%
Underlying EBITDA	**75.8**	65.3	16.1%

1. Revenue is online sales (net of returns) 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 2015 £m	FY 2014 £m	Variance
Retail	**1,033.7**	903.8	14.4%
Morrisons recharges	**55.1**	27.8	98.2%
Morrisons fees	**18.8**	17.3	8.7%
Total revenue	**1,107.6**	948.9	16.7%

Revenue increased by 16.7% to £1,107.6 million for the period. Revenue from retail activities was £1,033.7 million, an increase of 14.4%, which we believe to be ahead of the online grocery market. Revenue growth was driven by a 16.8% year-on-year increase in the full year average orders per week to 195,000. This was offset by a reduction in average order size, down 2.1% from £112.25 in 2014 to £109.95 in 2015, primarily due to deflation in the average item price as experienced across the grocery industry. During the period we continued to build on the strong growth from the prior year of our non-food business with revenue increasing by over 60% year-on-year.

There was a dilutive effect on the average basket from an increased mix of standalone destination site orders as they typically have smaller basket values.

The Morrisons arrangement contributed £73.9 million of revenue in 2015 (2014: £45.1 million). The main growth in revenue was driven by increased income from recharges for services provided to support the on-going expansion of the Morrisons.com business. The fee income remained broadly in line with the prior year and was comprised of the annual licence fees for services, technology support, research and development and management fees.

Gross profit

	FY 2015 £m	FY 2014 £m	Variance
Retail	301.4	267.8	12.6%
Morrisons recharges	54.9	27.8	97.5%
Morrisons fees	18.8	17.3	8.7%
Total gross profit	**375.1**	312.9	19.9%

Gross profit rose by 19.9% year-on-year to £375.1 million (2014: £312.9 million). Gross profit margin was 33.9% of revenue (2014: 33.0%), ahead of 2014 due to additional gross profit attributable to the Morrisons arrangement in the period. Retail gross margin reduced to 29.2% (2014: 29.6%) as a result of increased price competition. Gross profit from our arrangement with Morrisons was £73.7 million, an increase from £45.1 million in 2014, driven mainly by the growth in the Morrisons.com business.

Other income increased to £49.0 million, a 24.4% increase on year-on-year (2014: £39.4 million). Media income of £30.0 million was 2.9% of retail revenue (2014: 2.8%). We continue to grow our income from media related activities ahead of the rate of increase in revenue as we increasingly engage our suppliers in media opportunities on our customer interfaces (including website, mobile apps and mobile websites). Other income also included £11.2 million (2014: £8.9 million) of income arising from the leasing arrangements with Morrisons for MHE assets and £2.5 million (2014: £2.5 million) of rental income relating to the lease of CFC Dordon. This income, for the MHE assets, is generated from charging MHE lease costs to Morrisons, when combined with the share of results from joint venture, equates to the additional depreciation and lease interest costs that we incur for the share of the MHE assets effectively owned by Morrisons. Other income also comprised a second and final payment of £3.2 million for the surrender of the lease at our former White City operations which were transferred to a new build site nearby at Park Royal.

Operating Profit

	FY 2015 £m	FY 2014 £m	Variance
Distribution costs[1,2]	216.6	195.6	10.7%
Administrative expenses[1,2]	73.4	59.7	23.1%
Costs recharged to Morrisons[3]	54.9	27.8	97.5%
Depreciation and amortisation[4]	60.1	55.0	9.3%
Total distribution costs and administrative expense	**405.0**	338.1	19.8%

1. Excluding chargeable Morrisons costs, depreciation, amortisation and impairment charges
2. £2.4 million of reported administrative expenses in 2014 are now included as distribution costs
3. Morrisons costs include both distribution and administrative costs
4. Included within depreciation and amortisation for the period is a £1.8 million impairment charge (2014: £2.6 million)

Operating profit before the share of result from the joint venture and exceptional items for the period was £19.1 million (2014: £14.2 million).

Distribution costs and administrative expenses included costs for both the Ocado and Morrisons picking and delivery operations. Total distribution costs and administrative expenses including costs recharged to Morrisons grew by 19.8% year-on-year. Excluding Morrisons, costs grew by 12.9% year-on-year, below the growth in average orders per week of 16.8%. The costs relating to the Morrisons operations are recharged and included in revenue.

At £216.6 million, distribution costs increased by 10.7% compared to 2014, lower than the growth in retail revenue of 14.4%. Operational efficiency improved at both CFC Hatfield and CFC Dordon. Overall mature CFC UPH (for CFC Hatfield and CFC Dordon combined) was 155 in 2015 compared with 145 in 2014. The improvement in mature CFC UPH for the period was driven mainly by the productivity at CFC Dordon which had grown by nearly 20 UPH to 165 UPH for the full year 2015 and regularly exceeded 170 UPH by the end of the period. Deliveries per van per week have risen to 166 (2014: 163) as customer density improved.

During the period the Group opened three new spokes in Dagenham, West Drayton and Milton Keynes and moved an inner London spoke at White City to Park Royal. We also completed the expansion of the Bristol spoke by 50%. As a result of these new spoke openings, spoke fixed costs as a percentage of sales increased in the period.

9. Chief Financial Officer's Review (continued)

	FY 2015 £m	FY 2014 £m	Variance
Central costs – other[1,2]	55.1	44.7	23.3%
Central costs – share based management incentive charges	7.8	5.0	54.5%
Marketing costs (excluding vouchers)	10.5	10.0	5.0%
Total administrative expenses	**73.4**	59.7	22.8%

1. Excluding chargeable Morrisons costs, depreciation, amortisation and impairment
2. £2.4 million of reported administrative expenses in 2014 are now included as distribution costs

Total administrative expenses excluding depreciation, amortisation and costs recharged to Morrisons increased to £73.4 million, a 22.8% increase from 2014 and was 7.1% as a percentage of retail revenue (2014: 6.9%). Some of the cost increases were due to additional costs to operate the Morrisons services which are not recharged to Morrisons but for which the Group earns fees. In addition we continued to invest in our strategic initiatives to support future growth in our non-food business and Ocado Smart Platform. Share based management incentive costs increased due to the introduction of the third award under the long term incentive plan ("LTIP") for 2015. Share based management incentive costs are likely to stabilise in 2016 as the costs for the 2016 LTIP award (which are spread over 2016, 2017 and 2018) will be offset by the drop out of costs for the first LTIP award made in 2013 (which was spread over 2013, 2014 and 2015).

Marketing costs excluding voucher spend were marginally higher at £10.5 million (2014: £10.0 million) but lower as a percentage of retail revenue at 1.0% (2014: 1.1%). Despite this lower marketing spend as a percentage of retail revenue we continued to increase our new customer acquisitions per week, up over 20% versus 2014.

Total depreciation and amortisation costs were £60.1 million (2014: £55.0 million), an increase of 9.3% year-on-year and includes an impairment charge of £1.8 million (2014: £2.6 million). The higher depreciation and amortisation is primarily from the increased investment required for the development of CFC Dordon, which includes depreciation on assets jointly owned with Morrisons, and from the increased number of vans and LGVs required to support business growth. The impairment charges are due to the write off of certain assets at CFC Hatfield and as a result of a detailed review of our legacy systems due to the rewrite a number of key systems as part of our replatforming.

Share of result from joint venture

MHE JVCo Limited ("MHE JVCo") was incorporated in 2013 on the completion of the Morrisons agreement, with Ocado owning a 50% equity interest in this entity. MHE JVCo holds CFC Dordon 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 administration charges and depreciation on minor assets not subject to lease charges. The Group share of MHE JVCo profit after tax in the period amounted to £2.3 million (2014: £2.4 million).

Exceptional items

No exceptional items were reported in the period (2014: £0.3 million charge).

Net finance costs

Net finance costs of £9.5 million (2014: £9.1 million) exclude £0.9 million (2014: nil) of prepaid commitment fees which were incurred in connection with the £210.0 million Revolving Credit Facility ("RCF") and £1.6 million of additional arrangement fees. The small increase year-on-year of net finance costs recognised in the income statement was attributable to lower interest income on bank deposits.

Profit before tax

Profit before tax and exceptional items for the period was £11.9 million (2014: £7.5 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 has approximately £287.8 million (2014: £285.3 million) of unutilised carried forward tax losses at the end of the period. During 2015 Ocado incurred £36.2 million (2014: £29.1 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 2.01p (2014: 1.24p) and diluted earnings per share was 1.91p (2014: 1.18p).

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Capital expenditure

Capital expenditure for the period was £122.1 million (2014: £86.4 million) and comprised the following:

	FY 2015 £m	FY 2014 £m
Mature CFCs	3.2	10.9
New CFCs	52.9	16.5
Delivery	25.3	22.1
Technology	23.0	16.8
Fulfilment Development	13.3	16.3
Other	4.4	3.8
Total capital expenditure[1,2] (excluding share of MHE JVCo)	**122.1**	86.4
Total capital expenditure[3] (including share of MHE JVCo)	**126.5**	98.1

1. Capital expenditure includes tangible and intangible assets
2. Capital expenditure excludes assets leased from MHE JVCo under finance lease arrangements
3. Total capital expenditure includes Ocado share of the MHE JVCo of £4.4 million in 2015 and of £11.7 million in 2014

Total investment in Mature CFCs was £7.6 million, which includes the capital expenditure relating to MHE JVCo of £4.4 million. The investment was on resiliency projects (for example improving our pick aisles and upgrading some of our oldest conveyors) in CFC Hatfield, on improvement projects (for example bagging machines in both CFCs and the installation of a new pick aisle to increase capacity in CFC Dordon) and the purchase of operational totes in both CFCs.

We continue to build our new CFCs located in Andover and Erith. CFC Andover will be smaller than our existing CFCs (expected capacity of 65,000 OPW), and will utilise the first example of our proprietary MHE which is designed in the long term to be faster to install and more cost and capital efficient than the system in the current CFCs.

In January 2015, we announced plans for our latest CFC located in Erith, South East London. CFC Erith will be larger than our existing CFCs (expected capacity of over 200,000 OPW). We expect our site fit out to commence in 2016 and for the site to go live towards the end of 2017. We have invested less than £5m in 2015 on third party professional fees, construction insurance and internal staff costs supporting design and development.

Investment in new vehicles, including vans, trailers and tractors, which are typically on five year financing contracts, was higher than the prior year to support the business growth and the replacement of existing vehicles at the end of their term. Delivery capital expenditure also included investments for new spokes and the transfer of one site to a new location; Dagenham, West Drayton, Milton Keynes and Park Royal respectively. In addition to these new spokes we also completed the expansion of the Bristol spoke in the period. In total Delivery capital expenditure was £25.3 million (2014: £22.1 million).

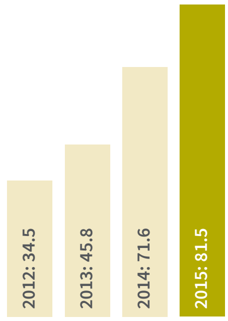
We continued to develop our own proprietary software and £18.1 million (2014: £14.1 million) of internal development costs were capitalised as intangible assets in the period, with a further £4.9 million (2014: £2.7 million) spent on computer hardware and software. Our technology headcount grew to over 700 staff at the end of the period (2014: 550 staff) as increased investments were made to support our strategic initiatives, including the 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 phase two and the further development of the Morrisons proposition.

Fulfilment development capital expenditure of £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.

EBITDA (£m)

81.5

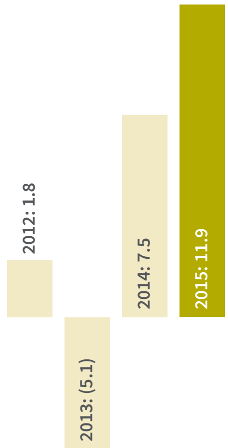
2014: 71.6



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

11.9

2014: 7.5



9. Chief Financial Officer's Review (continued)

"Operating profitability continued to strengthen in comparison to the prior period . . ."

". . . we continued to invest in our strategic initiatives to support future growth . . ."

Other capital expenditure of £4.4 million included investment in further capacity in the NFDC to support our non-food business growth, further investment to support the growth of our non-food destination sites and other various head office capital expenditure projects.

At 29 November 2015, capital commitments contracted, but not provided for by the Group, amounted to £22.3 million (1 December 2014: £22.9 million). We expect capital expenditure in 2016 to be approximately £150 million, to be invested 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.

Cash Flow

	FY 2015 £m	FY 2014 £m
EBITDA	**81.5**	71.6
Working capital movement	**2.3**	9.9
Exceptional items	**—**	(0.3)
Other non-cash items[1]	**8.7**	4.0
Finance costs paid	**(9.7)**	(9.7)
Operating cash flow	**82.8**	75.5
Capital investment	**(99.1)**	(78.8)
Dividend from joint venture[2]	**8.1**	—
Decrease in debt/finance obligations[3]	**(26.8)**	(34.6)
Proceeds from share issues net of transaction costs	**4.5**	3.7
Decrease in cash and cash equivalents	**(30.5)**	(34.2)

1. Other non-cash items include movements in provisions, share of result from MHE JVCo and share based payment charges
2. Dividend received from MHE JVCo of £8.1 million (2014: nil)
3. Includes financing fees paid

During the year the Group generated improved operating cash flow after finance costs of £82.8 million, up from £75.5 million in 2014, as above.

The operating cash flow increased by £7.3 million during the year primarily as a result of an increase in EBITDA of £9.9 million. The positive working capital movement of £2.3 million includes a £19.1 million increase in trade receivables primarily due to an increase in receivables from Morrisons and MHE JVCo. This is offset by a £23.7 million increase in trade and other payables due to increased trade accruals.

We continue to reinvest our cash for future growth and as a result the cash outflows due to capital investment increased to £99.1 million comprising investments in CFC Andover, development of our next generation fulfilment solution and spend on spoke sites.

In the period £26.8 million (2014: £34.6 million) of cash was utilised for the net repayment of debt, financing obligations and financing arrangement fees.

Balance sheet

The Group had cash and cash equivalents of £45.8 million at the period end (2014: £76.3 million) with the decrease mainly owing to a net cash outflow from investing activities in the period.

External gross debt at the period end, which excludes finance leases payable to MHE JVCo, was £53.3 million (2014: £44.9 million). The increase of £8.4 million is driven by £13.7 million of additional vehicle and property debt, offset by net repayments of £5.3 million of other asset backed finance borrowings.

Gross debt at the period end of £172.8 million (2014: £175.7 million) and includes amounts owing to MHE JVCo of £119.5 million (2014: £130.8 million).

Net external debt at the period end was £7.5 million (2014: Net external cash £31.4 million).

Increasing financing flexibility

During the period, the £100 million unsecured revolving credit facility was increased to £210 million with improved covenant levels and extended by 2 years to 1 July 2019. The participating banks continue to be Barclays, HSBC, RBS and Santander and we believe this new facility enhances our flexibility to exploit the increasing growth opportunities available to our business. The facility remained undrawn throughout the period.

Key performance indicators

The following table sets out a summary of selected unaudited operating information for 2015 and 2014:

	FY 2015 (unaudited)	FY 2014 (unaudited)	Variance %
Average orders per week	**195,000**	167,000	16.8%
Average order size (£)[1]	**109.95**	112.25	(2.1)%
Mature CFC efficiency (units per hour)[2]	**155**	145	6.9%
Average deliveries per van per week (DPV/week)	**166**	163	1.8%
Average product wastage (% of revenue)[3]	**0.7**	0.8	(0.1)%
Items delivered exactly as ordered (%)[4]	**99.3**	99.3	—
Deliveries on time or early (%)	**95.3**	95.3	—

Source: the information in the table above is derived from information extracted from internal financial and operating reporting systems and is unaudited

1. Average retail value of goods a customer receives (including VAT and delivery charge and including destination site orders) per order
2. Measured as units dispatched from the CFC per variable hour worked by CFC Hatfield and CFC Dordon operational personnel in 2014. We consider a CFC to be mature if it had been open 12 months by the start of the half year reporting period
3. Value of products purged for having passed Ocado's "use by" life guarantee divided by retail revenue
4. Percentage of all items delivered exactly as ordered, i.e. the percentage of items neither missing nor substituted