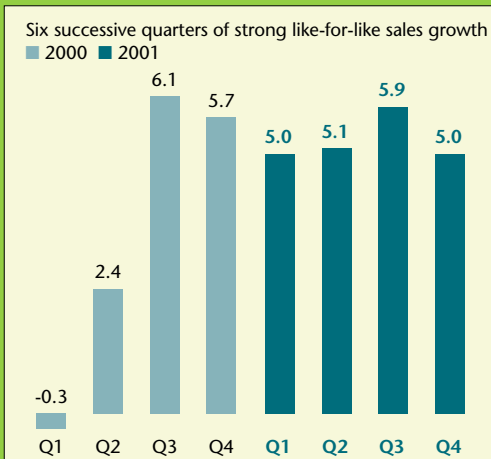


# delivering profitable growth



% like-for-like sales growth by quarter

In last year's annual report, Group Finance Director Simon Laffin outlined how Safeway's future profit recovery depended on attracting significant numbers of new customers to its stores. Twelve months on, with the turnaround of the business completed and a set of strong results having been delivered, Simon is keen to emphasise that Safeway's overriding goal remains sustained, profitable sales growth.

- 5.2% like-for-like sales growth
- 9.7% like-for-like volume growth
- Net margin up 0.7%
- 31% increase in profit (pre-property and tax)
- 33% increase in earnings per share (pre-property)
- Net debt reduced by £111 million, and gearing down to 51% (from 60% last year), supporting strengthening balance sheet.

Twelve months ago, I began my financial review by describing how, in the year ahead, new customers would be the key to Safeway achieving long-term sales growth and profit recovery. Last spring, we highlighted that 750,000 new customers had been attracted into Safeway stores, and I am pleased to report that, one year on, this has risen to over one million. Furthermore, as our customers' experience of shopping at Safeway has continued to improve, growth in average basket size has become an important component of our sales growth.

This continuing sales momentum, combined with a richer sales mix and business efficiency savings, has now delivered strong profit recovery. These positive factors will continue to fund extra investment in the new strategy, including our deep-cut weekly promotions, and substantial additional store staff to support our initiatives to improve customer service and product availability. They will also fund continuing in-store innovation, range and product development, whilst our strengthening balance sheet will support the increased capital investment required to implement the next phase of our development of the business, the roll-out of the new trading formats.

My financial review will explain how we have been able to grow operating profit by 25%, profit after interest by 31% and earnings per share (pre-property) by 33%.



## Sales

The success of our new commercial strategy continued to drive strong sales growth during the year. Total sales grew by 7.3% to £8.9 billion, with like-for-like (ie comparable stores) sales growth of 5.2%. A further 1.9% sales growth came from new space opened and 0.2% from an extra Easter trading period.

% Growth	1st half	2nd half	Full year
Like-for-like:			
Inflation	(5.6)	(3.3)	(4.5)
Volume	10.6	8.7	9.7
Total	5.0	5.4	5.2
Net new space	2.6	1.2	1.9
Easter*	0.4	–	0.2
<b>Total</b>	<b>8.0</b>	<b>6.6</b>	<b>7.3</b>

\* No Easter trading period in 1999/2000

Trading in the first half was strong, with 5.0% like-for-like growth in the first quarter, in spite of disinflation rising to 6.1% as we continued to cut prices and increase investment in our “Best Ever Deals” programme. This trend continued into the second quarter, when like-for-like growth accelerated marginally to 5.1%.

In the second half, we maintained the strong sales performance despite hitting the anniversary of our sales acceleration last year. During the 12 weeks ending 6 January 2001, like-for-like growth rose again to 5.9%, reflecting a buoyant Christmas trading period, further growth in customer numbers and increasing average spend from our existing customers. The fourth quarter saw another consistent like-for-like sales increase of 5%, representing 5.4% in the second half as a whole.

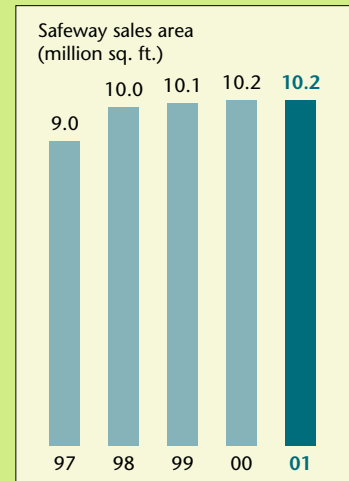
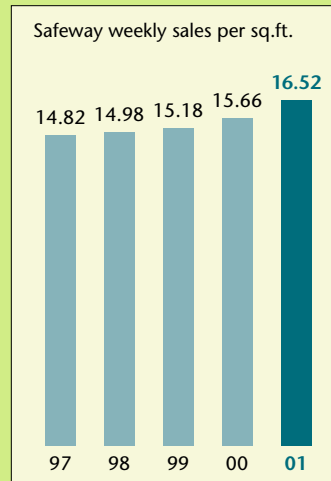
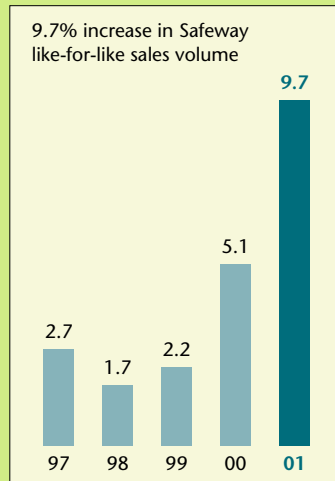
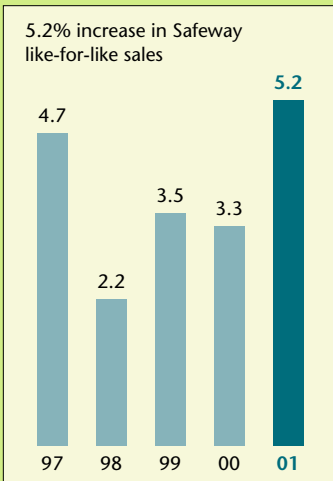
Our 12 joint venture stores in Northern Ireland made another strong contribution to group sales, rising to £190 million. Our Safeway/BP petrol station convenience store chain contributed a further £166 million to group sales (as we own 50% of this chain, we include only 50% of its total sales, which were £332 million).

## Group Operating Profit

Our operating profit totalled £395 million, up £78 million (25%) on the previous year. We have improved both gross and net

margins despite substantial extra investment in our Gonzales flyers, and in store and distribution overheads to support customer service and availability. In line with our commitment to reward the success of our people, we have paid bonuses to all staff of £25 million, £9 million more than last year. All of this increase went to store, logistics and support staff.

Driven by strong sales growth, our Northern Ireland stores made a £1.8 million contribution to group operating profit (last year a £2.3 million loss), before £2.5 million of allocated central support costs and management fees paid to our joint venture partner, Fitzwilton. We expect to see a rising contribution in the coming year as we continue to improve and expand our operations.



Unlike other recent years, there are no significant changes to the accounts or their format this year. A number of new accounting standards on such topics as deferred tax and pensions have recently been published which will have an impact over the next few years. Note 17.2 on page 49 provides an indication of our potential deferred tax liability as at the year end.

### Net Margin

The group's net margin increased by 0.7% for the full year, and by 1.3% in the second half, as illustrated below:

	1st half %	2nd half %	Full year %
Gross margin	0.4	-	0.2
Store wages	(0.3)	(0.2)	(0.3)
Distribution costs	(0.2)	(0.3)	(0.2)
Efficiency savings	0.5	0.4	0.4
Marketing costs	-	0.8	0.4
Millennium/redundancy	-	0.5	0.2
Other	(0.2)	0.1	-
<b>Overall change</b>	<b>0.2</b>	<b>1.3</b>	<b>0.7</b>

Gross margin was up 0.2% in spite of significant additional investment in deep cut deals during the year. In May 2000 we announced a massive boost to this programme, concentrating almost all our promotions on "Best Ever Deals". This additional promotional cost was paid for by a combination of the ending of loyalty card points, increasing supplier funding reflecting the emphasis on popular branded goods on our flyers, and better sales mix as our ambition to be "Best at Fresh" continued to influence our customers' typical basket.

We continued to invest in more store staff (0.3% sales) and in distribution capacity and labour (0.2%) to handle big increases in volume and improve product availability. These costs were offset by significant efficiency savings, amounting to 0.4% sales, particularly in our supply chain and business support costs, and by the residual impact of our decision last year to reduce marketing costs by 0.4% in stopping loyalty card points.

Within "other" above, we incurred an additional £20 million (0.2% sales) revenue cost in our store repair, refurbishment and store format development programme. It also includes an additional £9 million of bonuses to all staff.

The net effect of the above was to increase net margin by 0.5%, which was further enhanced by the impact of non-recurring costs in the previous year relating to the Millennium and central support redundancies (0.2%).

### BP Joint Venture

The BP joint venture made a pleasing initial profit contribution of £1.6 million. We are confident that this will grow further this year as the burden of pre-opening costs diminishes.

### Interest

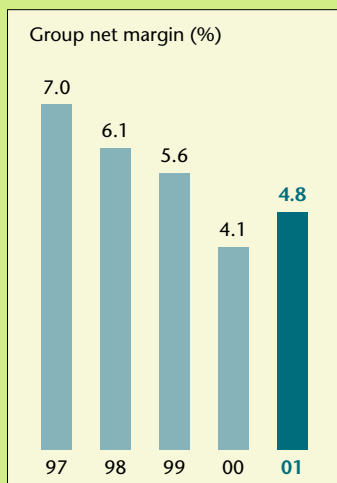
The net interest charge increased by £4.3 million, primarily due to the impact of the £252 million use of cash last year, offset by this year's reduction in net debt late in the year.

Interest cover (the number of times operating profit is greater than the net interest charge before adjusting for capitalised interest and investment income) strengthened to 4.6 times, from 3.9 times last year.

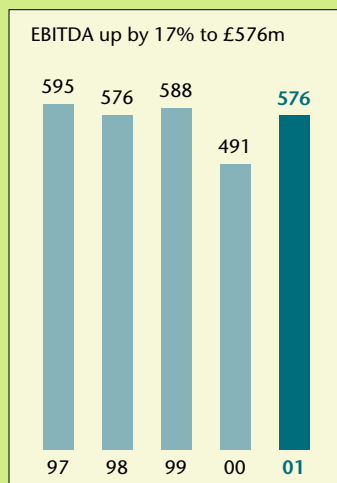
### Profit Before Taxation

Profit before tax and net property losses rose by 31% to £320 million. After net property losses, profit rose by 33%.

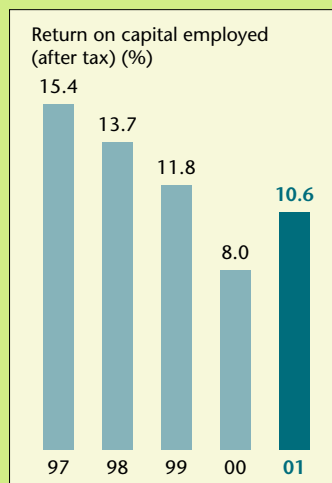
	2001 £m	Increase %
Operating profit	395	24.6
BP joint venture	2	
Net interest payable	(77)	
Profit after interest	320	30.7
Net property losses	(6)	
<b>Profit before tax</b>	<b>314</b>	<b>33.2</b>



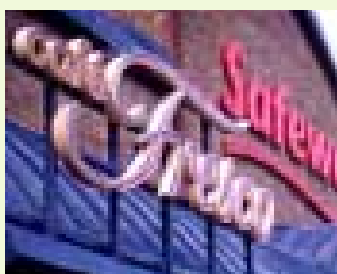
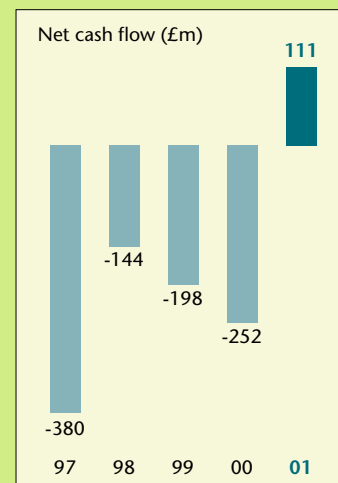
\* 1998 group net margin is before the cost of the store portfolio review and redundancy programme.



EBITDA: Earnings before interest (before exceptionals), taxation, depreciation and amortisation.



\* ROCE for 1998 is before the cost of the store portfolio review and redundancy programme.



**We have invested just over £200 million in capital expenditure in the last year, approximately three quarters of which related to existing stores. After launching our new concept store at St Katharine Docks shortly before Christmas, we refitted a further 51 supermarkets and convenience stores between January and April. During the year, we also relaunched 63 petrol station kiosks with an enhanced convenience range, opened our first Café Fresco in High Wycombe and completed the roll-out of new produce and bakery formats across the portfolio.**

**Property**

Due primarily to the disposal of a number of vacant properties during the year, property losses amounted to £6 million (last year £9 million).

**Taxation**

We have provided £96 million for corporation tax at a rate of 30% of our profit after interest, in line with the standard rate of corporation tax in the UK. This compares with a rate of 31% last year. The fall in the effective rate is due to a reduction in Northern Ireland losses, which are not available for full corporation tax group relief.

**Minority Interest**

As we have management control of, but own only 50% of the shares in our Northern Ireland subsidiary, our profit and loss account shows a minority contribution to reflect Fitzwilton's share of the post tax loss. This was £6 million this year compared to £7 million last year.

**Earnings and Dividends**

	2001	Increase %
Profit before tax	314	33.2
Earnings per share*	22.7p	32.7
Dividends per share	9.07p	5.0
Dividend cover	2.4x	0.4x

\* before net property losses

Earnings per share before property losses increased by 33% to 22.7p. Diluted earnings per share (which reflect the impact of outstanding share options) were up 36% at 22.0p compared with 16.2p last year.

**Dividend**

We stated in our interim results in November that, as we improve the performance of the business and invest in more projects which will yield higher returns than our cost of capital, we will seek to do so within a broadly balanced cash flow. In this context, we believe that it is appropriate, for the time being, to limit dividend growth below the rate of earnings, which will build dividend cover and fund increased investment in the business.

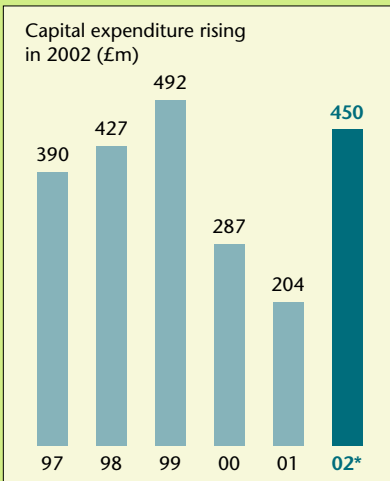
The Board is recommending a final dividend of 6.3p per share, giving a full year dividend of 9.07p. This is an increase of 5% versus last year's 8.64p per share. Dividend cover has increased to 2.4 times from 2.0 times last year.

**Cash Flow**

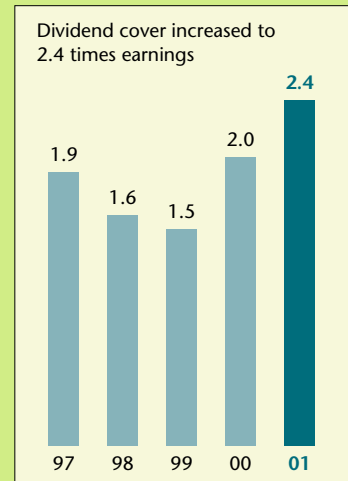
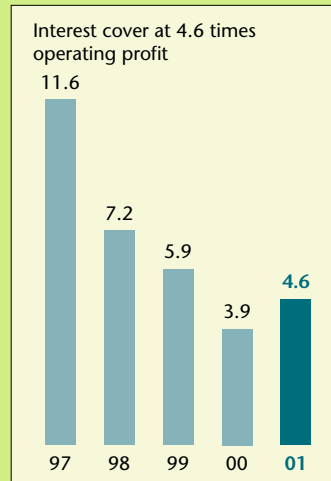
The group generated £111 million of net cash during the year.

	2001 £m	2000 £m
Earnings	580	493
Working capital	(46)	54
Capital spend	(189)	(319)
Tax paid	(90)	(135)
Interest paid	(77)	(74)
Other	18	16
Cash available to shareholders	196	35
Dividends paid	(89)	(131)
Share issues	4	6
Share buy-back	-	(162)
<b>Net cash flow</b>	<b>111</b>	<b>(252)</b>

As highlighted above, the increase in cash generated from operations versus last year stemmed primarily from higher profit, reduced capital expenditure and lower tax payments (last year reflected a one-off transitional cost as we moved towards payment of tax by instalments during the year under corporation tax self-assessment). These were offset by a one-off reduction in our negative working capital, partly as a



\*Estimate



Dividend cover (times): Profit for the financial year (before exceptionals) divided by dividends payable.

**A summary of the group's treasury policies, including details of borrowing facilities, is provided in Note 15 to the accounts. The principal treasury objective is to provide sufficient liquidity to meet the cash flow requirements of the business at the lowest possible cost to our shareholders.**

result of our customers redeeming their outstanding ABC points on closure of the loyalty scheme, and also because supplier contributions to our deep-cut promotions, which grew during the year, were not all collected by the year-end.

### Balance Sheet and Net Debt

By generating £111 million of cash during the year, we were able to reduce the group's net debt to £1,110 million from £1,221 million last year. As a result, gearing (net debt as a percentage of capital employed) fell to 51% from 60% last year.

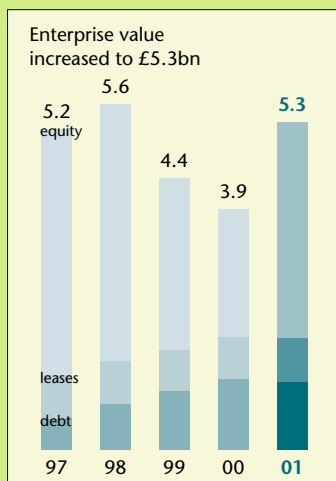
In the past 12 months we have not opened any new stores as we concentrated our resources on our existing assets. In the current year, we intend to open four new stores with a combined sales area of just over 100,000 square feet.

The scale of investment in existing stores will also rise this year from £146 million to £310 million as we embark upon more major store remodels and extensions. Combined with the resumption of a modest new store development programme, we expect capital expenditure to rise to £450 million this year. We plan to fund this spending increase within a broadly balanced cash flow.

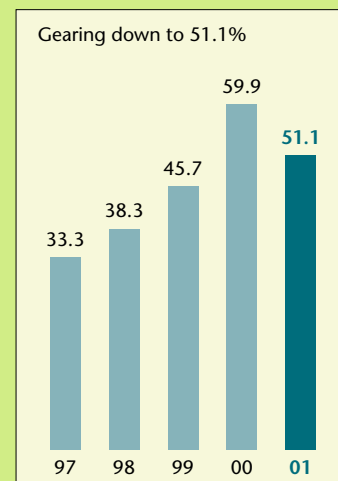
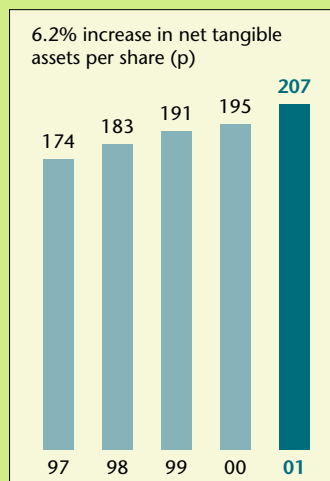
### The Future

Our overriding objective remains the delivery of sustained, profitable sales growth. We invest only in projects which we are confident will yield returns higher than our cost of capital. Today's low inflation climate, coupled with lower market risk premia, has reduced our estimate of our cost of capital to 7.2% (from 8.3% last year), and while we have no current plans to restart our share buy back programme, we will continue to actively manage our capital structure whenever possible to maintain a highly competitive cost of capital.

We are, of course, in a highly competitive sector and no company can afford to be complacent or guarantee future profit growth. It is only by providing better than others exactly what the customer wants, but at lower cost, that retailers prosper. However, with our rapid development of in-store formats, together with improvements in our product range, price competitiveness, on-shelf availability and customer service we are confident that sales will continue to grow. In order to fund these, we have doubled our efficiency programme to target 0.8% sales this year. Our future profit growth will therefore come largely from sales rather than growth in net margin. This is what we mean by sustained, profitable growth.



Enterprise value: Comprises year end market capitalisation and net debt together with the capitalised value of operating leases.



Gearing: Net debt divided by total capital employed.



Market updates on current trading are issued quarterly, the next being our First Quarter Trading Statement to be released on 10 July 2001, the day of our Annual General Meeting. Full details, including interviews with Carlos Criado-Perez and Simon Laffin, are also available on our website at [www.safeway.co.uk](http://www.safeway.co.uk)

#### Other financial ratios

	2001	2000	Increase
<b>Safeway sales per sq. ft. per week</b>			
Total Safeway sales (incl. VAT)/ Weighted average sales area	£ 16.52	15.66	+5.5%
<b>Sales per full-time equivalent (FTE) Safeway employee</b>			
Total Safeway sales (incl. VAT)/Average number of Safeway FTEs	£K 151.5	144.7	+4.7%
<b>Operating margin (excl. VAT)</b>			
Operating profit/Turnover (excl. VAT)	% 4.8	4.1	+0.7%
<b>Operating profit per FTE Safeway employee</b>			
Safeway operating profit/Average number of Safeway FTEs	£K 6.8	5.6	+21.4%
<b>Return on capital employed (ROCE)</b>			
Profit for the financial year/Average total capital employed	% 10.6	8.0	+2.6%
<b>Net tangible assets per share</b>			
Net assets/Year end number of shares in issue	pence 206.8	194.6	+6.3%
<b>Earnings per share (EPS) (before property)</b>			
Profit for the financial year/Average number of shares in issue	pence 22.7	17.1	+32.7%