Chairman's statement

A DIFFERENT WAY OF DOING BUSINESS

Our difference comes from our Partners, and the energy, commitment and personality they bring to delivering excellent customer service and high quality products to our customers.

KEY HEADLINES

PROFIT

Gross sales and revenue across the business increased. Operating profit growth recovered strongly in Waitrose & Partners, mainly due to improved gross margin. Operating profits were substantially down in John Lewis & Partners due to weaker Home sales, gross margin pressure, higher IT costs, the property impact of new shops and lower profit on sale of assets.

OUTLOOK

Given the current level of uncertainty, we expect 2019 trading conditions to remain challenging with slower sales growth and margin pressure still affecting John Lewis & Partners. However we are confident in our strategic direction and customer offer across both brands and have built up a strong liquidity position at nearly £1.5bn at January 2019 so that we have the financial headroom to mitigate future risks and make sure we can continue investing for the future.

See pages 34 to 36 for more details.

> 2018/19 was a challenging year in many respects internally and externally. We anticipated it would be and said in March 2018, and again in June, September and in January 2019, that we expected profits to be substantially lower.

£160.0m

Profit before Partnership Bonus, tax and exceptional items.

2018/19 was a challenging year in many respects, internally and externally. We anticipated it would be and said in March 2018, and again in June, September and in January 2019, that we expected profits to be substantially lower. They were. Profits ended 45% lower than last year and the Board decided to pay a Partnership Bonus of 3% – the lowest since 1953.

Within the overall numbers we saw a strong recovery in operating profit in Waitrose & Partners, up 18% (to £203.2m), mainly due to improved gross margins, but a sharp decline in John Lewis & Partners, of 56% (to £114.7m), because of weaker Home sales, gross margin pressure, higher IT costs, the property impact of new shops and lower profit on asset sales. Despite this we managed cash tightly and reduced total net debts by £401.3m.

Despite the trading pressures we were determined to press on with our strategy and we saw promising progress in many areas where we invested. In John Lewis & Partners, the launch of new exclusive products and expansion of our personal styling offer drove strong sales growth in Fashion, growing market share significantly. In addition, the investment in front line service delivered the best ever customer experience ratings in John Lewis & Partners. In Waitrose & Partners, significant investment in waitrose.com, new customer smartphone apps and customer delivery services has led to a strong increase in online grocery sales of 14%, well ahead of the market, and increased online customer satisfaction.

Our relaunch in September of both brands to include & Partners was an important signal of our determination to place Partners at the heart of the competitive difference we offer to customers. We made significant investments in Partners during the year, particularly in leadership development, in apprenticeships and in pay, with our average hourly rate for non-management Partners rising to £9.16, 17% above the National Living Wage. The average hourly rate of pay will increase by 4.5% following our April 2019 pay review.

With the level of trading pressure and the uncertainty we face politically and in the economy, we took further steps to build up our cash reserves so we're able to maintain annual investment at £400m–£500m per year, while ensuring we have the reserves to cope with whatever conditions or scenarios we face in the year ahead.

We expect 2019 trading conditions to remain challenging but are confident in our strategic direction and customer offer across both brands.

STRATEGIC PROGRESS

The market context continues to be tough. That's evident in our results, especially in John Lewis & Partners, where we saw near constant discounting across many categories from October onwards in response to the combination of subdued demand, excess retail space and some other retailers' distress.

As a result, although sales in John Lewis & Partners were up 0.7% overall, like-for-like sales were down 1.4%. Weaker Home sales combined with gross margin pressures drove around half of the reduction in profits, with the remainder largely due to additional IT costs and property related items.

In Waitrose & Partners we saw a 18% rebound in profits. This was driven by like-for-like sales growth of 1.3% and improved gross margins, which benefited from 24 range reviews, as well as stronger operational performance and wastage and costs that were well controlled.

Near term uncertainty, politically and in the economy, is having a major impact on consumer confidence, but we do not believe the market conditions are cyclical. The disruption we have seen on the high street, including business failures and renewed interest in mergers and acquisitions, are instead signs of an inevitable market adjustment. I predict there could be a reduction of as much as a third of all retail space, and retailers will require greater clarity on whether they are competing on scale or difference.

Chairman's statement — continued

The answer for the Partnership is clear and, despite tough conditions and lower profits, this has been a year when we have developed our brands and invested in Partners. Our difference comes from our Partners, and the energy, commitment and personality they bring to delivering excellent customer service and high quality products to our customers. This is signalled in our rebranding and is why we have stepped up investment so significantly in training and capability building.

In John Lewis & Partners our strongest sales growth came in areas where we have made the greatest investments in new product and services. Our full range relaunch of own-brand Womenswear, including new product, in-store concept and enhanced Partner training, delivered sales growth of 12.9%, and the expansion of our own-brand electricals range resulted in sales increasing by 11.2%. In the year ahead, our furniture assortment and Menswear collections will be completely relaunched.

In Waitrose & Partners we launched more than 5,000 new or updated products including extensive ranges of vegetarian and vegan products. The opening of our £1.5m new Food Innovation Studio also now gives us the edge when it comes to product innovation, with seven chefs working on new and unique products. We won 37 independent Christmas taste tests, almost twice the number as the previous year and considerably ahead of the next best retailer at 21. We completed 24 range reviews from breakfast cereals and sliced bread to meat and fish counters, removing duplication, making the offer clearer for customers and increasing our difference versus competitors.

Our customers are also rightly concerned about the impact retailers have on the environment and we have responded to these challenges. For example, we have committed to operations with net zero carbon emissions by 2050 and in Waitrose & Partners, we announced the removal of disposable coffee cups and plastic straws and are on track to phase out black plastic from our own-brand packaging by the end of 2019. We have also brought forward our target to make all our own-brand packaging widely recyclable, reusable or home compostable from 2025 to 2023. And in John Lewis & Partners, to help reduce the estimated 300,000 tonnes of clothing which gets sent to landfill each year in the UK, we've been piloting an innovative fashion 'buyback' service.

In the year we stepped up our service difference. We made several improvements to convenience, with shorter delivery windows, live order tracking and trials of in-home services across both brands. We have also introduced several added value services including Personal Styling and Beauty Studios in John Lewis & Partners and more Healthy Eating Specialists in Waitrose & Partners. We achieved our highest ever levels of customer experience ratings in John Lewis & Partners. Our focus on customer service in Waitrose & Partners was recognised by *Which?*, with the publication giving it the top position in its 2019 supermarket survey.

However, alongside these successes we also had challenges. The transition of John Lewis Core Home Services from branches to a centralised hub was the most significant. The changes are designed to create a more consistent experience for our customers, but we underestimated the transition requirements and this affected service standards.

> We have also brought forward our target to make all our Waitrose & Partners own-brand packaging widely recyclable, reusable or home compostable from 2025 to 2023.

> We will press ahead even faster with changes that make our business different to others in ways that are valued by customers.

OUR PARTNERS

Greater investment in our Partners is key to our strategy. We invested significantly in leadership development, for over 250 of our most senior leaders, and will extend that to many more this year. We expanded our apprenticeship programme, with over 900 apprentices enrolling in the year in areas such as retail, Large Goods Vehicle (LGV) driving, vehicle maintenance, hospitality and human resources. We made some of these 'open entry' to enable Partners to apply from any part of our business. Among the apprentices who have completed their programmes, 65% passed with distinction.

We have taken significant steps in our aim to be Britain's Healthiest Workplace with a review of our Partner dining rooms, including the food and drink we serve, and launching a Wellbeing Champions Network with 430 Partners recruited in more than 130 locations across the country. Partners have accessed our market-leading mental and physical health support services to either prevent health issues or promote quicker recovery, saving thousands of working days across the year. As we have sought to create jobs with more opportunities for Partners to contribute more value through greater use of skills, expertise and judgement, we increased pay for non-management Partners, with the average hourly rate of base pay rising from £8.91 to £9.16. The average hourly rate of pay will increase by a further 4.5% following our April 2019 pay review.

To deliver the level of distinctive difference and innovation we need for the future requires annual investment of £400m–£500m. The fact we have been able to sustain progress with our strategy is because we anticipated five years ago that market conditions would worsen. We took a series of connected steps to strengthen our financial reserves to enable continued investment despite lower profits. These included changes to our pension benefit in 2014, and proposed changes in 2019/20, deprioritising investment in new physical space from 2015, and halving the rate of Partnership Bonus distribution from 2016. We have made a number of divestments of shops and assets in the year. We have also made significant organisational changes including moving to single Partnership support functions in many areas. As a result, Partner numbers have reduced from 93,800 in January 2015 to 83,900 in January 2019. We will take a series of further steps this year in the move to an even more productive 'One Partnership' approach.

In response to the current economic uncertainty, we have built up a strong liquidity position at nearly £1.5bn at January 2019. This is almost double the level five years ago, despite having made deficit reduction contributions of more than £250m to our pension fund over the last three years, which was nearly 97% funded on an actuarial funding basis at January 2019. We have reduced total net debts by over £400m in the year and since the year-end have paid, from cash, a further £275m to redeem a bond that matured in April 2019.

LOOKING AHEAD

The trading conditions we face in the year ahead are likely to remain challenging. We will press ahead even faster with changes that make our business different to others in ways that are valued by customers. While there are factors that are outside of our control, we are confident of our strategy and the actions we are taking to deliver it.

Alongside the urgency of our commercial plans, this year will also see some important improvements in our governance with the creation of new Independent Director roles and steps to increase the influence and effectiveness of our democracy. As I said in November 2018, this year will also see the announcement of the next Chairman, who will take up their post in early 2020.

Everything we are doing is to ensure the Partnership steers a considered path at speed through times that are likely to remain challenging in retail. My aim, as always, is to ensure the Partnership is as well placed as possible to deliver successfully on our Constitution.

SIR CHARLIE MAYFIELD
Partner & Chairman
John Lewis Partnership