

OUR BUSINESS

CHIEF EXECUTIVE'S STRATEGIC UPDATE

By listening to our customers and simplifying how we do things, I believe we have the right strategy in place to make **M&S a relevant, profitable and truly sustainable retailer.**

STEVE ROWE CHIEF EXECUTIVE



OVERVIEW

A year ago, I started in my role as Chief Executive by posing a series of questions that I hoped would help unlock the future of M&S, giving us a platform from which to first recover and then to grow. 2016/17 has been a year of change as we started to answer these questions, which I address below.

The steps we are taking are making a difference and we are making progress. However, as we said when we set out our plan, it has resulted in some short-term pain. Some of the action needed has been costly and profits are down. Clothing & Home sales were down year-on-year as we reduced promotions and markdown activity. We expected this and we still believe we are doing the right thing for the future of our business. We have seen encouraging signs from the increase in full-price Clothing & Home sales and in the sales growth during the key Christmas trading period. And in Food, we continued to grow ahead of the market with new stores outperforming expectations.

The business has adapted well as we start to build a sustainable foundation for the future. We have laid a lot of the groundwork for our recovery; however, we are not there yet. I want to see consistent delivery over time and I want to see us move out of recovery. Even as our performance improves, we can't stand still. While we are still focused on recovering our business and we have a lot more to do, I am also starting to look to future growth opportunities, some of which I outline at the end of this update.

OUR CUSTOMERS

We asked how we could put customers at the heart of everything we do. Due to the changes we've made, we are now a more data-driven organisation where decisions are made based on what we know about our customers, not what we think we know. We conduct more customer listening groups than ever before; all trading meetings now begin with insight into our customers; and, as we celebrate ten years of leading the social and environmental agenda, we have repurposed Plan A to make it more customer-focused.

Our customer-focused changes are most keenly felt in our stores. We invested in customer service by recruiting additional colleagues into the areas we know are most important to our customers. We also rolled out our Making Every Moment Special in-store service initiative.

[Read more about Making Every Moment Special below](#)

Our new Spend It Well marketing campaign – like our Mrs Claus Christmas campaign before it – focuses squarely on our customers' lifestyles. It taps into people's emotional connection with M&S and is aimed at driving a reappraisal of our brand. Life is short so we should Spend It Well. The campaign encourages customers to make the most of what's relevant for them today.

CLOTHING & HOME

We asked how we could recover and grow our Clothing & Home business. The answer lay in making a series of common sense, customer-focused changes to the way we do things. In a tough market, I am pleased with the progress we are making.

MAKING EVERY MOMENT SPECIAL



Our Making Every Moment Special employee engagement programme has been transformational for our customers and our people alike. Through it, we believe we've taken customer service to new levels. Last summer, we gave over 70,000 store colleagues interactive training with the objective of putting customers at the heart of what we do. We encouraged them to make real-time decisions based on individual customers' needs and we removed non-customer-facing tasks from their daily routines, giving them more time to spend with customers. The response from

colleagues has been phenomenal and as positive as anything I've known in my 28 years at M&S. Our 'Customer at the Heart' site on Yammer, our internal social media network, contains thousands of examples of great service by our colleagues. Throughout our 133-year history, we have learnt that better service leads to better sales. Making Every Moment Special shows this principle in action. It has become our mantra across the business. By empowering our people to make customer-focused decisions, our sales floors are buzzing with a renewed sense of purpose.

OUR STRATEGY

CUSTOMERS AND BRAND
PUTTING THE CUSTOMER AT THE HEART
OF EVERYTHING WE DO

RECOVER AND GROW
CLOTHING & HOME



STYLE

AUTHORITY

QUALITY

Focus on product

Style, wardrobe essentials and fit

Drive execution

Price, availability and service

CONTINUE TO GROW
FOOD



NEWNESS

CONVENIENCE

QUALITY

Focus on product

Innovation, health and capability

Drive execution

Price, availability and convenience

UK STORE ESTATE

- Grow Food space
- c.60 fewer, more inspirational Clothing & Home stores
- Rebalance c.50 stores to growth areas

INTERNATIONAL

- Focus on partnership model and online
- Drive execution – price, availability and service

ORGANISATION & COSTS

- Create a lean, effective Head Office
- Continue to develop cost culture

We made shopping simpler for customers by reducing the number of times we launch new lines from 14 to nine times a year. We cut the number of garment options by 10%. We are phasing out the Indigo, Collezione and North Coast sub-brands. These measures enabled us to improve availability across our ranges. Previously, we acted too much like a 'fast fashion' company, prioritising frequency over quality and taking too many cues from catwalk fashions. So we improved our fits, fabrics and finishes, we increased availability and we refocused on delivering contemporary wearable style and wardrobe essentials. Our ranges are now more relevant to what customers want from M&S.

We started offering better value than ever before by reducing prices on 2,400 Clothing & Home lines. We simultaneously reduced our promotional activity. This put an end to confusing pricing which meant our products were either too expensive or too heavily discounted. Not only have these changes given clarity to customers, but they made our sales more profitable and boosted our full-price market share.

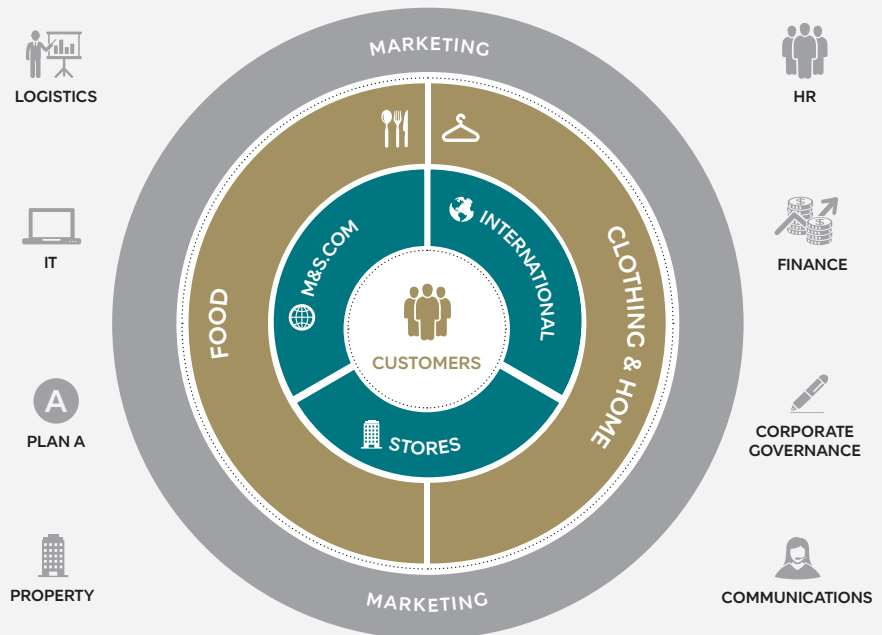
We also made our stores far easier to shop in by merchandising more of our clothes by product category rather than by brand. This change in emphasis reflected the changes we made last year to the way our teams design and buy products. Our shops are now simpler and more intuitive. They are based around customers' needs.

We are still in the recovery phase of our plan and getting it right is absolutely crucial to our success. In May this year, we announced a new role to lead this work. Jill McDonald will join as Managing Director, Clothing, Home & Beauty and will have overall profit and loss accountability for all aspects of our Clothing & Home business, from design and sourcing through to supply chain and logistics. The scope of this role highlights the importance we are placing on continuing to recover and starting to grow Clothing & Home. We are making encouraging progress and I believe we are on the right path to growth.

CHIEF EXECUTIVE'S STRATEGIC UPDATE CONTINUED

OUR OPERATING MODEL

Simplicity and accountability are key to running an agile and successful business. We are therefore changing our operating model to give us two clear profit and loss accountabilities – one for our Clothing & Home business unit and one for our Food business unit. Both sides of the business are now responsible for their own end-to-end profit & loss. As part of the change, M&S.com has moved from being a separate business unit to being a sales channel, along with Stores and International. All three channels now feed into our two business units, with our customers at the centre. Underpinning these changes is the ongoing drive for simplicity in the way we do things.



FOOD

Convenient. Special. Different. These are the reasons why customers love our food. These are also the reasons why our Food business is on a clear path to sustainable growth. We know that selling quality food from convenient locations is a winning formula: sales from the 30 owned Simply Food stores we opened this year are ahead of plan. We'll continue to grow our Food business by opening 250 further Food stores by 2020. We're succeeding in our aim of making every food moment special. Customers love our high levels of innovation – we renew around a quarter of our range every year – and they love the high quality of our products. We won't accept second-rate ingredients. In a world where you get what you pay for, it shows. This year we extended Collection, our top tier range for customers who want something extra special. And customers know they can trust us on health. It is their number one concern when it comes to buying food, so we launched 200 new products aimed at helping our customers to eat well, and extended our Made Without, Balanced for You and Eat Well ranges. The grocery market continues to be very competitive but we will continue to set ourselves apart with superior quality, innovation and convenient food in convenient locations. As we grow our Food store presence, our food will be even more accessible to more customers.

OUR PEOPLE

By thinking, working and behaving with a truly customer-centric mindset, I believe our people are integral to our success.

Last year I asked what our right cost base, shape and structure was, and how this would affect our people. In April 2017, we finalised the pay and pensions changes that I outlined last year and we now reward our people in a fairer, more consistent way. I am immensely proud that we now have pay and benefit parity across the business. Following detailed consultation with our National Business Involvement Group of elected employee representatives, we now offer one of the best reward packages in UK retail.

In November, we outlined further plans to simplify the business and lower our costs. This resulted in a reduction of roles at our Head Office and the decision to reduce our central London office space as we move to more efficient ways of working. Some of these decisions had a direct impact on a number of our employees. But I believe our people recognise that we made them for the right reasons and that they were necessary for our sustainable growth.

I would like to thank all our people for their dedication and professionalism in a year of significant but necessary change.

STORE ESTATE AND INTERNATIONAL

Our customers' shopping habits are changing, so I asked whether our UK and International store estate is the right shape for the future. It is not. Customers' behaviour is evolving, and the pace of change is accelerating. Rather than doing one big food shop a week, there is a growing trend of customers picking up food for now or for tonight. Look at how people use technology. They'll browse or buy online and collect in store. Or they'll buy on their smartphone for home delivery. Sales on M&S.com now account for 17% of Clothing & Home sales.

At the same time, customers want to shop in modern stores that offer a great experience. Our store portfolio needs to reflect how people live their lives today.

So we announced plans to rebalance our UK space to meet changing customer needs. The transformation will enable us to grow Clothing & Home sales through fewer, better stores. Over five years, we will change the use of around 25% of our space, with more of it being deployed to Food and other growth areas. Clothing & Home space will reduce by around 10%. Approximately 30 full-line stores will close, and 45 will be converted to Simply Food.

To be clear, this is neither a withdrawal nor a retrenchment. Due to our ambitious Food expansion we will have more stores in the future, not fewer. But our estate will be the shape which meets how our customers want to shop at M&S.

Our International operations have also changed. While our franchise business with our knowledgeable partners is profitable, our owned estate is not. This is unsustainable, so we are focusing on our joint venture and franchise partnerships and our growing online business, and exiting ten of our loss-making owned markets. The programme is on track. We have now closed all ten of our stores in China and completed employee consultations in the remaining markets. We remain a significant player on the global stage with a store or online presence in 55 markets. I believe in an international business for M&S and remain committed to it.

These changes show that we're willing to adapt to ensure we're in the best shape for our customers.

COSTS

Cost control remains a top priority. Our operating costs were up 3.8% this year as we put more colleagues into stores and absorbed the costs of our Food store opening programme. We funded some of this through our Crunch Costs initiative, which challenged all of our people to tackle unnecessary costs, and from simplifying our Head Office structure. Better buying initiatives, such as direct design and food packaging optimisation, mitigated the currency headwinds we saw on both sides of the business. The steps we've taken to transform M&S led to charges of £437.4m this year. These were largely driven by charges for International store closures and for the changes to pay and pensions.

While profits were significantly down, I continue to believe in good cash management, a robust balance sheet and a progressive dividend policy. We know how important our dividend is to shareholders big and small.

+ Read more in the **Financial Review** on p26-29

OUR CHAIRMAN

Our Chairman, Robert Swannell, has announced that he will step down in September. On behalf of all of us at M&S, I wish Robert well. He has overseen significant change at M&S. Our infrastructure now provides a strong platform for growth, and Robert has been instrumental in driving shareholder engagement, good governance and succession planning. He has also been a tremendous support to me personally over the last year. On behalf of the whole business, I would like to welcome Robert's successor, Archie Norman.

LOOKING AHEAD

My priorities for the year ahead are to continue to recover and grow Clothing & Home and to grow our Food business. I will also establish the foundations for new paths to growth. In the UK, these will focus on areas of market share opportunity in Kidswear, Footwear, Home and Beauty. Internationally, we will explore new territories with our franchise partners. And I will continue to develop talent within the organisation.

It continues to be a privilege to lead this fantastic company. Our job as a retailer is quite simple: we must offer customers great products at the right price in physical or digital environments that they enjoy, with great service. If we do this, they will come back to us for more.

But to do this year-in, year-out, we must constantly adapt. We must adapt both to stay in tune with our customers' needs and in the way we sell our products. Shopping habits won't stop changing, so neither must we.

As Chief Executive, I want to make M&S agile and flexible enough to change with our customers. I want to see the end of big transformation programmes followed by years of standing still, followed by yet more transformation. Remaining relevant should be a continuous process.

By simplifying how we do things and really listening to our customers, we've already become more agile this year. By rationalising our Clothing ranges and reshaping our store portfolio, we've started to put this agility into practice. In doing this, we've built a solid foundation for growth. We must never stop adapting our business for our customers.

Nothing makes me prouder of the work our teams do than hearing from our customers and what they love about M&S. Those customers are the reason we're here. They will remain at the heart of everything we do.



STEVE ROWE CHIEF EXECUTIVE

OPERATING COMMITTEE



Steve Rowe
Chief Executive



Helen Weir
Chief Finance Officer



Patrick Bousquet-Chavanne
Executive Director, Customer,
Marketing & M&S.com



Andy Adcock
Food Director



Sacha Berendji
Retail Director



Paul Friston
International Director



Dominic Fry
Communications & Investor
Relations Director



David Guise
Human Resources Director



Jo Jenkins
Womenswear, Lingerie &
Beauty Director



Amanda Mellor
Group Secretary and Head
of Corporate Governance