Ocado statement regarding agreement with Morrisons

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Ocado Group PLC
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London, 17 May 2013

Ocado Group plc

Ocado Group plc announces Wm Morrison Supermarkets plc as a strategic customer of its intellectual property

Summary
Following the announcement on 14 March 2013 confirming discussions with Wm Morrison Supermarkets plc ("Morrisons"), the Board of Ocado Group plc (the "Company" or "Ocado") today announces that the Company has entered into a 25 year agreement with Morrisons to license certain technology, logistics and distribution services to enable Morrisons to launch and develop its online grocery business. In addition, Ocado will sell to Morrisons assets and a half of its existing capacity in its Dordon Customer Fulfilment Centre ("CFC").

The Board of Ocado believes the agreement presents an attractive opportunity as:
· It allows Ocado to continue to improve its intellectual property ("IP"), with the fees earned under the agreement enabling greater investment in technology and research and development ("R&D");
· It improves Ocado's economic model with the sharing of costs and more efficient utilisation of fulfilment capacity;

- It validates Ocado's operating model and provides a template to monetise Ocado's unique IP and operational expertise in the provision of online retail, logistics and distribution services;
- It strengthens Ocado's balance sheet and reduces finance costs due to the upfront receipts of an estimated £165 million;
- Ocado's customers and the current contractual agreement with Waitrose will remain unaffected by these arrangements, and over time the financial flexibility and increased investment should result in continual improvement of Ocado's proposition to its customers.

The Board considers this agreement to be a Class 1 transaction under the Listing Rules and so expects to publish a Class 1 circular in due course.

Tim Steiner, Chief Executive Officer of Ocado, said:
"Morrisons' desire to offer its customers the choice of online shopping illustrates the structural shift we are seeing in favour of the channel. We see Morrisons' decision to adopt our model to drive its online launch as a further endorsement of our technological and logistical excellence. This validation should support the internationalisation of our model as well as the growth of our UK business by increased market use of our operating model, enhancing capital efficiency and improving returns.

"Our customers will see no change to the service they receive from Ocado as a result of this agreement. We will continue to source products under our long-term agreement with Waitrose, and our customers will continue to benefit from the existing high levels of service, wide range of products and competitive prices that they currently enjoy."

Dalton Philips, Chief Executive of Morrisons, said:
"This agreement is a significant strategic step for Morrisons. From a standing start, Morrisons will be competing in the fast growing online channel by the end of this year with a really compelling proposition. The customer gets our affordable fresh food delivered by Ocado's state of the art distribution system. I'm confident that Morrisons.com will grow over time to be an operation of real scale and significance whilst creating meaningful long-term value for Morrisons shareholders."

Enquiries:

Ocado Group plc

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Analyst conference call

There will be an analyst conference call at 8:00am today, details as follows:

Dial-in number:	+44 (0)20 3139 4830
Password:	23934876#
Replay facility available for 7 days:	+44 (0)20 3426 2807
Replay access number:	639392#

Notes to Editors

1. About Ocado

The principal activity of Ocado is retailing, logistics and distribution of grocery and consumer goods through the development of an operating system based on proprietary IP and technology. Ocado operates a state-of-the-art, highly automated centralised distribution model instead of a network of stores from which to service customers, which gives a number of advantages to customers and for the business. Ocado sells more than 30,000 different products and has a sourcing agreement with Waitrose, a leading high quality UK supermarket. Ocado sells branded, Ocado labelled and Waitrose labelled products to a delivery catchment covering around 70% of the UK population.

2. About Morrisons

Morrisons is one of the UK's largest food retailers with 500 stores and the only British supermarket to have its own food processing sites, abattoirs and a farm. It is unique in making almost a quarter of the fresh food it sells in store itself giving it unrivalled control over its supply chain. It's committed to supporting British farming and all Morrisons branded fresh meat is 100% British. It has more skilled specialists preparing fresh food in store than any other retailer with over 6,000 fully trained crafts people including butchers, bakers, fishmongers and cheesemongers. Every week it serves over 11 million customers. 129,000 colleagues across the business deliver great service to them. Its aim is to give customers more of what matters offering great quality food at low prices.

Ocado Group plc announces Morrisons as a strategic customer of its intellectual property

1. Introduction

Following the announcement on 14 March 2013 confirming discussions with Morrisons, Ocado today announces that it has entered into a 25 year agreement with Morrisons to license certain technology, logistics and distribution services to enable Morrisons to launch and develop its online grocery business ("Morrisons.com").

2. Background to and reasons for the agreement

Customers are changing the way they shop and online is the fastest growing channel in the UK. Morrisons is the UK's fourth largest food retailer and is committed to entering the fast growing online channel.

Ocado is one of Britain's leading online grocers, and at the forefront of the development of online shopping and technology, and therefore a suitable partner for Morrisons in this dramatically changing marketplace.

The agreement will provide Ocado with the opportunity to further develop its technological and logistical excellence and to accelerate the growth of Ocado.com, improve operating efficiency, create a template for licensing its superior technology, and allow it to repay in full the debt outstanding under its capex facility of £85 million.

Morrisons.com will be entirely separate from Ocado's online business, with its own customers and product range. Morrisons customers will order from Morrisons using a Morrisons.com website, selecting products sourced and ranged by Morrisons, fulfilled and delivered in a Morrisons owned and liveried van.

3. Principal terms of the agreement

There are two principal elements to the agreement.

A) A technology licensing and services arrangement

Ocado will provide Morrisons with a range of services enabling Morrisons to launch its own online grocery offering out of the Dordon CFC. In return for this, Ocado will receive a number of different payments:

- Ocado will receive an upfront payment of £30 million to license current technology and IP expected to be amortised over five years, after deducting implementation costs.
- An annual IT payment of initially 1% of Morrisons.com revenue, with a minimum of £3.5 million, to cover the maintenance, operations and infrastructure costs of IT services provided to Morrisons.
- In addition, Morrisons will make payments to cover certain costs based on:
  - § its share of the variable costs of the Dordon CFC;
  - § 50% of the fixed costs, maintenance, replacement and expansion capital expenditure of the Dordon CFC;
  - § a proportion of the fixed costs and a share of variable costs, based on agreed capacity usage of existing and future spoke sites.

  Operating costs within the CFC are subject to a management fee of 4% (excluding rent). Within the spoke network, the management fee applies to employment costs only, and is not applicable to fuel.

- Morrisons will pay an annual fee in respect of future R&D, calculated as one-third of Ocado's relevant annual R&D spend with the fee being fixed at £8 million for the first two years and capped at £8 million thereafter.
- Ocado will also receive a services bonus fee. For the first 15 years the service bonus fee is set at a minimum of 25% of the positive only annual EBIT of Morrisons.com. Dependant on a number of factors including its rate of growth of its online customers, Morrisons.com may not make a profit for a number of years.

B) Sale and leaseback of property and equipment

Ocado currently holds a long leasehold interest in the land and buildings of the Dordon CFC via a wholly-owned subsidiary, Last Mile Developments Limited ("LMD"). Interests in the land, buildings and mechanical handling equipment ("MHE") of the Dordon CFC will be acquired by Morrisons at book value on the following terms:

- Morrisons will acquire the shares of LMD and procure the discharge of approximately £80 million of internal and external debt;
- A new 25-year lease will be granted by LMD to Ocado at an annual rental of £4.9 million, of which 50% will be on-charged to Morrisons.com for its share of the Dordon CFC capacity;
- The MHE will be sold by Ocado to a new joint venture company owned 50/50 by Ocado and Morrisons for the duration of the arrangement, with Ocado receiving a consideration on completion of an estimated £55 million in cash in addition to its 50% share of the company with a potential further £3 million.

With the addition of planned expansion capital expenditure, the Dordon CFC is projected to have a total capacity of 180,000 to 190,000 orders per week at peak. Under the terms of the arrangement, Ocado will have available for its use 50% of this capacity. During FY2012 orders were fulfilled by the Hatfield CFC which currently has a total peak capacity of approximately 150,000 orders per week. Hence although the arrangement will reduce the current capacity available to Ocado, it allows sufficient headroom for significant growth.

Once the Dordon CFC becomes insufficient for the parties' projected needs, the parties expect to agree to develop new CFCs, to be built and operated by Ocado for either joint or sole use. The capital and operating costs of any joint use CFCs will be shared between the parties based on their agreed capacity share.

Further provisions of the agreement

- In the event that the commencement date for Morrisons.com does not occur by 31 July 2015, the Ocado group will be obliged to buy back from Morrisons the entire share capital of LMD and Morrisons' 50% holding in the MHE joint venture, in each case at a price reflecting the original purchase price less depreciation. The Board considers this remote. Services commencement is currently expected by January 2014.

- There is an obligation under the agreement that Ocado will provide the same standard of services to Morrisons.com as it provides to Ocado.com, expected to be the best end-to-end operating model for the grocery industry in the UK. In addition, there are requirements to achieve certain minimum service levels with reductions in the management fee only in the case of these not being achieved.

- The agreement contains a restrictive covenant with respect to exclusivity, under which Morrisons will not operate its online grocery business in Great Britain other than under this agreement, and Ocado will not provide similar online grocery services in Great Britain to more than one competitor of Morrisons at any one time.

- The agreements contain a number of termination rights including:

  § either party having a right to terminate the agreement if, before completion, a third party makes an offer for the entire issued share capital of the other and such offer obtains a board recommendation;

  § after completion, either party having a right to terminate the arrangements if a competitor acquires control of the other.

- Ocado is liable to pay Morrisons a break fee of £7 million if Morrisons terminates the agreement before completion by reason of Ocado failing to hold a shareholder meeting by 14 October 2013, Ocado's Board withdrawing its recommendation to Ocado's shareholders to approve the arrangements, or a third party making an offer for Ocado which offer is recommended by Ocado's Board. Morrisons is obliged to pay Ocado a break fee of £7 million if Ocado terminates the agreement before completion by reason of a third party making an offer for Morrisons which offer is recommended by Morrisons' Board.

4. Use of proceeds

On completion, the proceeds from the arrangements will be used in part to pay down debt of £85 million, being all of the capex facility currently outstanding, thereby reducing finance costs. As a result, there will remain additional cash on the balance sheet which gives Ocado flexibility and optionality to expand within the UK and internationally.

5. Expected timetable to completion

A circular containing further details on the agreement, the Board's recommendation, and the notice of the General Meeting and the resolution which may be required to approve the agreement will be sent to Ocado shareholders as soon as practicable. Completion of the agreement is expected to occur during the third quarter of 2013.

6. Current trading

Ocado's sales growth for the 12 weeks to 19 May 2013 is estimated to be over 15.5%.

Appendix: Summary financial effects of these arrangements

The anticipated net impact on the key line items of Ocado's financial statements can be summarised as follows.

Revenue

The agreement will contribute a mid-single digit percentage of Ocado's revenue in its first full year. This is primarily as a result of the addition of the various fees under the operating services agreement, the recharging of certain shared costs to Morrisons.com, the amortisation over five years of the initial up-front license fee and cost contributions relating to Morrisons.com's use of the Dordon CFC.

Profitability

The agreement will be significantly accretive to Ocado's net profitability in the first full year. We anticipate that the agreement will contribute a mid-teen million pound improvement to Ocado's net profit, comprised primarily of the benefit from service fees and cost sharing arrangements, less an increase in interest payments.

The impact on EBITDA is expected to be greater than that to net profit by approximately £4-5 million, primarily as a result of an increased interest charge. The interest savings from the repayment of the outstanding borrowings will be more than offset by an increase in interest expense from MHE finance leases of around £8 million.

Cashflow and phasing of capacity and savings

The agreement will significantly strengthen Ocado's balance sheet and cashflow profile. On completion, Ocado will receive a total cash inflow of an estimated £165 million, prior to the repayment of £85m due under the existing capex facility. The cashflow impact of the net profitability above will be less primarily due to the effect of the amortisation of the up-front license fee.

As a result of this agreement, Ocado is expected to rephase its capacity planning, bringing forward the building of future CFCs in order to cater to Ocado's order growth, or in the case future CFCs are also shared, the combined order growth of Ocado and Morrisons.com. Such rephasing would have a timing impact on Ocado's future cash flows relating to fixed costs, as well as capital expenditure for future CFCs. These future CFCs may be leased to reduce future capital expenditure requirements.

Work to complete Phase 2 of the Dordon CFC will commence on completion of the agreement, with Ocado's share estimated at £16 million. Ocado anticipates commencing a search for a suitable location for a potentially shared CFC3 towards the end of 2014.

END

INFORMATION REGARDING FORWARD LOOKING STATEMENTS

This document includes statements that are, or may be deemed to be, "forward-looking statements". These forward-looking statements can be identified by the use of forward-looking terminology, including the terms "believes", "estimates", "plans", "projects", "anticipates", "expects", "intends", "may", "will", or "should" or, in each case, their negative or other variations or comparable terminology, or by discussions of strategy, plans, objectives, goals, future events or intentions. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this document and include, but are not limited to, statements regarding Ocado's intentions, beliefs or current expectations concerning, among other things, Ocado's results of operations, financial position, prospects, growth, strategies and the industry in which it operates. By their nature, forward-looking statements involve risk and uncertainty because they relate to future events and circumstances. Forward -looking statements are not guarantees of future performance and the actual results of Ocado's operations and financial position, and the development of the markets and the industry in which Ocado operates, may differ materially from those described in, or suggested by, the forward-looking statements contained in this document. In addition, even if the results of operations, financial position and the development of the markets and the industry in which Ocado operates are consistent with the forward-looking statements contained in this document, those results or developments may not be indicative of results or developments in subsequent periods. A number of factors could cause results and developments to differ materially from those expressed or implied by the forward-looking statements including, without limitation, general economic and business conditions, industry trends, competition, changes in regulation, currency fluctuations, changes in its business strategy, political and economic uncertainty and other factors discussed in this announcement. Forward-looking statements may, and often do, differ materially from actual results. Any forward-looking statements in this document speak only as of their respective dates, reflect Ocado's current view with respect to future events and are subject to risks relating to future events and other risks, uncertainties and assumptions relating to Ocado's operations, results of operations and growth strategy. Subject to the requirements of the FCA, the London Stock Exchange, the Listing Rules and the Disclosure and Transparency Rules (and / or any regulatory requirements) or applicable law, Ocado explicitly disclaims any obligation or undertaking publicly to release the result of any revisions to any forward-looking statements in this document that may occur due to any change in the Company's expectations or to reflect events or circumstances after the date of this document. No statement in this document is intended as a profit forecast or profit estimate.

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