THE ACCOUNTS OF THE CO-OPERATIVE GROUP: TURNAROUND TO REBUILD

The Full Report

An Analysis of the Group's Accounts with a focus on 2013-2015

katrose@live.co.uk

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Introduction

This report is intended to provide an update on the progress of the Co-operative, recently renamed the Co-op, following-on from my previous report 'The Accounts of the Co-operative Group, a Summary from 2009 to 2014'. This publication is also accompanied by its supplement 'The Accounts of the Co-operative Group: Turnaround to Rebuild, The Remuneration Supplement'.

The years 2013 to 2015 have seen positive growth in the businesses which provide the largest share of the Group's profits and a multi-million pound turnaround for the legal business; however, the E-store and Insurance businesses have recorded losses instead of profits, the Insurance business has been particularly vulnerable to external factors including claims for flood damage.

The losses in some Co-operative Group businesses have concealed the improvements made in other areas, contributing to an overall decline in Underlying Profit of £22 million. Another factor has also contributed to the decline in Underlying Profit though, this factor is Corporate Costs. Despite restatements, due to changes made to what constitutes a Corporate Cost, reducing Corporate Costs by £33 million from 2013 to the restatement of 2014; Corporate Costs have almost doubled between 2009 and 2015, from £84.3 million to £160 million.

Food and Funerals have both seen underlying profits grow between 2013 and 2015, though the causes of their growth do differ. Funeralcare has seen its revenue increase between 2014 and 2015, which suggests that increases in revenue were a significant factor behind its Underlying Profit increase. Funeralcare colleague numbers have been subject to change between 2013 and 2015, first falling by 114, then increasing by 176. Changes to Food colleague numbers have been more significant in scale, between 2013 and 2014 Food colleague numbers fell by 9,217 or 13%; their numbers then increased by 2,194 or 4% between 2014 and 2015.

Food's underlying profits have increased between 2014 and 2015, though for the second year in a row this has not been caused by any increase in revenue. To gain a further understanding of what is happening to revenues within the grocery sector that the Food business must operate in, this report compares Co-operative Food's revenues to that of its main competitors of a similar size; the technical term for competitors of a similar size being 'benchmark businesses'. The majority of these benchmark businesses were seeing increasing revenues until at least 2013; however, with the notable exception of John Lewis, their revenues either stalled or declined between 2014 and 2015 and this indicates that 2014/15 has not been a good year for large-scale Food retail.

Annual reports for the Co-operative's benchmark businesses indicate that they are being put under pressure by the rise of the convenience format on which the Co-operative is now focussed. The Chief Executive of Tesco, Dave Lewis, stated in Tesco's 2015 Annual Report that 'the channel shift to online and convenience presented both challenge and opportunity'. The Co-operative is embracing the rise of Convenience as an opportunity, moving further into this growing market.

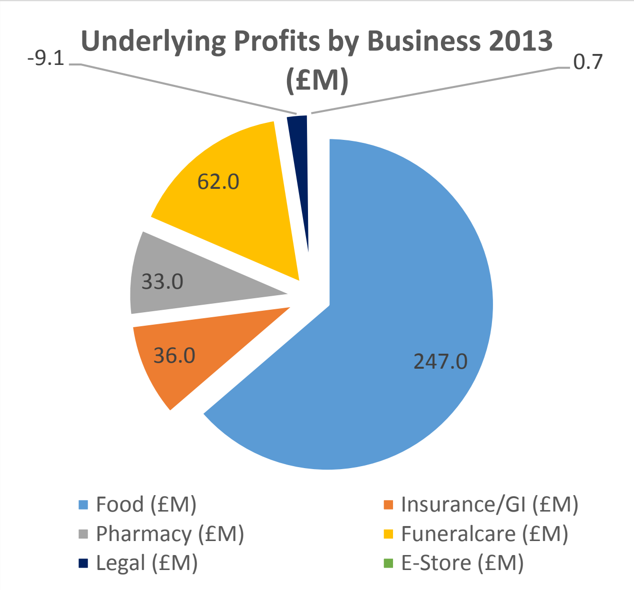
To gain a greater understanding of the Co-operative's financial situation asset to liability ratios have been compared, the comparison reveals a change of 0.03%, in real terms this means no change has occurred to the balance of assets and liabilities. Within the liabilities category, interest-bearing loans and borrowings have increased by £31 million between 2014 and 2015.

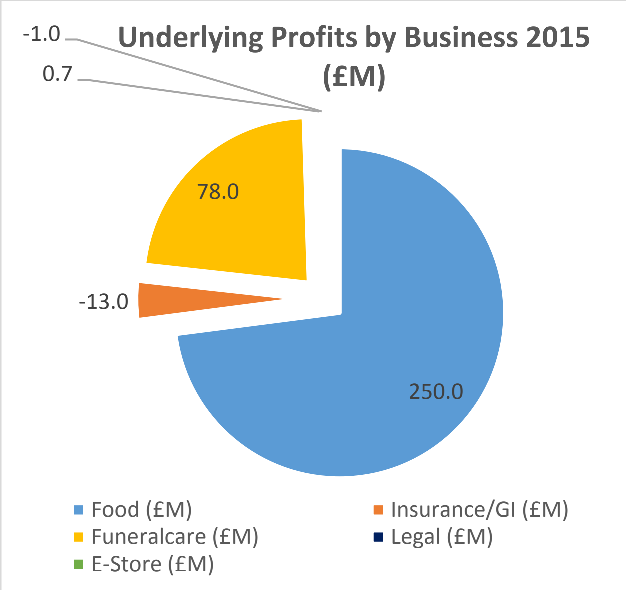
The NOMA project to develop the area of Manchester around One Angel Square continues. In 2015 the Co-operative provided Capital and Loan advances of £41,850,000.

How the Businesses' Contributions to Group Underlying Profits Have Changed

Between 2013 and 2015 the influence of the Food business upon the Group's overall underlying profits has grown substantially. This relative growth has not been caused by any substantial increase in Food's Underlying Profit, instead the sale of the Pharmacy business has coincided with a significant fall in Insurance's Underlying Profit. The E-store business has also seen its small Underlying Profit in 2013 decline to a small loss in 2015.

These figures do also contain some positive news which is indicative of progress in the turnaround process. The modest growth in Food's Underlying Profit is a significant improvement upon the year-on-year decline in Food's Underlying Profit seen prior to 2013. Meanwhile, Legal has seen an exponential improvement in its sustainability between 2013 and 2015.

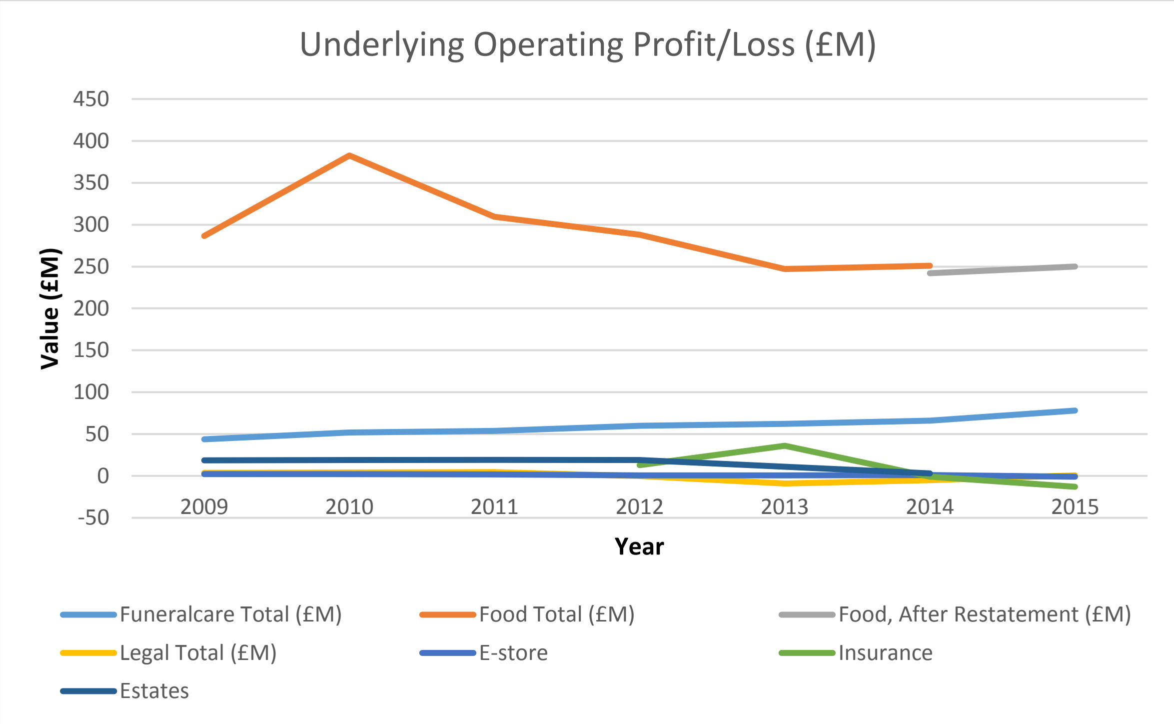




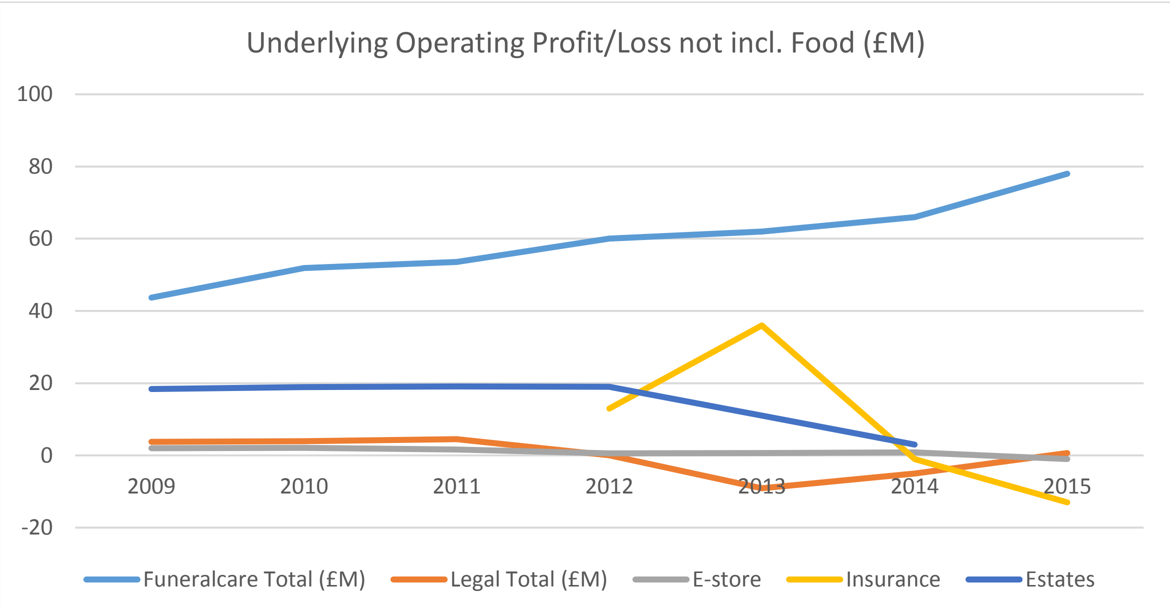
Underlying Profit/Loss by Business

Year	Funeralcare Total (£M)	Food Total (£M)	Legal Total (£M)	E-store	Insurance
2009	43.7	286.4	3.8	2	-
2010	51.9	382.6	3.9	2.1	-
2011	53.6	309.4	4.5	1.6	-
2012	60	288	0	0.6	13
2013	62	247	-9.1	0.7	36
2014	66	251	-5	0.6	-1*
2015	78	250	0.7	-1	-13

These figures necessarily understate the influence of Food upon the Group as a whole following the movement of Estates losses into Food's underlying profit category. The restatement which followed this change in reporting practice in 2014 was not greatly significant in terms of Food's Underlying Profits as a whole. With regard to 2015, no conclusions can be drawn as Estates Profits/Lossses, underlying or otherwise, are not disclosed. However, on the evidence of 2014, it would seem unlikely for Estates losses to have had a material impact on the profits of the Food business. These restatements have also seen Insurance's Underlying Loss of £7 million in 2014 restated as a loss of £1 million for 2014 when reported the following year.



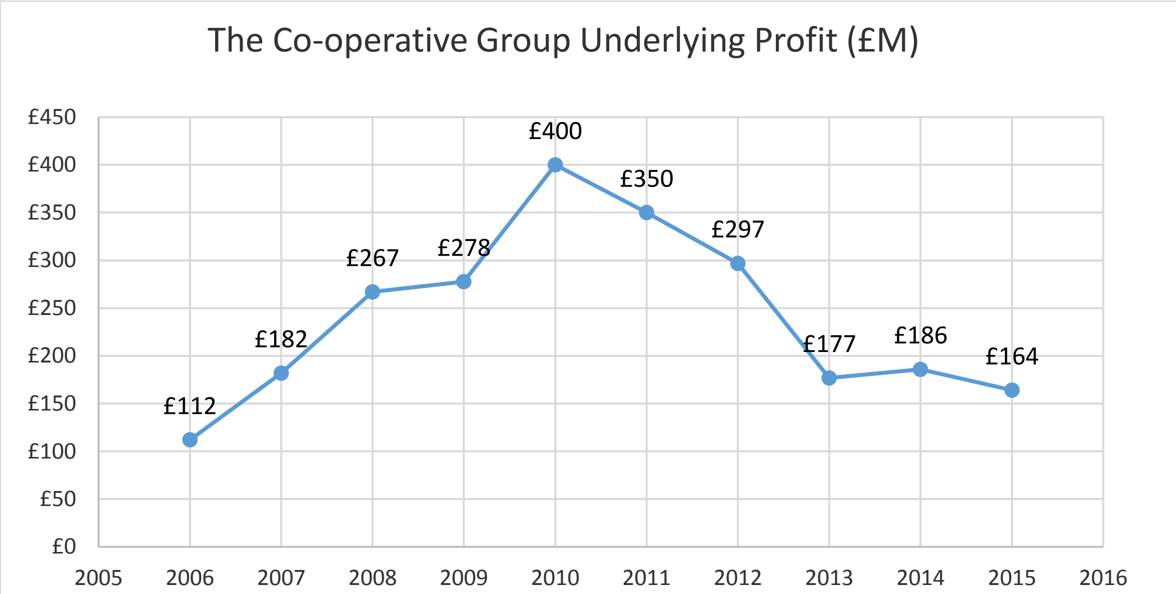
The Funeralcare business has been delivering increases in underlying profit since at least 2009 and an increase in death rates has seen its underlying profits increase more than usual in 2015. The gap between the Food business's underlying profits and those of the other businesses is such that the progress of other businesses is more effectively evidenced in the following chart.



It now becomes apparent that the Insurance business has experienced two turbulent years in a row, whilst the E-store that recorded over £2million of underlying profit in 2010, has seen underlying profits of £0.8 million in 2014 (re-stated from £0.6 million in 2014) turn to losses of £1million in 2015. The Legal business has made significant progress in 2015, recording its first underlying profit since 2011. In 2013 Legal reported an Underlying Loss of £9.1million, whereas 2015 saw it report Underlying Profit of £0.7million; this £9.8million turnaround is a very positive sign for its future.

Underlying Profits and Corporate Costs

The combination of profit and loss-making businesses has hindered attempts to increase underlying profits despite the progress made in areas such as Legal and Food.



Business profits are not the only factor affecting the Group's underlying profits, however, the frequently reclassified area of Corporate Costs has also impacted upon this reporting category.

Corporate Costs 2009-2015 (£M)

Year	Costs from supporting functions	Corporate costs	Central Costs (£M)	Corporate, Group costs and other adjustments: Underlying segment operating profit (£M)	Corporate Membership and Federal USOP (£M) + Group costs and other adjustments USOP (£M)
2009					84.3
2010				98	97.7
2011				87	
2012			111.0	103	
2013		176.0	192.0		
2014	129.0	146.0			
2015	160.0				

Restatement
Initial Statement

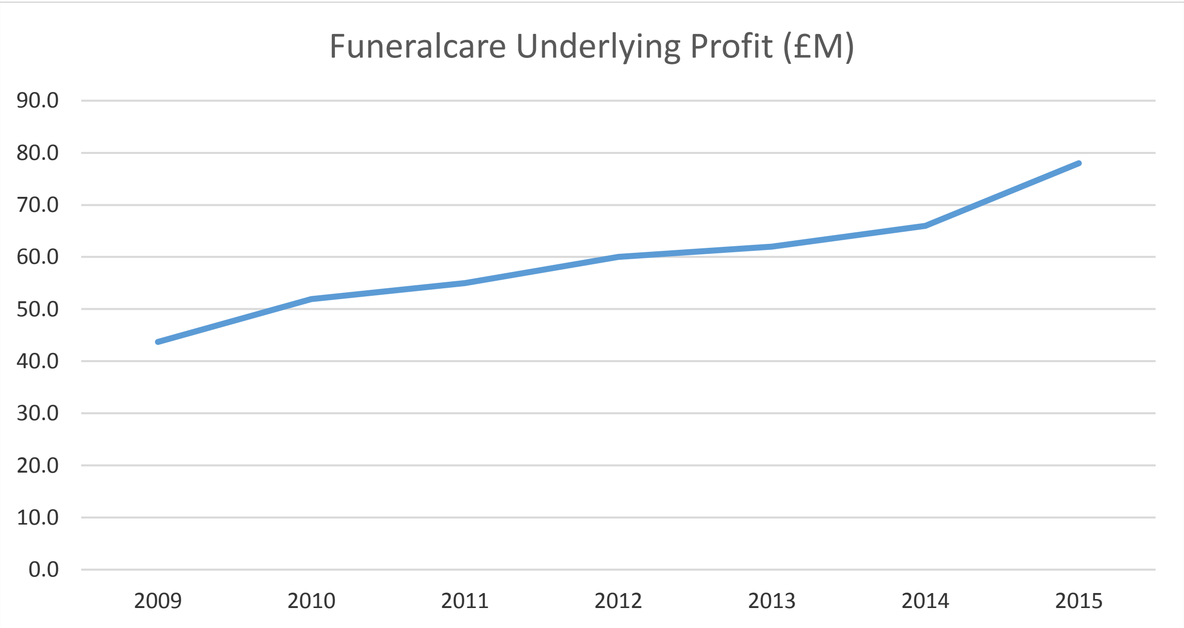
The two re-categorising restatements in 2010 and 2012 changed the reported value by a combined total of £8.3m, whilst the two re-categorising restatements in 2013 and 2014 changed the reported value by a combined total of £33m. The respective annual reports reveal that the 2013 and 2014 figures, which were reported after the fact, were restated and re-categorised for the same reason;

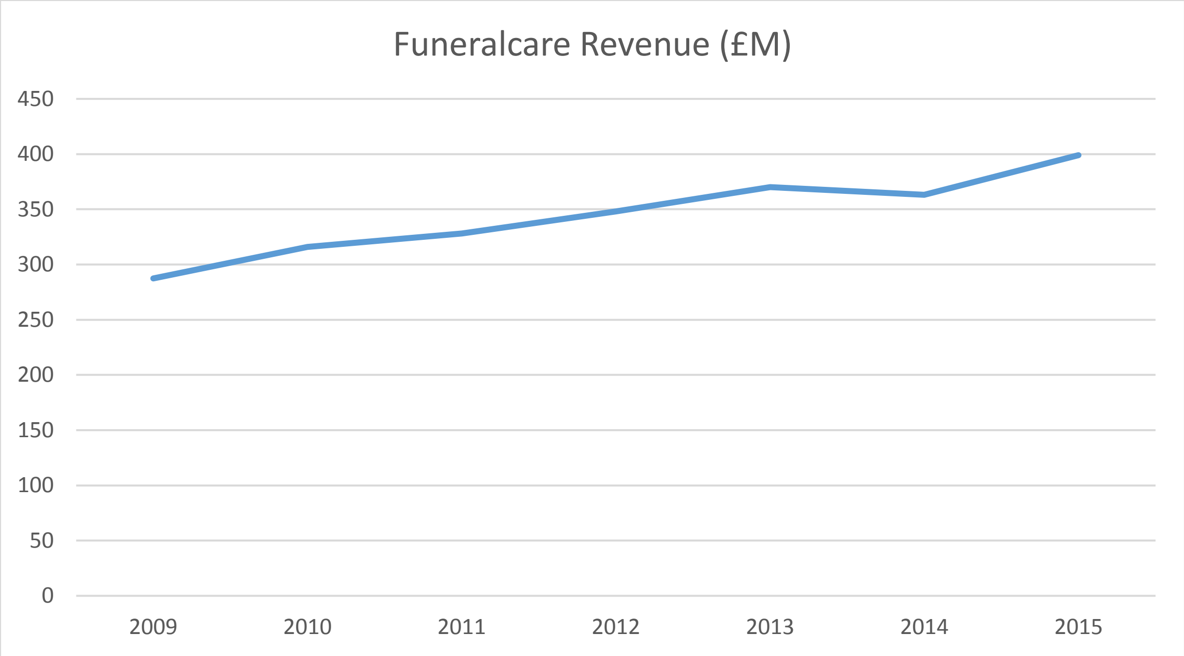
loss-making categories had been removed from them in each case. Despite the effects of re-categorising restatements, charting the initial statements of Corporate Costs still reveals a clear pattern; four years of increases and only two years of decreases, resulting in Corporate Costs nearly doubling overall.

Core Businesses: Food and Funerals

When examining the progress of businesses, underlying profit and revenue are both key metrics. Comparing the two reveals whether any increase in underlying profits is in-fact caused by an increase in revenue.

Funeralcare





In the case of Funeralcare, the strong correlation between changes in underlying profit and those in revenue suggests that increases in revenue are likely to be a significant factor behind its increases in underlying profit.

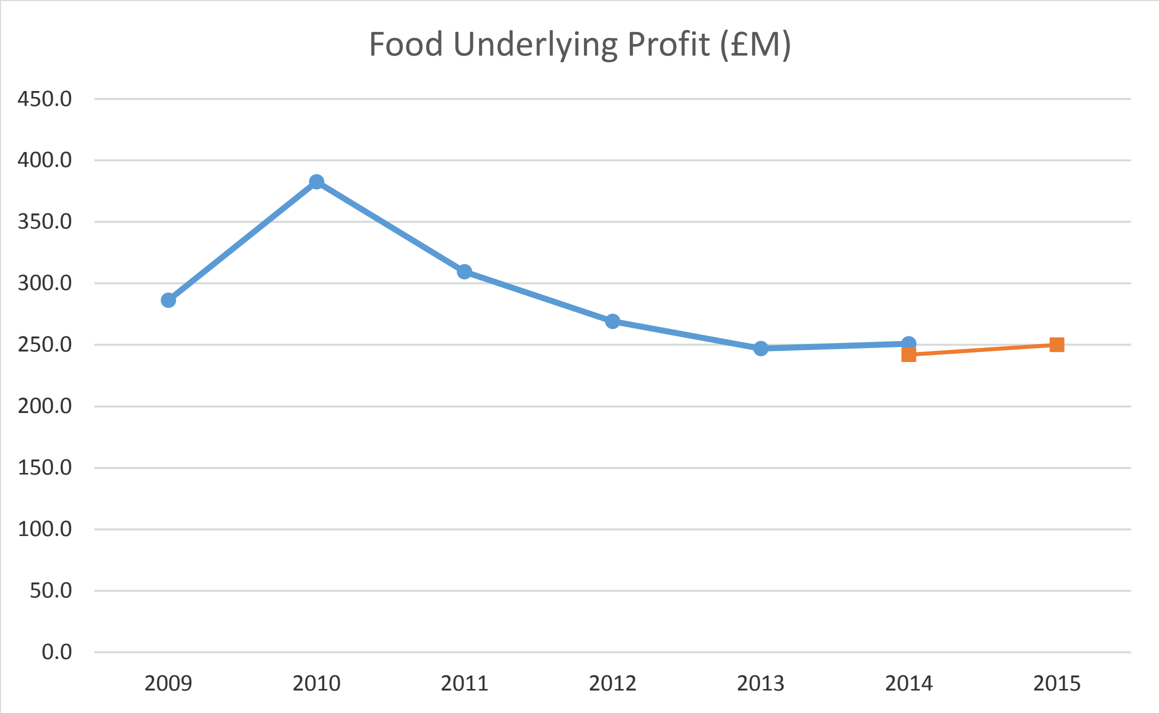
The Funeralcare business has seen a reduction in colleague to funeral home ratios between 2013 and 2015. The number of funeral homes has increased by 60, whilst the number of colleagues has increased by just 62. These years saw the number of funeral homes rise relatively steadily; yet, colleague numbers fell by 114 between 2013 and 2014, they then rose again by 176 between 2014 and 2015.

Year	2010	2011	2012	2013	2014	2015
Funeral homes	865	888	910	926	961	986
Funeralcare Colleagues	4,084	4,057	4,191	4,230	4,116	4,292

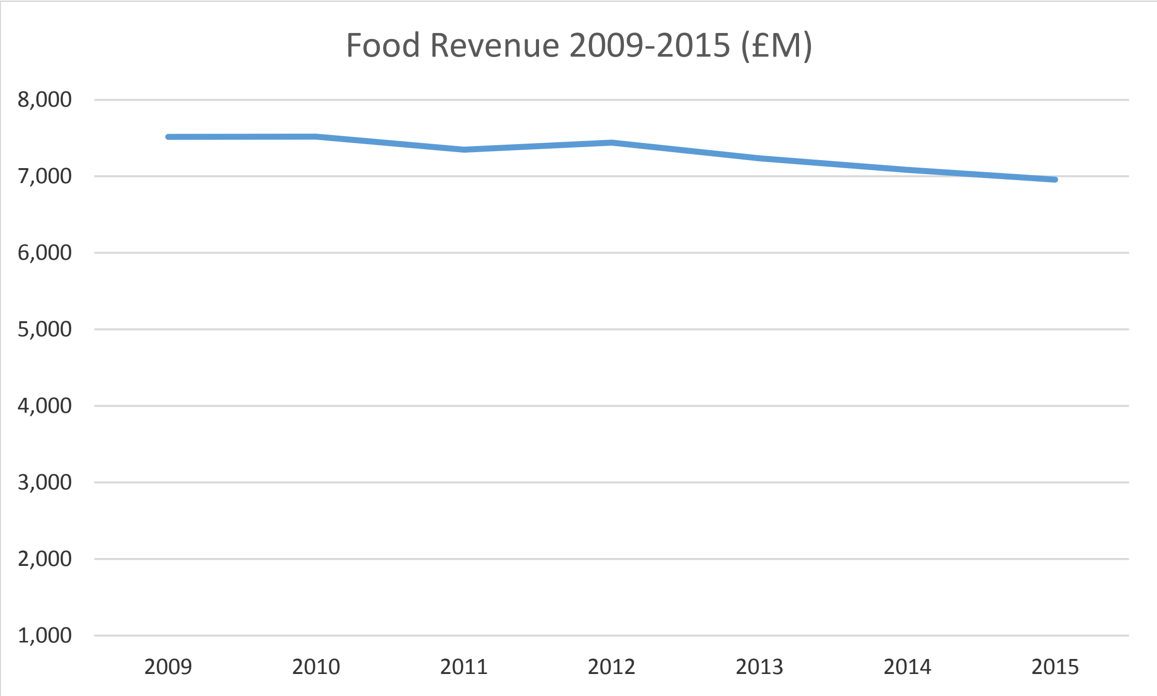
Food

A comparison of Food's Underlying Profits to its Revenue is indicative of the fact that it has faced greater challenges than the Funeralcare business.

The restatement of Food's Underlying Profit for 2014 saw the addition of Estates losses to the Food category, these losses had previously formed part of Corporate Costs. This movement caused Food's Underlying Profit levels to fall by £9million in relation to 2014; the Estates losses remain part of the Food category in relation to 2015.



The changes to Revenue are proportionally rather less significant than those to Underlying Profit; yet the continued fall in Revenue is evidently not causing the increase in Underlying Profit. Other methods by which Underlying Profit might be increased are through efficiency savings, in addition to the replacement of less profitable stores with stores that might sell less but at a significantly lower running cost, both factors will have had an impact in this case:



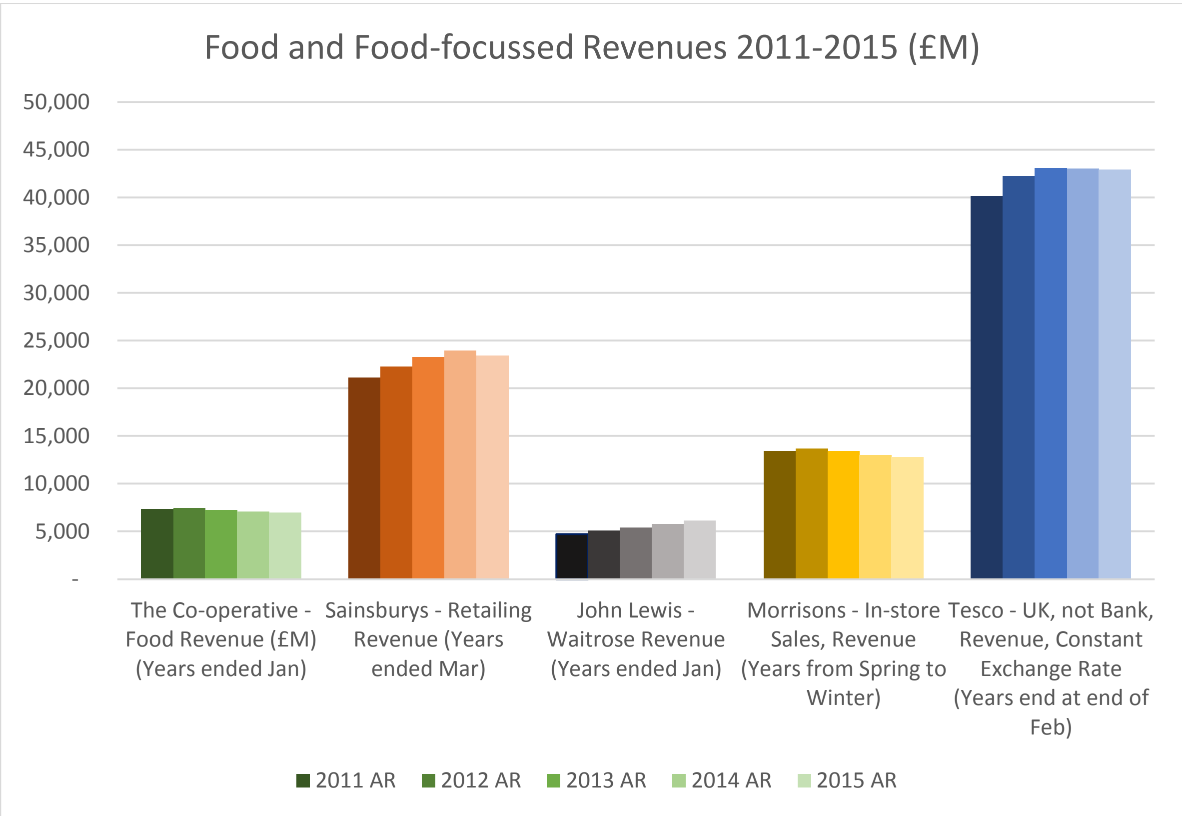
There was some investment in Food colleague levels in 2015, with colleague to store ratios increasing for the first time since 2010.

Year	2010	2011	2012	2013	2014	2015
Food stores	2,883	2,801	2,816	2,779	2,796	2,802
Food Colleagues	85,000	75,000	72,670	69,482	60,265	62,459

Co-operative Food and Its Competitors

Food Revenue may be affected by any number of external factors so the following chart compares the progress of the Group's Food Business Revenue relative to that of other food retailers:

Business	2011 AR	2012 AR	2013 AR	2014 AR	2015 AR	Change
The Co-operative - Food Revenue (£M) (Years ended Jan)	7,348	7,442	7,237	7,085	6,958	-5%
Sainsburys - Retailing Revenue (Years ended Mar)	21,102	22,294	23,303	23,921	23,443	11%
John Lewis - Waitrose Revenue (Years ended Jan)	4,700	5,072	5,416	5,754	6,135	31%
Morrisons - In-store Sales, Revenue (Years from Spring to Winter)	13,436	13,674	13,434	12,999	12,811	-5%
Tesco - UK, not Bank, Revenue, Constant Exchange Rate (Years end at end of Feb)	40,116	42,248	43,088	43,057	42,939	7%



Whilst Co-operative Food's Revenue peaked in 2012, Sainsburys' Retailing Revenue was increasing year after year until 2014; the growth of Tesco's non-bank UK Revenue stalled in 2013; while

Waitrose's Annual Revenue was still growing at last count; however, Morrisons' In-store and Other Sales Revenue has mirrored the Group's Food business in that both have seen Revenue fall since 2012. For the largest food retailers 2015 has been a challenging year.

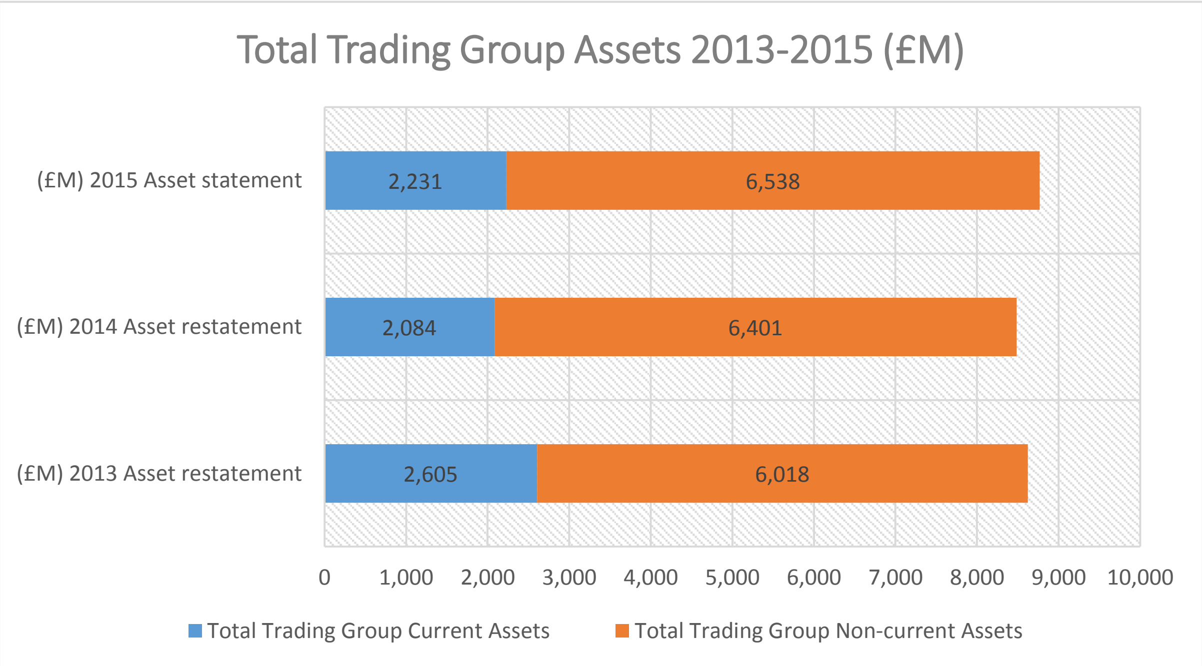
One of the more encouraging findings from reading the annual reports of our benchmark businesses is that the Group's increased emphasis on convenience is supported by their reports as well as that of the Co-operative. The Chief Executive of Tesco, Dave Lewis, stated in Tesco's 2015 Annual Report that 'the channel shift to online and convenience presented both challenge and opportunity'. Meanwhile, the Chairman of Sainsburys, David Tyler, states in their 2015 Annual Report that 'The UK grocery market is in the midst of major change as customers have significantly adjusted their shopping habits in recent years. People go grocery shopping more often, buy fewer items on each visit and are constantly looking for ways to make their lives more convenient. This trend has triggered significant growth in both convenience and discount stores but has adversely affected sales in supermarkets'. The fact that the Co-operative Group is moving into a growth area and away from the struggling supermarket model does bode well for its future sustainability.

Assets and Liabilities 2013-2015

As changes in Assets and Liabilities prior to 2013 have been covered in a previous report, this report will focus on movements in Assets and Liabilities from 2013 onwards.

Assets

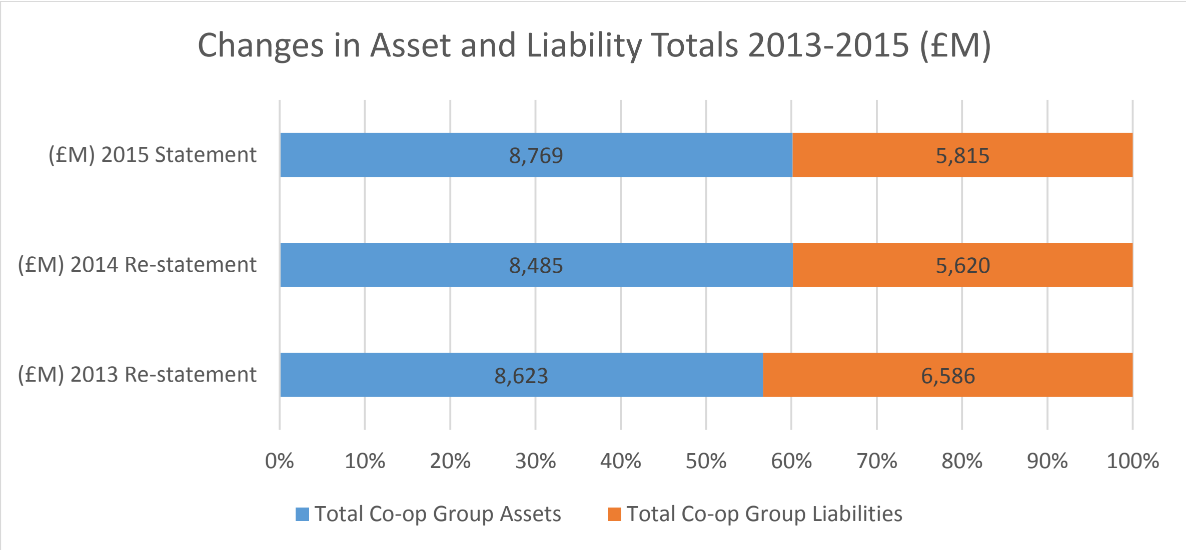
In order to understand what the changes in Asset levels mean, it is first necessary to review what a Current Asset is and what a Non-current Asset is. Current Assets include 'Trade and other receivables', 'Cash and cash equivalents' and 'Assets classified as held for sale'. Non-current Assets include 'Property, plant and equipment', 'Derivatives' and 'Pension Assets'. This indicates that 'Current' or 'Non-current' refers to how soon the Co-operative Group expects to see the benefit of the cash (or cash equivalent) value of the asset; Current Assets are those which are expected to be converted to cash within a year.



The Group's current assets fell in value in 2014, £503million of that decline being caused by a fall in the value of trade and other receivables from £1.07 billion in 2013 to £566 million in 2014; they have recovered to some extent in 2015.

Changes in Assets and Liabilities Compared

The value of the Group's total assets is higher in 2015 than it was in 2013, despite the 2014 dip in total assets' value. However, in order to place this in context it is necessary to compare changes in assets to those in liabilities.



It is clear from the above chart that, following the progress made between 2013 and 2014, between 2014 and 2015 increases in the Co-op Group's Assets have coincided with increases in its Liabilities. This means that during the later two-year period growth in the Group's Assets has not placed it in a better position to manage its Liabilities, because its Liabilities have also grown.

Changes in Asset and Liability Totals 2013-2015 (£M)	Total Co-op Group Assets	Total Co-op Group Liabilities
(£M) 2013 Re-statement	56.70%	43.30%
(£M) 2014 Re-statement	60.16%	39.84%
(£M) 2015 Statement	60.13%	39.87%

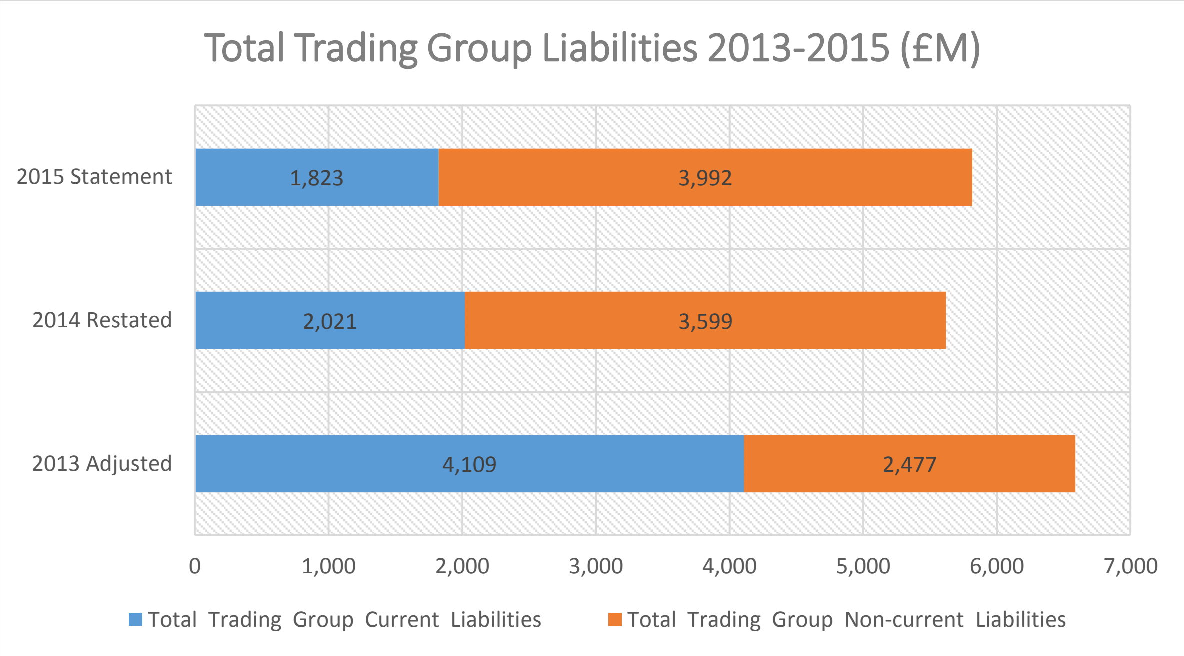
The overall change in the Group's Asset to Liability ratio, between 2014 and 2015, is 0.03% in favour of Liabilities; this change is so small as to be negligible and mean no real change has occurred. No real change would be less of a concern if the Group did not have £1.09billion of interest-bearing debt to pay back.

Liabilities

One of the Co-operative Group's more substantial Liabilities is its interest-bearing debt, debt which has increased by £31million in the last year:

Interest-bearing loans and borrowings (£M)		
(Non-) Current	**Value of borrowing £M**	**Total for Year**
Current 2013	1544	1550
Non-current 2013	6	
Current 2014	69	1062
Non-current 2014	993	
Current 2015	22	1093
Non-current 2015	1071	

However, the Co-op Group's Liabilities have become marginally less of an immediate concern as the majority of the former Current Liabilities are now Non-current Liabilities; the fact that they are due less imminently should give the business more time to find the funds to meet them.

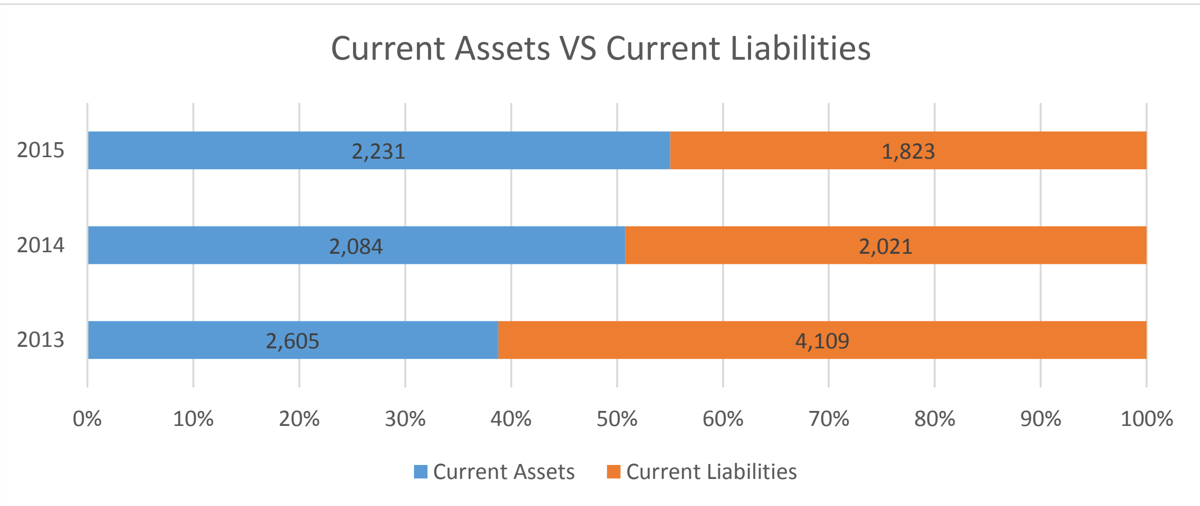


Working Capital Ratio 2013-2015

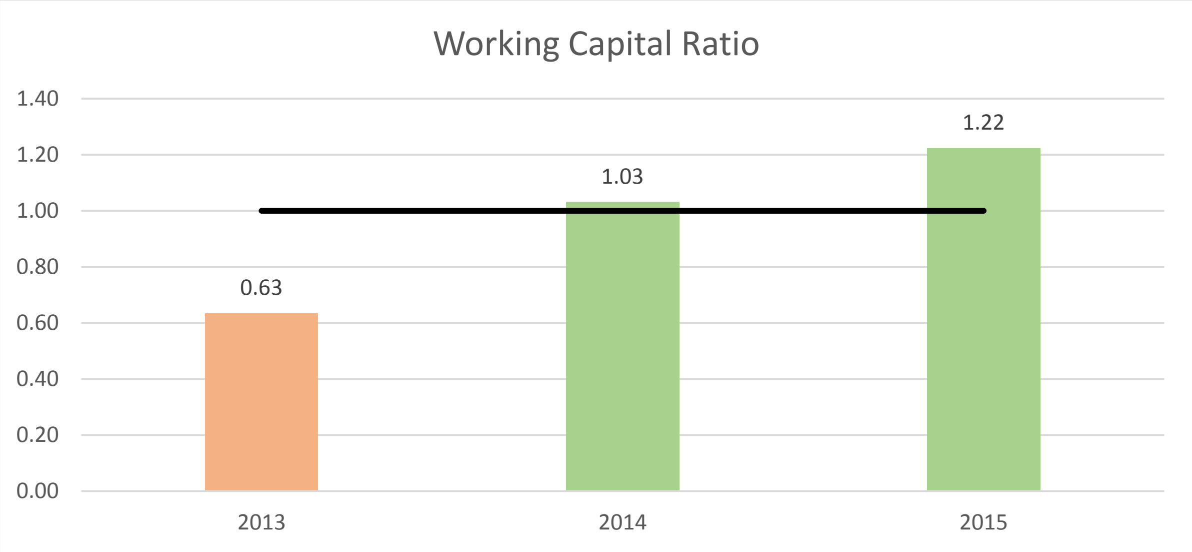
The Working Capital Ratio illustrates how able a business is to meet its current obligations should they happen to be called in immediately; it is not likely that they would be called in at once, but this does tell the reader how well the business is doing at managing its current short-term obligations.

Working Capital			
Budget Lines	**2013**	**2014**	**2015**
Current Assets	2,605	2,084	2,231
Current Liabilities	4,109	2,021	1,823
Working Capital: Current Ratio = Current Assets / Current Liabilities	0.63:1	1.03:1	1.22:1

If we compare the Current Asset and Current Liability totals through the years a clear pattern emerges:



Working Capital is another way of representing this data:



If you divide the Current Assets by the Current Liabilities then you get the Working Capital Ratio. If the total for this Working Capital Ratio is greater than 1.00, then the Current Liabilities (money which is owed, but likely to be repaid within a year) are less than the Current Assets (resources that are expected to be cashed-in within a year).

The fact that Co-op Group has nearly doubled its Working Capital Ratio between 2013 and 2015 means that they are substantially more able to manage their short term spending than they were and this is a clear sign of significant progress.

NOMA

On 5 June 2014, the Group completed a joint venture with Hermes Real Estate to develop the £800m NOMA scheme in Manchester city centre via a joint venture. NOMA is considered to be 'strategic to the Group's activities as it is developing the Group support centre's surroundings'; it is unclear how this supports the Group's core retail businesses. Furthermore, as 'the Group's risk associated with its interest in NOMA arises if property values were to fall in Manchester', it is to be hoped that the predicted post-Brexit property price decline does not affect Manchester. The Co-operative Group and Britel Fund Trustees Limited each hold 50% of NOMA Group's shares. The Full Accounts for NOMA Group, 2014-15, show 'Capital and Loan advances' of £41,850,000 by Britel Fund Trustees Limited and £41,850,000 by Co-operative Group Limited.

Conclusion

The data in this report reveals a business which is very much in transition. Food is becoming more efficient and profitable, but whether revenue is improving is difficult to tell when the reports show a business still undergoing significant changes. Food revenues for 2014/15 are down for the majority of the Food business's competitors who are of a similar size. Funeralcare is continuing to perform well. The Legal business has seen its losses transformed into a small profit. General Insurance has seen its profits turn to losses as floods have struck its Members' homes and businesses. The E-store is again recording a loss. Underlying profits are down this year and Corporate Costs have increased again, though the definition of Corporate Costs is fluid and the extra expenditure probably has a number of sources within this catch-all category.

Asset to liability ratios have changed by a negligible amount between 2014 and 2015, interest-bearing debt has increased by £31 million over this same period, but the ratio of current assets to current liabilities has improved dramatically, indicating a significant improvement in the Co-operative's ability to manage its current liabilities. NOMA has seen significant investment in 2015, receiving Capital and Loan advances of £41,850,000 from the Co-operative.

While it appears that it will take a number of years before the Co-operative's debts are repaid, the Group's businesses and its financial sustainability do seem to be improving; this suggests that we will see a restored Co-operative, it just might take a while.