

Extracts from the Business Review

(About GRO Foods and Our vision are extracted from the introduction to the Business Review)

About GRO Foods

GRO Foods is a UK listed supermarket selling a wide range of food and non-food products from stores in six countries. The main markets are in Europe (60%) and the USA (25%). In recent years much of our sales growth has come from the emerging Asian economies of India and China, which now account for 15% of total sales. The Group owns 700 stores and employs 150,000 people globally.

Our vision

The Group's vision is to be the leading supermarket in the provision of responsibly sourced, quality food and non-food products.

The impact of sustainability issues on our key strategic objectives

The following section describes how sustainability issues impact on the achievement of our four key business objectives.

1. Sales growth

Strategy

This objective will be achieved by improving the shopping experience, expanding the number of retail outlets, particularly in high growth areas, and continually innovating to deliver great value products that meet the needs of our customers.

Sustainability context

Expanding our retail network increases the impact we have on the environment, mainly through increased carbon emissions and use of water in both our direct and indirect operations. It also increases the importance of rising concerns regarding health issues such as obesity and diabetes.

Risk and opportunities

We have amended our store development model to build only "eco-stores", which use at least 70% less energy than standard stores, and as a result are experiencing a 22% improvement in the level of planning permission granted. We are also focusing on mitigating environmental threats to our stores to enhance the value of our property stock.

Governments are legislating to reduce the salt and sugar content of food products and we face risks if we are not well placed to meet changing requirements. We are therefore developing our own-brand food lines to ensure they meet both the appropriate legislation and the consumer demand for great tasting, affordable food that meets a growing desire for more balanced diets.

Staying ahead of legislation and communicating the nutritional benefits of our products has resulted in an increase in the number of weekly customer visits from 18 to 18.5 million. The UK's Food Standards Authority (FSA) is at the forefront of science in this area and we are applying UK guidelines across our operations worldwide.

2. Improving operational efficiency and delivering cost savings

Strategy

We look to deliver ever greater value to our customers and improve returns to our shareholders by enhancing efficiency and lowering costs. To mitigate the impacts on our business of volatile and increasing energy costs and emerging carbon and waste reduction legislation, we are focusing on reducing our energy use and minimising waste.

Sustainability context

As a retailer, we use significant amounts of energy, which in 2009 cost £40 million and equated to carbon emissions of 360,000 tonnes. While we could buy more "green energy", we feel it is more prudent to seek to reduce our energy consumption and invest in our own renewable energy capacity. We are also reducing emissions from our transport by more efficient loading and the introduction of electric vehicles.

Waste is another impact with which the retail sector is increasingly associated, whether from packaging, food waste generated directly by our own stores, or indirectly by our suppliers and customers. This year we created packaging waste of 650,000 tonnes, construction waste from new stores of 450,000 tonnes and sent 35,000 tonnes of waste to landfill. We have committed to halve the weight of packaging of our products, reduce our new build construction waste by 50% and divert all food waste from landfill to energy generation and composting by 2014.

Risk and opportunities

Medium-term, energy price volatility poses the greatest threat to our cost base. More immediately, legislation such as the UK's Carbon Reduction Commitment (CRC) will take approximately £5 million from our 2011 cash flow, while UK landfill tax is set to double by 2013. When similar legislation is imposed across all our markets, as anticipated, the risk will be multiplied many times over.

We will reduce our environmental impact and achieve cost savings by reducing the amount of energy used. The cumulative benefits of our waste reduction programmes have resulted in £10 million in cost savings in 2009.

Our Key Performance Indicators

The table below outlines our KPIs for each of our four strategic objectives.

Strategic objective	KPI targets (by 2014)	2009 Performance	Benchmark
1. Sales growth	<ul style="list-style-type: none"> 5% sales increase year-on-year 4% like-for-like sales increase per year 	<ul style="list-style-type: none"> 5% increase 4.1% increase 	The grocery sector in our key markets has grown on average by 2.2% year-on-year in the last five years and is forecast to grow at 3.3% per annum for the next five years. Our growth targets are above the average for the sector.
2. Operational efficiency and cost savings	<ul style="list-style-type: none"> Reduce operating costs by 5% 	<ul style="list-style-type: none"> 2% reduction 	Sector average operating margin among grocery retailers in our developed markets was 4.5% in 2008/09. We will maintain our above average margin position
3. Securing a sustainable supply base	<ul style="list-style-type: none"> Mitigation plans in place for all of the top 1,000 own-brand product lines identified 'at risk' 	<ul style="list-style-type: none"> Mitigation plans in place for a further 85 product lines 	The Department for Environment, Food and Rural Affairs estimates 37% of England's acreage for vegetables grown in the open is "at risk" from flooding due to climate change. The UN Food and Agriculture Organization estimates that agricultural productivity in developing countries may decline between 9% and 21% as a result of climate change. We will remain ahead of the market in developing a secure, sustainable supply chain.
4. Supporting our employees and the communities in which we operate	<ul style="list-style-type: none"> Less than 10% employee turnover per annum 3% absenteeism or less 	<ul style="list-style-type: none"> 10.4% employee turnover 3.3% absenteeism 	Average staff turnover in the UK retail sector is 17%. We will maintain our market leading position on this benchmark.

3. Securing a sustainable supply base

Strategy

Our business depends on the quality and availability of goods for our customers. Increasingly we seek to ensure that our purchases promote social and environmental well-being, while simultaneously protecting our supply base from the risks associated with climate change and diminishing natural resources.

Sustainability context

The majority of the business's environmental and social impacts are in our supply chain, which is complex and global in nature. The major impacts include carbon emissions, water use, land use changes and labour standards.

There is now significant awareness of the sustainability impacts that a major company generates as a result of the goods and products it procures. Customers, in particular, are ever more attuned to the sources of the food and products that they buy. It is both our responsibility and in our interest to maximize the positive and minimize the negative impacts of procurement decisions.

At the same time, climate change and water stress threatens our business, making it increasingly challenging to source many agricultural products from traditional locations.

Risk and opportunities

This year 30% of our own-brand food and beverage products came from a certified sustainable source, supporting increased market share of 2% in these product categories. We are also using local suppliers in all our markets where there is a notable environmental benefit or customer preference.

Since 2007, we have assessed 300 of our top 1,000 own-brand food and beverage products to ensure that they are insulated as far as possible from the impacts of climate change and water stress. Of the products we have assessed to date, 170 have been identified as "at risk" and we have already put in mitigation plans for 85 of these.

4. Supporting our employees and the communities in which we operate

Strategy

We aim to be welcomed in the communities in which we currently operate and into which we seek to expand. We do this by investing in the skills and welfare of our employees and by aligning our community involvement activities with community and employee interests.

Sustainability context

Over 90% of employees in retail outlets come from the communities in which stores are located. Perhaps our most valuable direct social contribution is providing these employees with a safe place to work, where they can acquire skills that equip them throughout their careers and enable them to develop and progress within our company.

These employees become our greatest advocates in the communities where we operate. Thus, promoting the welfare of our employees and serving our communities is fundamental to our reputation and our licence to operate. In recent years, we have also realized the benefit of linking employee engagement activities with community involvement.

Risk and opportunities

We face competition for talent from all our major competitors. In addition, turnover of staff and absenteeism add significant costs to our business – at least £50 million in 2009. Managing these risks requires significant investment in training, over £14 million this year. We are seeing a return on this investment with reduced absenteeism and employee turnover, down to 3.3% and 10.4% from a baseline of 3.5% and 11.0% respectively.

While we contributed directly £13 million globally to community activities, we are getting a significantly greater return to our business through improved employee morale and relations with communities. This has delivered substantial benefits to local communities and resulted in very positive media coverage, equivalent to an estimated £19 million spent on advertising in local and national press.

Our Connected Performance Report

The purpose of our Connected Performance Report is to report on the performance of specific actions taken to address the sustainability issues described and how these can contribute to the achievement of our overall strategic objectives.

Extract from our Operating and Financial Review – The Connected Performance Report

In order to achieve sales growth we will increase floor space over the next five years and ensure that both new and existing stores are 'eco-efficient' and mitigated against the physical and regulatory risks of climate change. We will continue to invest in new product innovation, providing healthy, quality foods that our customers expect from us. We will meet the increasing demands of our customers for healthy food products by reducing the salt and sugar content of our own-brand products, following the recommended targets set by the UK's Food Standards Agency.

1 Sales growth

Target	Performance																																																						
<p>New stores</p> <ul style="list-style-type: none"> Open 160 new stores from 2007 to 2014; 100 will be in Europe and 60 will be in India and China. All new stores will be 'eco-stores' that require 70% less energy compared to standard stores. 	<p>Investment in growth</p> <ul style="list-style-type: none"> Number of new stores opened Total premium to build eco stores (£ million) Total lifetime savings in energy costs over a 25 year lifespan (£ million) 																																																						
<p>New product innovation</p> <ul style="list-style-type: none"> Increase sales of our healthy 'Balanced' food range by £200 million by 2014. Reduce salt and sugar content in our main product lines (bread, cereal, frozen convenience and ready meals) to meet and exceed the FSA's recommended limits. 	<table border="1"> <thead> <tr> <th rowspan="2"></th> <th colspan="4">Salt and Sugar per 100g serving</th> </tr> <tr> <th colspan="2">FSA targets (2010)</th> <th colspan="2">Current GRO content</th> </tr> <tr> <th>Main lines</th> <th>Salt</th> <th>Sugar</th> <th>Salt</th> <th>Sugar</th> </tr> </thead> <tbody> <tr> <td>Bread</td> <td>0.8g</td> <td>N/A*</td> <td>1.1g</td> <td>4.0g</td> </tr> <tr> <td>Cereal</td> <td>0.8g</td> <td>N/A*</td> <td>1.0g</td> <td>3.0g</td> </tr> <tr> <td>Frozen convenience (average)</td> <td>0.8g</td> <td>N/A*</td> <td>16.0g</td> <td>1.0g</td> </tr> <tr> <td>Ready meal (average)</td> <td>0.8g</td> <td>N/A*</td> <td>12.0g</td> <td>1.5g</td> </tr> <tr> <td>Total main product lines</td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td>Total other product lines</td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td>Total 'Balanced' range</td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td>Total</td> <td></td> <td></td> <td></td> <td></td> </tr> </tbody> </table> <p>* The FSA does not provide RDA for sugar. They suggest sugar should account for approximately 11% of daily calorific intake. Our calculations are based upon relative contribution that each food product would make up in an average person's daily diet.</p>		Salt and Sugar per 100g serving				FSA targets (2010)		Current GRO content		Main lines	Salt	Sugar	Salt	Sugar	Bread	0.8g	N/A*	1.1g	4.0g	Cereal	0.8g	N/A*	1.0g	3.0g	Frozen convenience (average)	0.8g	N/A*	16.0g	1.0g	Ready meal (average)	0.8g	N/A*	12.0g	1.5g	Total main product lines					Total other product lines					Total 'Balanced' range					Total				
	Salt and Sugar per 100g serving																																																						
	FSA targets (2010)		Current GRO content																																																				
Main lines	Salt	Sugar	Salt	Sugar																																																			
Bread	0.8g	N/A*	1.1g	4.0g																																																			
Cereal	0.8g	N/A*	1.0g	3.0g																																																			
Frozen convenience (average)	0.8g	N/A*	16.0g	1.0g																																																			
Ready meal (average)	0.8g	N/A*	12.0g	1.5g																																																			
Total main product lines																																																							
Total other product lines																																																							
Total 'Balanced' range																																																							
Total																																																							



	2007 (Baseline)	2008 (Actual)	2009 (Actual)	2010-2014 (Target)
	10	20	20	110
	95	190	190	1,045
	79	146	142	718

Comments

During 2009, GRO obtained planning permission for 45 new stores in Europe and five stores in India and China. Compared with standard stores, environmental stores have a higher planning application acceptance rate, an improvement of 22% in our European markets. Significant additional investment is required to build our new 'eco-stores', but these require 70% less energy than standard stores and will reduce emissions by this amount as well. More efficient refrigeration, lighting, heating and ventilation systems in these new stores will significantly help to achieve these energy savings.

GRO target (2015)		2009 Investment in R&D (£ million)	2009 Advertising/ Consumer engagement spend (£ million)	2009 Food sales (£ million)	2014 Sales target (£ million)
Salt	Sugar				
0.7g	3.5g	1.0	0.5	500	800
0.7g	2.5g	1.5	0.5	1,000	1,700
8.0g	0.1g	3.0	2.0	2,500	3,000
8.0g	0.2g	2.5	2.0	3,000	4,000
		8.0	5.0	7,000	9,500
				7,800	9,240
				200	400
				15,000	19,140

Sales of our 'Balanced' range reached £200 million in 2009. We invested £8 million in research and development to reduce the salt and sugar content of the four main product lines. We will not meet the FSA's proposed targets for salt content in bread and cereals by 2010, but are on track to meet these targets by 2015. Reductions in the salt content of frozen convenience and ready meal products will not meet the 2010 targets either, but our research shows that our salt and sugar contents of these products are lower than that of our competitors, and we are targeting significant reductions by 2015. We have seen an increase in the number of weekly customer visits from 18 million per week to 18.5 million since 2008. A survey conducted in 2009 indicates that approximately 50% of this increase is attributable to our new, healthier product ranges, associated advertising and other customer engagement activities to promote healthy living.

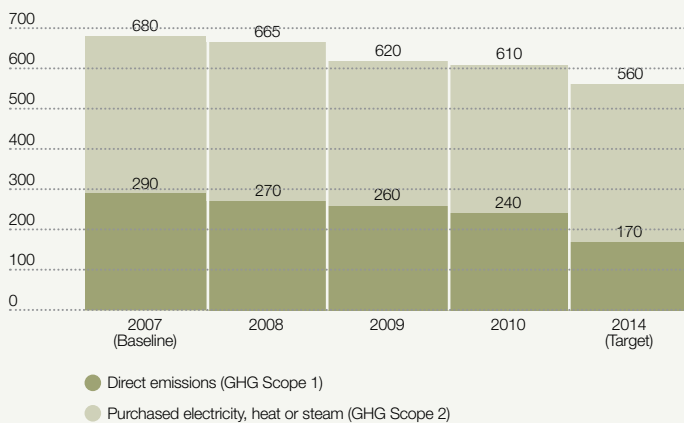
Extract from our Operating and Financial Review – The Connected Performance Report

One of our biggest costs is energy use, which accounts for approximately 15% of total operating costs (approximately 5% stores and 10% transport) and we are developing energy efficiency programmes which will allow us to increase sales while reducing greenhouse gas emissions and help us meet the required legislation. Waste is also a significant cost as a result of landfill and associated transportation costs and we also have a specific waste reduction programme in place to reduce these costs.

2. Improving operational efficiency and delivering cost savings

Target	Performance					
	2007 (Baseline)	2008	2009	2010 (Projected)	2014 (Target)	
Reduce total energy use						
• Increase investment in renewable energy so that 40% of all energy needs will be generated from such sources by 2014.	Annual energy cost (£ million)	45	43	40	38	35
• Reduce CO ₂ emissions by 120,000 tonnes (18%) by 2014 against a 2007 baseline.	GRO – kg CO ₂ e /m ² of floor space	320	320	300	290	180
• Reduce our CO ₂ emissions per square metre by 44% by 2014 against a 2007 baseline for existing stores.	Renewable energy generated on-site (% of total)	18	18	25	30	40
• Reduce road miles travelled per pallet of stock by 10% by 2014.	Investment in on-site energy generation (£ million)	8	8.5	10	9	8
	Investment in energy efficiency measures (£ million)	20	15	15	10	30
	Annual savings ¹ (£ million)	9	9.5	10	10.5	15
	Average payback period (years) ¹	3	2.5	2.5	1.8	2.5
	<small>1 Savings and payback periods in respect of investments in on-site energy generation and efficiency measures made since 2007</small>					
Minimize waste						
• Divert all food waste from landfill by 2014.	Expenditure to reduce all waste (£ million)	(5)	(10)	(20)	(20)	(30)
• Reduce packaging weight in our products by an average of 50% by 2014.	Annual savings ¹ (£ million)	1	5	10	40	100
• Reduce construction waste to landfill by 50% by 2014.	Average payback period (years)	5	2	2	0.5	0.75
	<small>1 Savings generated specifically from the investment made since 2007</small>					

CO₂ equivalent emissions (kt)



Comments

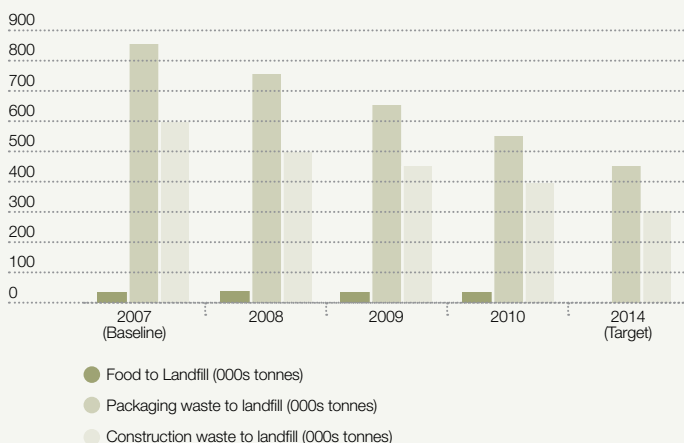
In 2009, we invested £15 million in energy efficiency and £10 million in on-site renewable energy technology. Both these investments have reduced total energy costs and resulted in annual savings of £10 million.

25% of our store energy is from renewable sources which has helped us to reduce the risk of exposure to reduced energy availability and price volatility. This means we are on track to meet our 2014 target of 40% on-site power generation.

We reduced carbon emissions by over 3% in 2009 and are on track to meet the 2014 reduction target of 180 kgCO₂e/m², a 44% reduction against a 2007 baseline. The EU target for carbon emissions reduction is 20% by 2020 and we are aiming to maximize our contribution towards this target.

We are reducing road miles travelled per pallet of stock by increasing use of shipping and rail which has resulted in fewer trucks on the road. We are also streamlining transport from warehouses and have introduced a new logistics management system to help further improve efficiency.

Waste to Landfill



In 2009 we diverted over 70% of all food waste from landfill to either anaerobic digestion or composting, resulting in savings in Landfill Tax and transportation. We are well on track to achieve our 2014 target of zero food waste to landfill.

We conducted trials with all top tier suppliers in 2009 on 50% of our top selling product lines to reduce packaging. For all products we successfully reduced packaging by 10%. This reduced cost of goods sold by up to 15% in some categories which covered our investment in the trial and enabled any further savings to be passed onto our customers.

We have signed up to the Waste & Resources Action Programme (WRAP) voluntary agreement on halving construction waste to landfill by 2014. We are seeking to implement this policy in developing markets by working with suppliers to develop recycling capacity.

In 2009 by reducing food, packaging and construction waste we realized savings of £10 million, which means we are on track to achieve our 2014 targets.

Extract from our Operating and Financial Review – The Connected Performance Report

GRO's supply chains are complex and global in nature and we create social and environmental impacts along all points of these chains. Such issues pose risks to the long term sustainability of our business and we are committed to addressing them in the most responsible way. We also recognize the challenges to security of supply posed by climate change and we are taking action to mitigate these risks in collaboration with our suppliers.

3. Securing a sustainable supply base

Target	Performance
<p>Supplier standards</p>	<p>Own-brand products from certified sustainable sources</p>
<ul style="list-style-type: none"> Increase the percentage of own-brand food and beverage products that are from certified sustainable sources to 50% by 2014. 	<p>Value of sales (£ million)</p> <p>Percentage of total own-brand food and beverage sales (%)</p>
<ul style="list-style-type: none"> Increase the number of local suppliers used in all regions where we operate by 3,000 by 2014, against a 2007 baseline. 	<p>Own-brand products from local sources</p> <p>Total number of local suppliers</p> <p>Value of sales from local suppliers (£ million)</p> <p>Cost of changing to local suppliers (£ million)</p> <p>Annual savings through reduced shipping and transport costs (£ million)</p> <p>Net financial benefit from changing to local suppliers (£ million)</p>
<p>Assess and mitigate the risks from environmental and social risks to the supply chain</p>	<p>Environmental and social risk – top 1,000 own-brand product lines</p>
<ul style="list-style-type: none"> By 2014, assess our top 1,000 own-brand product lines and, in collaboration with our suppliers, implement mitigation plans for all those identified as 'at risk'. 	<p>No. of product lines assessed for risk (total number)</p> <p>Sales value of product lines assessed for risk (£ million)</p> <p>No. of product lines identified 'at risk' (total number)</p> <p>Mitigation plans in place for product lines identified at risk (%)</p>

2007 (Baseline)	2008	2009	2010 (Projected)	2014 (Target)
200	300	475	800	1,200
10	25	30	35	50

Comments

Through our procurement of goods we contribute millions of pounds to farmers in low income countries. In order to gain independent approval of our contribution in these countries, as favoured by our consumers, we are increasing the volumes of own-brand products from certified sustainable sources.

Additionally, increasing the proportion of certified sustainable products in our supply chains mitigates risks, particularly in security and consistency of supply as well as improving quality.

Customers have shown a sustained interest in purchasing these products over the economic downturn. They tell us this differentiates GRO in the market and this has helped us to increase market share by 2% in these product categories this year.

2007 (Baseline)	2008	2009	2010 (Projected)	2014 (Target)
3,000	3,300	3,600	4,000	6,000
100	120	140	180	360
3	4	5	5	8
5	6	8	10	18
2	2	3	5	10

Developing a selection of locally sourced produce is an important part of our sustainable supply chain strategy. Customers tell us they are concerned about supporting local businesses. They have responded extremely well to our efforts in providing locally sourced produce and this has been a key contributor to increasing our market share in 2009.

Increasing use of local suppliers for seasonal produce has also led to cost savings through reduced shipping and transport costs, which has saved the business £8 million this year.

2007 (Baseline)	2008	2009	2010 (Projected)	2014 (Target)
100	200	300	500	1,000
1,000	1,500	2,100	2,500	5,000
50	125	170	-	-
40	40	50	60	100

In 2009 we assessed environmental and social risks in the supply chain for a further 100 of our top 1,000 own-brand product lines, accounting for a further £600 million in sales.

To date, we have identified 170 product lines 'at risk' and have created mitigation plans for 85 of these.

We will continue to work with our suppliers to complete the assessment of the remaining 700 product lines, applying the lessons learnt from our work this year.

Extract from our Operating and Financial Review – The Connected Performance Report

The success of our business depends on the well-being and job satisfaction of our employees and their motivation to provide the best service to our customers. With over 90% of our retail sales force coming from the community in which the store is based, we see serving the needs of employees and communities as intrinsically linked and are committed to investing in both the wellbeing of our employees and the community we serve.

4. Supporting our employees and the communities in which we operate

Target	Performance
Employee engagement and morale	
<ul style="list-style-type: none"> Achieve employee engagement scores of 70% or above. Reduce employee turnover to 5% or less per year. 	<ul style="list-style-type: none"> Total number of employees (FTE) Gross total wages paid (£ million) Employers total tax paid (£ million) Annual employee turnover (%) Employee absenteeism (%) Employee absenteeism costs (£ million) Investment in training (£ million) Employee engagement scores (%) Total savings from reduced employee turnover, absenteeism and associated costs (£ million)

Positive impact on the community	Performance in 2009		
<ul style="list-style-type: none"> Be recognized as contributing positively to the communities where we operate. 	Inputs (company contribution)	Leverage (additional contributions due to our efforts)	Outputs
	<ul style="list-style-type: none"> £13 million (cash) Worldwide, 100,000 hours given by employees, equivalent to £650,000 Food redistributed to communities, equivalent to £6 million 	<ul style="list-style-type: none"> £10 million additional funding from UK Environment Agency and NGO, Edu-Carbon £15 million donated by customers through in-store collection £1.2 million raised by employees for local causes 	<ul style="list-style-type: none"> 400 UK schools receive energy saving advice and education 250 GRO Walk to School Programmes, 90 GRO School buses Outreach activities in over 200 communities in China and India

2007 (Baseline)	2008	2009	2010 (Projected)	2014 (Target)
143,541	147,800	149,780	153,700	160,000
2,511	2,600	2,650	2,734	2,910
206	211	220	235	250
11.0	10.7	10.4	10.0	9.2
3.5	3.5	3.3	3.2	3.0
55	53	50	50	45
10	12	14	16	24
56	56	60	63	70
5	5	12	13	15

Comments

A fundamental aspect of our strategy is to ensure our employees' well-being. We believe that satisfied employees will recommend our offering to their neighbours and enhance our reputation in the communities in which we operate.

We are investing in training that will increase the skills of our employees. This training not only provides us with more literate and skilled employees, which enables us to run our business better, but it has also been shown to make a huge difference to employee satisfaction and subsequent retention.

We want to be known for the skills that we help people from our communities to develop. We are using opportunities to participate in community activities as part of a new retail skills programme, as well as a means to promote employee engagement. Our research shows that employees who feel able to express their values through their workplace give an additional 2%–3% discretionary effort.

Impacts (community)
<ul style="list-style-type: none"> • UK-wide CO₂e reduction of 0.5 million tonnes • Reduced congestion • Improved local environments in key emerging market communities

Impacts (business)
<ul style="list-style-type: none"> • £3.2 million additional sales attributed to GRO Bus programme • Increased brand awareness equivalent to £19 million of advertising • Recognition among local authorities and central government, supporting access and planning applications

GRO directly invested £13 million in charitable or community activities in 2009. We identify community or charitable activities where our employees, customers and wider community believe there is the greatest need. We align this with assessments of where we can achieve the greatest community impact, along with activities that make clear commercial sense.

The focus on environment and education is helping to improve the physical environment in local communities, reducing traffic and pollution through GRO's Walk to School initiative and the GRO school bus programme.

We are undertaking work to understand better the impacts of our community activities and will report on this in next year's Operating and Financial Review.