

OUR BUSINESS

CHAIRMAN'S STATEMENT

This year Steve has set out clear and decisive plans. I will leave an **M&S that is well equipped for the digital age and totally focused on its customers**. This more relevant M&S is underpinned by effective succession planning, good governance and active shareholder engagement which have been my focus during my time as Chairman.

ROBERT SWANNELL CHAIRMAN



INTERIM

6.8p

PAID ON 13 JANUARY 2017

FINAL

11.9p

TO BE PAID ON 14 JULY 2017

TOTAL DIVIDEND FOR 2016/17

18.7p

OVERVIEW

This is my last Annual Report as Chairman after more than six years at M&S. It has been an extraordinary honour to serve this company.

Since Steve Rowe became Chief Executive, he has set out clear plans to accelerate the pace of change across M&S. By simplifying the way we do things and by focusing on the customer, we have laid solid foundations for growth. We repositioned our Clothing & Home business, made important decisions about the future shape of our UK and International store estates, and put in place fairer pay and benefits for our employees.

It has been a year of great change outside M&S as well. Last summer's vote to leave the European Union has caused inevitable uncertainty. Nobody yet knows what the long-term effect of Brexit will be. Like many businesses we have been impacted by the depreciation of sterling, but it is our job to seize the opportunities ahead and prepare for all eventualities.

We have made some hard decisions. Some have led to significant adjustments to our profits this year and also, in the case of repositioning our Clothing & Home business, to some short-term reduction in our adjusted profits. However, these changes needed to be made for the long-term health of the business. Decisive action and strong execution have never been more important to compete in a fast-changing retail environment. These actions allow us to embrace the future from a position of strength, well equipped for a digital age and with a sustainable business model.

PERFORMANCE

I believe our food is, without exaggeration, among the best in the world. Once again, we delivered a good performance in a tough market. Sales grew as customers responded to the quality of our food and the convenience of our stores. We are very pleased with the overall performance of the Simply Food stores opened during the year. The return on capital from the format remains compelling. With product innovation remaining the backbone of our Food business and a strong, but measured, store opening programme, we have a clear path to growth.

We repositioned our Clothing & Home business for sustainable growth by ending a damaging cycle of promotions and discounts. We also refocused our ranges on stylish, wearable, great-quality essentials. By implementing a sensible, competitive pricing architecture for our customers, we have seen encouraging improvements in full-price sales. As expected, fewer promotions and less discounting resulted in lower sales. There is much work still to do but we are beginning to see signs of recovery. Steve made it clear a year ago that this repositioning would have a short-term negative impact on profits but would set us up for sustainable performance and a stronger business in the long term. A year on, we are even clearer that this was the right thing to do.

Our International business had a challenging year. However, we announced a clear strategy to focus on our strong franchise partnerships and our established joint ventures, and operate in fewer owned markets, by exiting ten owned, loss-making markets and 53 stores.

Overall, adjusted profit before tax was £613.8m, down 10.3% on last year. However, due to charges of £437.4m, Group profits fell to £176.4m. The main elements of the charges relate to the cost of implementing the new pay and pensions arrangements, and the cost of the International store closures. I was Chairman when about half of these 53 stores opened and so must accept my full share of the responsibility for this disappointing result. However, consumer behaviour has changed in the intervening years. We had already significantly scaled back our ambitions in owned markets before we announced these closure plans, and just as there was a rationale for opening the stores then, there is one for closing them now. It is essential that we adapt to our customers' changing needs and recognise the current realities of the markets in which we operate, despite the short-term cost.

Having the right stores in the right places is also why we are reshaping our UK store portfolio, as we focus on having less, more inspiring Clothing & Home space and growing our Food space. At the end of this five-year programme we will have increased our space overall and employed more people. Our stores will be more relevant to the changing needs and habits of our customers in a digital world.

HIGHLIGHTS OF THIS YEAR'S GOVERNANCE REPORT

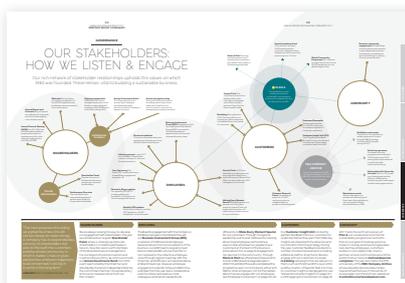
The Governance report provides:

- A clear and honest review of the year;
- A clear map illustrating our stakeholder considerations and engagement;
- The outcome of our independent Board Evaluation;
- Greater disclosure around Board discussions and associated actions; and
- Our approach to risk and risk appetite.

As a Board we regularly discuss:

- Strategy and performance
- Culture and behaviour
- Succession planning
- Ecommerce
- Cyber and IT
- The M&S brand
- International
- Supply chain
- Risk
- Property
- Plan A

+ Read more on p34-83



INTRODUCTION



ARCHIE NORMAN
CHAIRMAN DESIGNATE

In May, we announced that Archie Norman will join M&S as Chairman on 1 September 2017. Archie has significant retail experience and a long-term track record of value creation in several major British companies. He has led transformations of major businesses in the UK and abroad, and served on the boards of several others, most recently as Chairman of ITV plc.

VALUES AND PLAN A

Our values of Inspiration, Innovation, Integrity and In Touch run through everything we do at M&S. This is a business that tries to do the right thing and this is demonstrated in many ways, from our Long Service Awards to helping disadvantaged people into work, to the charity support delivered through Plan A.

This isn't new; it is part of what has defined us for over a century. In 1964 Lord Sieff, our then Deputy Chairman, spoke about our values. *"The main purpose of building up a great business should not be merely to make money,"* Lord Sieff said. *"A company has its responsibilities, not only to shareholders but also to the staff, the customers and the whole community in which it trades. Unless it gives satisfaction, and even happiness to all concerned, it will fail in its aims in the long term."* His comments are as pertinent as ever and this philosophy continues to guide the way we do business at M&S.

This year marks the tenth anniversary of Plan A. I am extremely proud of the work we have done. From becoming a zero waste to landfill business and sourcing raw materials more responsibly, to our ambitious programmes to support workers throughout our global supply chain, we have sought to lead the way on truly sustainable change. We recently relaunched Plan A and the latest version is aimed at being even more relevant to customers and the communities in which we trade.

BOARD CHANGES

Since I became Chairman in 2011 I have consistently focused on succession planning as one of the most important tasks for the Board. Last year, after a rigorous process, we appointed Steve as Chief Executive, the first internal appointee for many years. Steve's strategy is firmly in place so this is now the right time for a new Chairman to take over as plans for growth in the longer term are developed.

After an equally rigorous process led by Vindi Banga and our Nomination Committee, I will be replaced as Chairman by Archie Norman in September. Archie brings a breadth and depth of relevant experience to M&S and an extensive track record in retail and brands. I am delighted with Archie's appointment and I wish him great success in this role.

SHAREHOLDER RETURNS AND DIVIDENDS

We know how important our dividend is to shareholders. Our policy remains progressive, with dividends broadly covered twice by earnings. Despite a reduction of 10.3% in our adjusted profits, we have decided to maintain the total dividend per share for the year at the same level as last year with the proposed payment of a final dividend of 11.9p per share; this dividend

remains well covered on a cash basis. Given the cash costs associated with our strategic change and the uncertain market conditions, we consider it is prudent not to make additional returns of cash to shareholders under our enhanced return programme.

A STRONGER COMPANY

I will leave M&S a stronger company. We are now set up to compete, with a modern distribution and logistics backbone and excellent digital, design and sourcing capabilities. I have been committed to strong governance throughout my tenure and your Board today has a balanced breadth of talent, both among the executives and the non-executives.

We have worked to increase engagement with our shareholders and employees. Over the last six years, we have engaged our major institutional shareholders in depth in our business to ensure as much transparency as possible. Now, through our Shareholder Panel, we are engaging with our private shareholders in an unprecedented way. In addition, through channels such as my regular meetings with the Chair of our Business Involvement Groups (BIC), M&S's network of elected employees, and his attendance at our Board, we are engaging with our people as never before.

Having focused on these three pillars – governance, succession and engagement – I believe M&S is now better prepared for the further changes ahead.

There is no business I would have been prouder to chair than M&S. I will miss being part of it, its values and the place it holds in customers' hearts. My colleagues at M&S are the most dedicated I have ever worked with and I never fail to be impressed by their commitment to the business. They want M&S to succeed and they know what 'doing the right thing' means.

The last six years have seen profound changes in retail and at M&S; technology has transformed the way that people shop. Under Steve, change will continue unabated – it must. To meet the challenges ahead, M&S must be bold, ambitious and decisive. It must think big and execute effectively. And, as Lord Sieff said, it must also give satisfaction and happiness to its customers, its employees and its communities.

Finally, I would like to thank our customers, our employees and our shareholders for their support. It has been an unforgettable privilege to be Chairman of M&S and I wish the business every success in the years ahead.

ROBERT SWANNELL CHAIRMAN