J Sainsbury plc

Interim Results Presentation

Wednesday 14 November 2012

David Tyler: Chairman

Good morning, thank you for coming and welcome to Sainsbury's interim results presentation for the six months to 29th September 2012. I'm going to say very little this morning, the numbers do the talking and John and Justin as normal will take you through them.

I have to say I'm pleased that the Sainsbury's business is firing on all cylinders at present. The management team, and indeed all our 150,000 colleagues, deserve our plaudits for achieving this success in what are tough market conditions.

What is the success based on? I always point when asked this question to three different areas. First, we have a clear vision to be the most trusted retailer, where people love to work and shop. Our values are key to achieving this, underpinning our customer relationships and motivating our colleagues.

Secondly, we aim to be far sighted and invest in what we expect to be growth areas in the future. Our hard work in recent years for example in online and in convenience is benefitting us today, as you'll see in the figures.

And thirdly, we aim to improve our return on capital employed by carrying out a wide range of actions designed to improve the customer offer and designed to reduce our cost levels. This consistent approach across these three areas is paying dividends for shareholders. Our share of the market has gone up, our profits are up, and most importantly, all this has been done while we continue to invest in the business through the profit and loss account with the objective of further outperformance in the future.

So that's all I'm going to say by way of introduction, I'm going to hand over to John to take us through the numbers. John.

John Rogers, Chief Financial Officer

Thank you David, and good morning everyone. So straight into the financial highlights of the first half. Sales of £13.4 billion, up 4% year-on-year, delivering an operating profit of £412 million, up 4%, taking account of finance costs of £59 million, and profits from our joint ventures of £20 million, a good uptick year-on-year there, delivered a profit before tax of £373 million, up 5.4%.

That delivers basic earnings per share of 15.2p, up 9.4% and of course that growth rate is boosted by the lower tax rate in line with what we guided to, again reflecting the lower corporate tax rates year-on-year. An interim dividend of 4.8p per share, again that's a mechanical calculation of 30% of last year's full dividend, and profits outside of underlying of £32 million, and I'll come on later to explain those in a little bit more detail, all delivering a profit before tax of £405 million. And these results represent a very good set of figures, both

in terms of the sales growth and also the profit growth in what is clearly a very challenging retail environment.

So, moving on now to that sales growth; like-for-like as we've already reported of 1.7%, and of course that includes a 0.8% contribution from extensions. A little bit lower than the 2% that we guided to at the prelims reflecting the tough retail environment, but again, well ahead of the market, about 2 percentage points ahead of the market which is broadly flat. Sales from new space of 2.4%, a little bit better than that that we guided to, the 2% again reflected some good performance coming through in the new investment stores that we're making, and adding those two together of course delivering an overall growth in our sales of 4.1%, pretty much bang in line with where we guided to at the prelims.

In terms of looking forward into the second half we expect the environment to remain challenging, and of course we have some tougher comps year-on-year, and also a smaller contribution coming through from extensions, reflecting the step down in our property programme, but we're guiding to, and I think this is a stretch guidance for the business, a like-for-like, similar in the second half to that that we saw in the first. And in terms of contribution from net new space, a little bit of a tick down from the first half of 2.4%, but above the 2% that we guided to again at the prelims. So overall, a total sales growth in the second half slightly below the 4%.

Coming on now to profits, underlying EBITDAR of £930 million, up 3.8% and underlying operating profit of £412 million, up 4%, so good profit growth there. And in the margin level as we said, that was guided to at the prelims, we expected it to be roughly flat, actually if you take account of the small increase in fuel prices there's a one bp accretion in both of those margin numbers.

And that margin of course has been facilitated through our cost savings plan, we saw cost inflation coming through at just under 3%, so towards the upper end of our 2% to 3% range, and we've managed to offset that cost inflation with £60 million of savings in the business. And of course those savings come across from a broad range of areas, whether it's retail labour, supply chain logistics, procurement, IT infrastructure, we've managed to deliver those savings from across the board. And of course, many of those savings are of course precipitate or catalysed by the investments that we're making in our IT infrastructure, so helping deliver those savings year-on-year. And it is important to note of course this important message here that this is a very consistent message, we've delivered these savings year-on-year in the business, at least £100 million each year over the last five years, and at the same time as that we've been able to maintain and improve indeed our key customer metrics, so availability in our stores as well as our customer service, and that's a track record that we are, as I said, very proud of. Guidance for the full year remains unchanged, so we expect to deliver the full £100 million of savings that we guided at the prelims for the full year.

Coming on now to our joint ventures, good performance at the Bank, an uptick in profitability from £7 million this time last year to £12 million in the first half, reflecting growing that business, so we're growing our loan book, we're growing our insurance book, and again that's coming through in terms of the numbers. And actually very good control over our bad debts as well, we had one of the lowest bad debt ratios in the industry when you compare ourselves to our peers. So good performance coming through there on the Bank, and property joint ventures in line with where we guided, similar results year-on-year. And we expect the momentum in the Bank's results to continue through into the second half, and again for the property joint ventures we expect to be flat year-on-year.

Coming on now to our interest costs, interest costs of £59 million. Lower than that that we guided to, and we've been able to deliver that through very tight control, as I said, of our costs, very tight control of our cash and our working capital, and that's allowed us to deliver a lower interest charge than we've guided to, that's improved our net interest cover to 7.3 times, and we're changing our guidance for interest for the full year, we said at the prelims we expected interest costs to be £5 million to £10 million higher for the year, we're now changing that guidance to expect those interest costs to be zero to £5 million higher for the full year.

Coming now to results, profits outside of underlying, the key item here of course is our profits through our sale and leaseback activity, and again we've seen a good step up year-on-year, £39 million this time last year, £48 million of profits coming through from our sale and leaseback activity for this year, and you'll see the various other accounting adjustments that get you down to the net figure of £32 million.

Coming on now to margins, again delivering margins in line with our guidance, unchanged year-on-year, and I think it's important for this slide in particular to step back and look at, put these in the context of the overall industry environment, because of course for many of our competitors we're expecting to see margins decline year-on-year, negative movements year-on-year, and in that context maintaining these margins year-on-year, something we're particularly proud of as a business.

And of course when you look at the ROCE, again we've maintained that flat year-on-year against the very tough industry backdrop. And in fact, if you were to add the property profits that I've made reference to, or looked at the last 12 months of property profits, and you add that to the bottom line then actually we would have delivered a return on capital above 12%, so again it's an important contribution. And if you look back over the last three years and you average those profits over the last few years, the contribution of those profits to our return on capital would be an addition 1.2%, so it's a very important part of the value that we deliver to our shareholders.

Growing space, 351,000 square feet in the first half in line with the guidance of a million for the full year, in fact we've got about 300,000 square feet of new space that we're opening in the next four or five weeks alone, so a big step up in activity as we normally see at this time of year in the run up to Christmas wanting to get stores open for our customers before Christmas. So in the first half we've done five supermarkets, three extensions, 14 refurbs, and again if you remember we guided in relation to the capex a little bit of de-emphasising of extensions, so fewer extensions year-on-year, but a big step up in refurbs. And of course 49 convenience stores, very pleasing to see the run rate on those stores increase year-on-year, we are clearly well in line with our guidance for the full year of doing one to two convenience stores per week, and we hope that we'll continue that momentum of those stores into the second half. So confirming our guidance of around 5% space growth for the full year, about a million square feet in total and our one to two convenience stores per week.

Coming on now to property value and property profits, again maintaining our property value at £11.2 billion, the same as it was at the end of the last financial year. There's been a few movements within that, so we've had an additional £140 odd million as a result of the development activity, new stores that we've put down over the last six months, and of course that is offset by the sale and leasebacks that we've done. Those two broadly play a draw so the property value has remained the same, there's been no movement shift in the yield there. So £11.2 billion, significant asset backing of the business, and of course the point that I've already highlighted which is the property profits coming through consistently year-on-year, and of course the £48 million that you see on the chart here reflects obviously the first half of the year, I won't be guiding to what we think, the second half of the year is, that

always depends of course on the market conditions and whether we can sell properties at the right value, but clearly we've had some good momentum in the first half of the year in that respect.

Capex, core capex, lower than last year, £576 million versus £682 million, again reflecting the step down in space. As I said there's been a little shift in where we're spending that money, a bit more on refurbs, a bit less on extensions, overall net capex again down year-on-year reflecting the step back as I said in the new space. We're very comfortable with the guidance of a billion for the full year. And just coming on to this slide, this is actually a new slide that we're showing this year, and it really demonstrates the investment that we've been making in our core estate consistently year-on-year over the last ten years. What this slide shows is for our entire estate is the last time that we invested in these stores, and as you can see what it shows is that over 90% of our supermarket estate has received an investment in the last ten years, which again reflects the fact this is an ongoing investment, maintaining the standards and service levels in our stores year-on-year. And if you look at the run rates for '11/'12 and '12/'13, again we're touching 50 or so, 60 stores a year, and if you do the maths of course with a portfolio of supermarkets of 500 stores that's roughly 10% as you'd expect us to do if our intention is to invest in each of our stores every ten years on average.

Encouraging performance on cash flow, 15% increase in our cash flow from operations, reflecting good cost control, very tight cost control in the first half, and of course very strong management of our working capital position as well. We always see a step up in our working capital at this time from the year end as a result of the build up of inventory of course for Christmas, but that step up this year has been less than it was last year through our tight management of inventory and that's helped our cash flow. So cash flow from operation up 15%, a very strong position. And of course that's allowed us to manage our net debt levels, so the net debt we're reporting at the half is pretty similar to the net debt that we had the same time last year.

So the balance sheet, we talked about the property of £11.2 billion, strong asset backing, the debts of £2.2 billion, of course we've got facilities of £3.4 billion, so plenty of capacity in the business to continue to grow and to continue to deliver on the growth opportunities that we believe are available in the UK market. Strong cash flows and the deficit position on the pensions increased slightly from the end of the year as a result of a reduction in the discount rate. Guidance for the full year for net debt, again happy to maintain the guidance that we gave at the prelims of £2.2 billion.

Coming on now to the balance sheet measures, demonstrating very strong stability in our balance sheet, a strong balance sheet, those measures have been consistent now for the last five years, and of course pointing in particular to the chart on the right hand bottom where we've got our capex as a percent of sales, clearly we've seen that come down to the 4.7%, reflecting the step back in the investments that we're making obviously in new space.

So to summarise, a strong performance in the market, we've outperformed on sales, again significantly ahead of the market, we've outperformed on profits in an industry where profits on average are probably going backwards, and we're delivering against our space targets, so a good set of performance in a very challenging market environment. We continue to focus on our ROCE, of course we've seen the ROCE flat year-on-year, we're expecting to see accretion come through in time, again reflecting the investments that we've made in our property pipeline. Underlying profits up as I've mentioned already and again, important to emphasise the contribution that property profits makes to our overall business, and of course our returns to our shareholders.

So a good position, a strong balance sheet backed by the property, I think we're in a healthy place going into the golden quarter coming into Christmas. So that concludes the financial overview, I'll hand over now to Justin to give you a business update.

Justin King, Chief Executive

Well, as you've already heard from John we've delivered continued outperformance of the market, I want to talk a little bit about that. I'm going to spend a bit of time talking about what we think our point of difference is, how we're uniquely helping our customers live well for less, and in that regard focus on our cross-channel approach, both channels in themselves, but also the impact on customers of being able to serve them in multiple channels. And as you would expect I'll spend a little bit of time talking through an update of our progress of events and our long term vision for growth.

This slide will come as no surprise to you, you can see clearly in the last six months the orange line there our outperformance to the market, a market which has delivered little or no underlying growth over the last six months, but one where we, I think you can see we've stretched our legs, a year or so ago most of the grocers were performing at roughly the same level, we've seen some quite significant divergence over the last six months or so.

And that's against, again something that is not news to you, a really tough consumer backdrop, and consumers are feeling the pressure and they're not changing their view of how tough it is or indeed how tough it's going to be, every measure, this is the GFK one of consumer confidence, places consumer confidence at close to all time record lows, with an expectation it's going to stay there for a good time to come. And a big part of that of course is how it feels in their weekly budgeting. The chart on the right showing the interrelationship between wage growth and cost inflation. Of course there's been commentary in the last 24 hours that they've flipped back the other way, inflation likely to be in the next period of time ahead of wage growth, but we've seen over the last year or so a very significant dip in disposable income, it's actually flattened in recent months, for the last five or six months most monitors have been having household disposal income about flat year-on-year.

I think our view of that is that the outlook is probably that the current position is about the centreline, as indeed this chart shows, but that the changes in consumer behaviour that have been brought about as a result of that pressure are sticky, they're here with us to stay, and of course with that as a background context and our performance in the last six months being delivered against that you'd expect us to say therefore that we have confidence in our ability to continue to perform. This chart, we talked about the components of this many times, the big change that happened a year or so ago of a slightly smaller weekly shop, more frequent shopping, particularly through convenience top up shopping, leading to customers being able to manage their cash flow week to week, month to month, waste less and therefore buy less and the breadline, the volume growth clearly shows the market in volume decline for a good year or so.

As you can see, the lines have come back together, we're not I think going to get into predicting where they might go, broadly speaking though I think the way to think about it is there's been a change in behaviour and it's stuck, and even though over the last few months there hasn't been a further stimulus for change, there hasn't been any fall back to the old ways. So we see this as being the new reality that we'll deal with in the longer term.

Looking at the last six months then, we internally referred to 2012 as a year like no other, in particular because of our special relationship with the Queen's Diamond Jubilee, and the Paralympics in particular which were knockout events for us, but particularly in terms of engaging with our colleagues and customers. There was a day, 3rd September, when we

took 5,000 colleagues to the Olympic Park, a very proud day for the company, we called it turning the Park orange, literally it was turning the Park white actually, we thought wearing orange tee shirts was probably a little too much, but a great day in the company's history.

I said back six months ago when asked what do we think the Olympics, the Jubilee, the Paralympics would be in terms of sales, we felt then and it turned out to be the case they were not sales events in the round, the events themselves were, you know, the Jubilee, the two or three days before it rained was a fantastic sales event but the build-up, as we've seen for all major sales events in recent years was characterised by people cutting back, saving money so they could splash out when the special event came and then we also saw in the weeks immediately following, not least of which because the weather was truly awful in June and early July, people cutting back to sort of re-establish their balance sheet. So it wasn't a sales event but it was definitely a mood event and we believe we uniquely reaped that change in positive mood because of our association in particular with the Paralympics.

And we're not resting on our laurels, we've already announced major legacy programmes, our continued sponsorship of the British Paralympic Association and our investment in a programme called Active Kids for All which is a train the trainer programme in schools and in sports clubs in bringing about inclusivity in sport for young people in the UK. So this has got legs for us we think for the next four years too.

Now I said we felt that Live Well For Less uniquely captured the public mood but it's what sits behind Live Well for Less, it's a fantastic piece of brand communication but it's what sits behind it that's really capturing the public mood. First and foremost own-label, I'll show the data later but we have the highest own label penetration amongst major grocers and the fastest growing too. And that's a reflection of the hard yards that we've covered, not just in recent months but recent years. We're now 85% through relaunching the whole of by Sainsbury's, the core of our own label offer, around 80% of all of our own label sales is by Sainsbury's and that's been key in encouraging our customers to save money through switching from brands to own label.

But that goes hand in hand with a unique tool on brands. Brand Match has worked uniquely well in reassuring our customers of a fact we've asserted many, many times and that is that our pricing on brands is competitive. We know we have a perception gap and some independent monitors are starting to identify, and Brand Match has played its part in this, but that perception gap is closing. How could it not? 250 million coupons in the last year, over half of them telling customers at the till that their branded shopping that they've just done was cheaper than at Tesco and Asda and that includes deals, and that's made it uniquely powerful.

And of course we are at record with the scratch, but rightly so about the power of data. Our ability to use Nectar data, the live nature of Nectar, our long-term relationship with them, celebrated the tenth anniversary in the half, all combines with the unique technology that is coupon-at-till an ability to have an instant communication with customers to mean that we can invest our marketing and promotional pound in a more powerful way than can our competitors. And in a world where a lot of money is being spent in vouchering and promotions, a lot of it in a very untargeted way, that's a key competitive advantage, spending your money well in ways that customers want to receive it. The secret of a good coupon is that customers use it, because that means it's for something that they wanted to buy.

David touched on this and as you move the conversation with customers to a place where they believe the pricing is indeed the same across all the major grocers, that conversation must shift, is shifting, to what are the other reasons that I choose to shop with a supermarket

and the investments that we're making in our values are all components of why people choose to shop with us.

We've continued to lead on health, I think we've seen the conversation change radically in the last six months. Many people who have been nay sayers of front of pack labelling finally joining the party. We've known for years, we did our first front of pack labelling seven years ago, that this is something that customers wanted, an ability to eat a healthier diet.

Our milk pricing model came into its own in the last six months, a lot of conversation about fair prices for UK dairy farmers, the ability to say, "Our farmers are paid by a unique model," a model that they voted on which protects them for the pricing increases they're seeing but also ensures that they continue to invest in animal and environmental stewardship has really played strongly with customers.

A lot of our environment investments, perhaps less powerful with customers, if you're in a shop with photovoltaic on the roof you'll probably have noticed it, we are the biggest multi-site operator of photovoltaic in Europe, fairly marginal claim to fame I accept but we are, but importantly John talked about cost savings, they contribute towards cost savings too. There's a straightforward capital case, as well as an environmental case for the investments that we're making here.

And I hope most of you got the opportunity to see the FareShare event we did in store about a month ago. Our customers donated a million meals, we matched it with a million meals, seeing their charitable community efforts pop up in their community is incredibly important to consumers today.

And there will be of course today a huge conversation around jobs. We announced just yesterday a further 5,000 Christmas temps, we'd already announced 15,000, but we're also investing for the future. We think we have a unique opportunity to bring a talent base into the business today, 150 young trainee managers as it identifies on the slide, who will be our store managers of the future. That's a ten, a 15, a 20 year investment. Over half of our store managers joined us before their 21st birthday, often during the 1970s and 80s when we were recruiting talented young people in a period of growth, much like we are now.

And all of that is recognised fairly widely. I know, of course, there is a degree of scepticism about industry awards but it is unprecedented for one retailer to win, as we have, the retail industry awards for grocery retailer five times in the last seven years and the convenience retailer of the year three times in a row, a recognition that isn't just the top line that is recognised as beating the industry, it's our overall performance.

And moving on to our strategy, it is long term. This is not a new slide to you so I'm not going to dwell on it, it's one we've been presenting since 2007 and we do think that consistency over time is part of our success, part of our strength. We've maintained leadership in the quality of our own-brand back to that by Sainsbury's relaunch, over half of the products, around two thirds, have a product improvement, a quality improvement to go together with the repackaging under the new brand. And that's a real point of difference that is a determiner to store choice for many of our customers. So maintaining leadership there.

And own-brand we think will be a key fighting ground in the run up to Christmas, a lot of customers are going to choose own-brand as a way of maintaining the quality of their Christmas whilst cutting their budget to suit and you'll see that in our advertising, a big focus on own-brand. As I said 85% of by Sainsbury's relaunched and many awards already to recognise the power of that relaunch. But I also wanted to make a point that it goes across

all of the brands. You see there our freefrom range, gluten and dairy-free range, 30% year on year.

Now I think it is small and so we shouldn't overplay it but remember the point I made earlier, if you're starting to move away from customers choosing stores on price because they're reassured on price, they are able to make the choice on the thing that's important to them and I think that stunning growth in freefrom is not a reflection of a sudden step on in people being aware that they're dairy or gluten intolerant it is people being able to choose where they shop for the particular issues that are important to them and 30% growth is the result.

And I think it does sometimes surprise people but our basics range is the number two entry price point brand. We believe there's a very simple reason for that and it's that every promise we make on own-brand we make on basics too. Because the vast majority of our customers buy basics, by Sainsbury's and Taste the Difference, if not in the same shopping basket then over time. So they expect the brand promise to be the same.

What does that all add up to? Well I mentioned this earlier, we have the highest level of penetration, a higher own label penetration than our grocery competitors and from that higher base we're growing significantly more strongly so those investments are bearing fruit.

On non-food you'll have seen from the trading statement growing ahead of our food business it's pulling us up if you like in terms of performance, so we're very comfortable with the performance of our extensions and indeed in non-food within our core business. But worth remembering we set out five years ago to make our non-food offer available to more customers, it was 11% or thereabouts five years ago, 31% now of the UK population within 15 minutes of our full non-food offer. That's fantastic progress but of course leaves plenty of headroom and that's why extensions still form part of our capital plans going forward.

Our Convenience business is really having a knockout year, growing a little bit short of 20% it's capitalised on that changing consumer trend of top-up shopping. Our objective was to open one or two a week, we're achieving that now. And that's been hard fought, as I comment on the slide we have a property team, they've been in place for a number of years now, our hit rate is very high in terms of the sites from when we see them to when we open them and our success rate in predicting the performance of those sites high too, securing the returns that John talked about earlier. So that's a hard fought piece of progress and one that gives us confidence we can continue to go at that rate, one to two a week, pretty much as far forward as we can see.

And groceries online, clearly we're riding the crest of a wave. There is a big change in customer behaviour but we are the fastest growing of the major grocery online operators, over 20% year on year and we've continued to lead on all the key dimensions of online service in independent research, availability, the quality of the product and service, the ease of use of the website, to which we've added, I think in the last six months, a mobile operation, and of course customer service, most notably at the doorstep. Some of key brand ambassadors are online delivery drivers.

And quietly in the background the vast majority of our stores now have Click & Collect and that will be a big part of non-food shopping for customers in the next four or five weeks in the run up to Christmas.

But I mentioned earlier I wanted to comment on the interplay and this slide is a simple demonstration of that interplay. Each of our businesses, supermarkets, convenience, groceries online, are strong businesses in themselves, businesses of scale with strong growth. But it's what happens when people start shopping across those channels that's

incredibly powerful. As you can see there's a real sweet spot, consumer shopping online and in supermarkets spend over twice as much money with us as a consumers just shopping in supermarkets. The powerful interplays into Convenience, perhaps less so, but nonetheless as you can see multiples of performance.

Why is this important? It’s important insight firstly that you can only have it if you have data. So we’re able to see this and we can see it location by location because of Nectar data. And secondly, it means once you understand it you can incentivise it. You may have been surprised if you’re a grocery shopper in our supermarkets to see us incentivising you to shop online as well. Well there’s a very simple reason for that we understand the impact that it has on your shopping behaviour, not just online but back in your grocery shop. So really important insight and when you have the data you can do powerful things with it.

I could of course actually put the Bank on that previous slide, because we see a not dissimilar effect we’re using Nectar data and Nectar points, as you know, to cross-sell banking products. That’s partly what underpins the success of the bank, our ability to talk to customers who we know are in the markets for financial products. And their collecting of Nectar points for many is a reason for why they choose our banking products. But we also have cashback products. I think uniquely amongst grocery supermarkets we do incentivise through loyalty points, but we are also fighting in the cashback arena too.

Little things like Travel Money growing fast for us. It’s become a very online business, although we have 120 or so kiosks in store. And you’ll have seen the recent announcements we’ve made on strengthening the management team. That has been another investment ready for the future, a strong management team in the bank; and as you saw from John, fantastic profit progress: 12 million up from 7 million in the hal,f our share of the Bank’s profits.

Not a lot of cash yet on this slide. But the fourth leg of our strategy is to invest for the future; we always have. All the investments we make for the future we include in our underlying profit performance. We believe that investments for the future are a part of running the business on an ongoing basis. And in years to come some of these investments, hopefully all of these investments, will deliver in scale. The largest scale at the moment of course is our pharmacy business we already have the fourth largest pharmacy business in the UK, and with the development of hospital pharmacy – a couple of them noted there on the slide – big scale step-ons for our pharmacy business.

So that’s our strategy. I just wanted to close that by remaking the point I already made, but one that’s worth re-making, which is it’s a slide you’ve been seeing for five years; our delivery of our strategy is consistent, it’s long term, and we believe that’s a key part of why it’s successful.

So in conclusion, therefore, I hope you can see that we’ve stood at what we’ve asserted, which is good sales and profit performance. I think it really does bear repeating that what lies behind that is unique tools available only to Sainsbury’s; the insight that we have and the ability to use that insight to change customer behaviour, to give them value in a way that’s worthwhile and important to them. And that strategy in place for a long time with successful delivery, giving us confidence that we’ll continue to deliver going forward.

So traditional at this time to share with you our Christmas ad. Some of you will have seen it last night if you’re an I’m a Celebrity fan. So, I won’t embarrass you by asking if you’ve seen the ad because we’ll all know you were watching I’m a Celebrity. Our Christmas ad last to break. Just so you know we have a tradition in Sainsbury’s – I think it’s a thoroughly good

one – we don't break our ad until after Armistice Day that's meant this year we're the last to break.

I think you can see from Christmas advertising this year most people have had a not dissimilar insight, which is Christmas is as much in the preparation as it is in the day itself. But I do think our insight is subtly different, and that is it isn't so much about the preparation but that there are indeed golden moments on the journey to Christmas Day itself; that indeed Christmas Day is about Christmas days – there are many days along the way that we celebrate, not just Christmas Day itself. Our advertising celebrates that. We think it's uplifting and joyous, as we think Christmas advertising should be. It's designed to make you smile. And it gives us the ability to have multiple executions there will be 12 on television between now and Christmas. And we've got a selection of them for you to see now before we move to Q&A.

((Adverts))

So Mike, do you want to join us we'll move to questions.

<u>Question 1</u>

Mike Dennis – MF Global

I've got three questions. Usually you give us a breakdown of your margins in terms of the progress you've made in the underlying business, and then the sale and leaseback and investment in space. I was wondering if you could go through that again. And also give an indication of what Brand Match actually did to the gross margin in terms of the additional investment?

Second question, you talk about other options outside of the core business; what about China, an update on that, or other international markets you might have looked at?

Third question, Convenience; could you give us an idea of the scale that you've now achieved in that business; what exactly has it done for your operating margin? Thanks.

Answer: Justin King

Well I thought we always went out of our way not to give you a breakdown on margins actually, Mike. But I'll ask John to illuminate a bit.

If I could pick up on a couple and get Mike to talk about Brand Match. I mean, as far as China is concerned no change, we have a small team on the ground. You might think that's been a long time, it's been a couple of years – we don't think that's a long time. We think it's a very big call if we were ever to make a decision and understanding the market well, but also over the long term is an important part of that. As we said before, they're bolted on to the operation we already have in Shanghai as a sourcing operation, which makes it an affordable and manageable cost. And if we ever have anything to update, one way or another, we'll update you but nothing further to tell you now.

Answer: John Rogers

The reason why we didn't show that slide this time is because the effect is less marked. So actually if you look at the net impact of our investments in growth it's broadly flat year-on-year. Equally the same in terms of our investments in new space, so again, it's broadly flat

year-on-year as we're seeing the benefit of the pipeline start to come through. And of course then leaseback impacts us by about 4bps to 5bps. So if you translate all that upwards from the bottom line flat margin that gives an underlying margin growth of about 5bps.

Answer: Mike Coupe, Group Commercial Director

And on Brand Match, no we won't tell you the cost. We'll give you some numbers around the 250 million vouchers that we've issued. We're very pleased with Brand Match. We talk about the value, but we don't give you the third triangulation point. But it is self evidently the case that Brand Match has worked well for us. But we mustn't lose sight of the fact that it's in the context of lots of other good things that we're doing. So it's not just Brand Match it's about our development of own-label, it's about the standards that we achieve in our stores, it's about availability. So it's more than just Brand Match that has driven the business in the last 12 to 18 months.

Answer: Justin King

And on course Brand Match works because our prices are competitive. I think that's the other point that is worth repeating.

On Convenience, well we're heading towards our 500th store, turnover is closer to 2 billion than 1. We see the ability to open one to two a week – we did 49 in the first half – as far forward as we can see. You don't have a long property pipeline on Convenience so I couldn't tell you where we're going to be opening a shop in a year's time because most of those are yet to be identified, far less contracted. But we have commented in the past that the market wasn't presenting enough opportunities, and I think we see the market presenting those opportunities now; there's a bit more activity around property development in the right space that we would need it to be in to throw up convenience store opportunities. There is of course one part of the property pipeline where there is still vigorous competition; Tesco, Waitrose, Morrison's have said they're going to compete in that space, and of course the Co-op to an extent have always competed in that space – although they have their own challenges at the moment. So it's competitive space for the best locations. But nonetheless 49 in the first half.

<u>Question 2</u>

Andrew Gwynn – Exane

Just wondering how the business responds to the changing industry dynamics. Obviously we have this sort of blanket vouchering that you alluded to in the presentation, obviously yesterday with Morrison's 10% off card and so forth. And in addition at the other end of the market we have the likes of Aldi growing like stink. I think in the past you've almost dismissed them as being quite small, saying that they're sort of 4%, 5% share of the market, but obviously that is growing very rapidly. Is there anything that you believe that Sainsbury's need to do to respond to that? Or are you waiting for Tesco to put them back in their box?

Answer: Justin King

I'll ask Mike to talk about blanket vouchering and vouchering more generally. No, what I've said in the past about discounters in general is that their success as an indicator of something fundamentally changing amongst consumers has been overplayed. If you look at the headline mass, the headline mass are that Aldi and Lidl are growing strongly their combined sales are still today less than while Aldi, Lidl's and Netto's were two years ago. So I think you have to be careful to keep it in context. But nonetheless it's where the strongest

growth is currently being achieved. Clearly new stores bring new customers but if you look at where discounters are seeing their growth at the moment it's an extra item or two in the shopping basket. And therefore they're benefiting in a way from that convenience shift, the fact that people are spending less items in the weekly grocery shop, and topping up in convenience stores or indeed at discount stores. And many discount stores, of course, are in a convenient location. You might add Iceland into the mix of that debate too.

We are conscious – you have to be if your position is midmarket, as ours is – of the competitive dynamic in all dimensions whether it be very price driven through the discounters or quality driven at the other end of the market. The secret of a midmarket position is to do everything well enough that you can nick from all directions, or at the very least not lose in any direction. And that's the secret of our success. I've always said it's the place to be if you execute it well.

And having data, which I'm sure is a good feed in for Mike to talk about vouchering, is key to understanding that. If you can see the individual changes in shopping behaviour of your individual customers you can provide the right incentives to change that behaviour back, or sometimes to prevent that behaviour in the first place.

Answer: Mike Coupe

And I would add to that. We've been pretty consistent now for six or seven years around what it is that we're trying to achieve and the way we're going about executing that. And I would argue that's one of the reasons for our success. I recognise there are some more ways, as you described it, changing industry dynamics that go on around the edges but we've been absolutely consistent in driving own-label, making sure that we're competitive on price, and then also driving our points of difference. And this comes back to the point about our use of data: in the end we're able to target our activity much more towards our customers than our competitors. So rather than blanket activity that we see amongst our competitive set, we're able to use Nectar data to target activity at this time of year, like any other time of year, to the right customers in the right way. And as Justin has already said, an example of that would be the redemption levels we get on the vouchers it shows that we're doing the right things for the customers that we're trying to target.

<u>Question 3</u>

Jonathan Pritchard – Oriel Securities

I'm just interested in your comments on volume. I think there's a pretty strong possibility that in the second half you'll see inflation re-emerge quite strongly. Do you not fear that that may have a slightly binary mirror effect and send volumes back south again, causing more pressure on volumes and P&Ls across the industry?

And then secondly, what's the latest on food Click & Collect?

Answer: Justin King

Well, reducing volumes don't put pressure on the industry P&L, reducing cash in till puts pressure on the industry P&L. Of course if you keep putting cash in till with lower volumes some of the pressures are released in terms of cost lines in the business; supply chains, merchandising and so on. The reason volumes are important is they're an indicator of customer mood. And ultimately growing volumes is a part of what drives growing top lines notwithstanding where inflation might be. I said, when we saw the volume step-down a couple of years ago, that it was a result of customers achieving a good thing, wasting less.

We said that we thought that it probably had another year's legs in it we're in the middle of that year, it clearly did have another year's legs in it. It might have another year's legs in it. Customers are still wasting and there is the potential for them to cut back. And there's no doubt that if you saw a significant step-on in inflation that one of the things customers have to do is to look at volume. But as we've seen in the last six months they've been increasingly doing that, in Sainsbury's at least, by switching what they buy particularly driving own-label, which of course is a great way of dialling out apparent inflation in your weekly shopping basket.

It also does depend what you mean by a significant kick-on. Inflation is somewhere between 2% to 3% on groceries, depending on what measure. I think we'd say the pressure is on the upside it will probably have a three in front of it sometime soon. But I don't think we see it kicking on much beyond that. But any inflation is unhelpful to consumers.

The answer to the second question is nothing to say about food Click & Collect. We'll watch the developments of our competitors closely but we think our model at the moment is the right model for our customers.

<u>Question 4</u>

Andrew Kasoulis – Credit Suisse

Do you have within the long-term vision any specific financial targets? You don't share return on capital targets or net debt EBITDAR targets for example; do you have those targets and can you share them with us, please?

Answer: Justin King

Of course we target the business we target it on a one-year basis, we target it on a three-year basis and a five-year basis. No, we're not going to share them beyond the fact that if you open the pages of our annual report and accounts you can see what management are incentivised to achieve. And I think we lay out our long-term incentives for management as clearly as anybody, better than most and I'd draw your attention to those. It clearly includes return on capital; a key component of that of course is driving earnings per share. And you'll see that management are clearly incentivised on that.

Answer: John Rogers

Just to build on what Justin's just said, if you look at some of those key targets like the balance sheet metric you mentioned net debt to EBITDAR, if you follow through the logic, if you like, of the mass and the growth story, you would expect to see the net debt to EBITDAR figure maintained at its current level. Of course as we get the benefit coming through of the maturing new space you'd expect to see that level come down over time. So we'd expect to see a strengthening balance sheet over time.

And in relation to ROCE I think it really does depend on the industry backdrop. If the industry returns to the 2% to 3% like-for-like growth that is our midterm guidance then we would expect to see the ROCE accretion come through and the operating margin accretion come through, the 10bps to 20bps. In the current environment it's a very tough environment, and we think maintaining unchanged operating margins year-on-year is a very good performance in the context of competition going backwards. But if we do return to those industry norms then we would expect to see that accretion come through, reflecting, as we said in the past, the maturity of the new space.

Question 5

John Kershaw – Exane

You've said in the past, Justin, as we all tend to agree, that online doesn't yet make money so it's very good to increase customer loyalty on the top line but with doing a lot more online sales of grocery can you perhaps expand on the economics of that and why it's economically rational to drive business there.

And then just on the price perception, can you share some numbers around how it's improved because clearly Brand Match has been a powerful tool but perhaps expanding on that, certainly some of the price survey work we do suggests just around the edge your background pricing has actually drifted a bit, which if you can get away with it is no bad thing, but perhaps help us understand that.

Answer: Justin King

Well I'm not sure I quite said online doesn't make money; what I've said fairly consistently if you look at what it costs in isolation to deliver an online delivery the average delivery charges at £3 to £5 in the industry doesn't reflect the cost of delivering that service. But of course that's true of lots of things that we do; we build car parks on our stores and we don't charge for them. But we're not overly concerned that our car parks don't make money because they're a key component of why people come to our shops and spend in the stores. And you may think I'm being flippant in making the parallel with the car park but I'm not; you cannot operate a superstore grocery business successfully, we believe, today without an online offer because the vast majority of consumers want both. And what I was trying to demonstrate in the slide is that it is increasingly a two plus two equalling a number greater than four process, that as your customers start shopping across channel they become more loyal to the business in total. Over time you're able to grow the in-store sales of the customer that also buys online. It's why we incentivise them to make that switch. And pivotal to all of that, and to concluding therefore that online is the right thing to do and incentivising people to add online to their shopping portfolio, is the data, which shows those changes in behaviour, trip to trip and over time. So I am very comfortable that our food online business is a profitable part of our overall business mix, because of the impact it has in total on our customer loyalty relationship.

Of course Jon (Rudoe) sitting down here at the front who runs our online operation, Jon (Rudoe) could sit here for the next 15 minutes and tell you a load of fantastic stuff we're doing to make the online business itself more profitable, more efficient use of lorries, more efficient picking in-store, different systems that allow us to give better substitutions to our customers; there's a plethora of things we're doing to make that a better business in itself, we're not just relying on the pay-off, if you like, back in the mother ship.

In terms of price perception, we're sort of content that there are plenty of observers that are in the public domain, some in the room who do their own survey data, all of which point towards a step in the right direction. There's still a good gap to fill, I think I've said in the past that if you are famous for quality it's pretty difficult, if not impossible, to have your price perception matching your price reality, because most consumers are pretty rational, they believe that if the quality is better they're probably paying a little bit more. And of course much price perception is at a total basket level. And customers that shop in Sainsbury's buy better own label, they buy better fresh food, and they buy more of it. So they do tend to spend more, all other things being equal, when they shop with Sainsbury's and that's part of what sets price perception. And that's why Brand Match can be so powerful, because if you're standing by the till having spent more money than you expected to, but with the

reassurance of knowing it wasn't on brands, then you can be much more comfortable with the decisions you've made on the fresh food you've bought, the own label that you've bought, that it was your own personal trade-off between quality and price that meant you spent more money.

And in terms of the underlying pricing, I don't like those words at all. We would never say that of ourselves. No our pricing position hasn't drifted and we would never let ourselves off the hook, not least of which that Brand Match, as I said, only works if our pricing is competitive, because we need 50% or more of the vouchers to be telling customers that in fact their shopping was cheaper today in Sainsbury's own brands.

Answer: Mike Coupe

It would be great if you could share the data and then we can put you right on it!

But we track 14,000 products week in week out, so I suspect our measurement of ourselves is a lot more comprehensive than your measurement of us.

Question 6

Dave McCarthy – Investec

Just want to have a look at your sales growth. You've told us your convenience business is growing by over £300 million per annum, your internet business is growing by £200 million per annum, so that's £500 million, but you're guiding us to just £800 million per annum total sales growth. So we've only got around £300 million coming out of conventional stores, where of course you invest in almost all of your billion pound capex into that. So you're investing a multiple of your sales growth. So just really looking for some comments on the imbalance between your capex and sales growth in existing stores.

And then secondly I just wanted to ask about capitalised interest. I had expected it to be coming down as you're unwinding a bit of a pipeline maybe, but it's up a touch. I just wondered, can you tell us why that's the case and what's happening with your undeveloped assets that you are capitalising?

Answer: Justin King

I'll get John to pick up on the second.

We're not going to apologise for having invested in all the bits of the market that are currently growing, reflecting changes in consumer behaviour. A good business that's customer facing should be directing its capital towards things that customers want to do. And at the moment that's extended stores because we give them a full non-food offer and as you can see from our sales growth it's something our customers want in our shops the way we deliver it. And I've always said customers like an extended store if they walk in and they love the food hall; and they do, because we always make the first investment in the food hall. We're investing in our convenience estate, we've been investing for a long time in our online business. As I said earlier always taking the costs of those investments, be they capital or revenue within our core P&L. And those investments are paying off.

The reality of the maths of course is exactly what you've described it, it means that the underlying sales growth from core uninvested estate is currently a negative not a positive figure. It's a lower negative than most of our competitors, I have to say, because as you can

see, and part of the reason John put up the slide, I think we've been doing a really good housekeeping job as well, I don't think any of our competitors could point towards an estate that has been kept as up to date and as well invested for customers as ours, you know, a very small number of stores without an investment in the last ten years. And that's an important part of why our core estate, notwithstanding all of that commentary, negative though it is, is performing better than the average for the core estate of our competitors. So I think we're doing the right things and we're spending our money prudently and well, both for the short term, things like convenience are very quick pay back investments, but also for the long term, sometimes biting the bullet on 15 refurbishments, which are the toughest investments if you're viewing them as discretionary, to justify. But refurbishments are not discretionary, they're only discretionary for a year or two or three and as some of our competitors have had to note in recent months, that it suddenly becomes an imperative to play catch-up if you convince yourself over a number of years keeping your estate up to date is discretionary, and we don't believe that would be the right thing to do for the long term.

Answer: John Rogers

Just before I comment on the capitalised interest, just to add to Justin's comments, you do have to remember, Dave, in this of course the build up curve for new stores that we've talked about in the past. And what gives me comfort is when we do the post-investment reviews on all of our investments, which we do at a very detailed level twice a year, the overall investment programme that we've put in place is on track to deliver the 15% IRR target that we set ourselves. When you look at the performance of our new stores again those are on track to deliver. I think there's a capital efficiency point as well of course, in that we are investing in those parts of the country where actually the cost of buying the land, the cost of building those stores, is lower as well. So whilst the trading intensity, if you like, of those new stores won't be as high as what you would see in the south and south east, the capital cost is obviously a lot lower and so you do get good capital efficiency coming through. So I think we're pretty comfortable that the investment programme we have in place is delivering good returns for shareholders.

In response to capitalised interest, we will see a similar level, actually, of capitalised interest this year to that that we saw last year. We'd expect to see that number come down over time for all the reasons that you've highlighted.

Question 7

James Grzinic – Jefferies International

Can you give us an idea of what you expect that extension help to LFLs be in the second half?

And for Justin, what does the reach of non-food become if we add the Click & Collect option, all the stores? 31% becomes what?

Answer: Justin King

70-odd is the reach of our estate in convenience stores. But we wouldn't quote it quite that way because I don't think we would do it on a 15 minute drive time. I don't think we would claim that Click & Collect in a convenience store in Hull is going to have a 15 minute catchment, it's going to have a two minute catchment and by foot. So I think it's a bit apples and pears but directionally the reach of the store estate is north of 70.

Answer: John Rogers

And from performance for extensions in the second half expected to be 0.1, 0.2 versus the 0.8 in the first half. And that's why I made reference to the like-for-likes in the second half, that is a stretched target given the comps that we've got for Q3 and Q4, and obviously that fall in the contribution from extensions.

Question 8

Caroline Gulliver – Espirito Santo

It's just a really quick question just on electricals. I know this is a relatively small part of the business but have you seen any impact from Comet going into administration? Are you expecting any pick-up, particularly online?

Answer: Mike Coupe

That's a very complex question to answer. First of all we had an immediate impact because our white goods were actually served by Comet so we had some fancy footwork to deal with the customers that were impacted by that. But actually, generally speaking, our electrical business has been a star performer in the last six to 12 months, so we've done incredibly well and we're very pleased with that performance and no doubt the Comet demise, if anything, has an upside not a downside, so we'd expect that to perhaps improve. But electricals in the round has been a very good business for us in the last year.

Concluding comments – Justin King

Thank you very much. We'll talk to you all again early January with the Christmas trading statement, and we'll see you all again in May. Thank you.