J Sainsbury plc

J Sainsbury plc Third Quarter Trading Statement 2011-12

Wednesday 11th January 2012

Justin King

Good morning everyone, Happy New Year. Thanks for coming on the line this morning. I'm joined by John Rogers and Mike Coupe. As you know we're announcing this morning our third quarter trading statement, that's for the 14 weeks to 7th January. And as you see I'm sure it's a record breaking Christmas completing a strong quarter.

Our total sales up 7%, or 4.5% excluding fuel, and on the important underlying basis like for like sales up 2.1%.

Of course that's a growth on growth Christmas 2010 Sainsbury's were clear winners and therefore our two year like for like figure demonstrates that 5.7% like for like excluding fuel.

And we're particularly pleased with the operations of the business. We had significantly more customers through our doors, 26 million in Christmas week, 1.5 million up on a year ago, and we delivered record levels of service and availability to them.

Of course I should remind you we're reporting a full quarter here, 14 weeks through to January 7th, which means we exclude any distorting effects of the New Year as well, and you've seen, I'm sure, through your analysis of the Kantar data yesterday that the quarter is characterised by relatively diminimist levels of sales growth for the market during October and November and then customers spending a little bit more during December. This is entirely in line with our expectations, indeed something that we've commented on in the past, customers tightening the purse strings when there's no particular need to spend so they can for special occasions, be they family or of course something like Christmas then spend a little bit more. And we think that at Sainsbury's we deliver against that challenge for household budgets uniquely and well, and that's indeed why were trading successfully.

And you can see that behaviour evidenced by some of the comments we've made about Taste the Difference and Basics, both growing strongly, indeed Taste the Difference at around 10%. That's customers managing those challenges week in, week out. And indeed over half our shopping baskets that contain Taste the Difference also contain Basics at the same time, showing you that it's very much about all customers doing this, not some customers buying at one end of the quality spectrum and some at the other.

And overall we're very pleased with how we've delivered Live Well For Less, the new brand strap line that we launched in the quarter for our customers. They tell us it reflects precisely how they're trying to manage the challenges of their weekly shopping for groceries. And a powerful part of that in the quarter has been Brand Match. It's been a great hit with our customers and that's why we've extended it into 2012.

Also we're commenting on another unique part of our offer, Nectar. 100 million, a new record of Nectar points redeemed, demonstrating again that across the year customers are saving up Nectar points for that big shopping occasion that is Christmas as very much the order of the day if you're managing the challenges of a weekly shopping budget. So another record there.

It hasn't just, though, been a Christmas about food. Our general merchandise business continues to grow faster than food and we're pleased with that, of course up against the last minute rush in December 2010 ahead of the VAT price increase, continuing to grow we think is a strong performance.

We've also had a record as far as space is concerned; 600,000 square feet of space added in the quarter, including our thousandth store in Irvine in Scotland. And of course you saw in the top line figures the 2.4% contribution to overall sales of new space, so very pleased with the performance of our new space.

Convenience continues to be a particular success; 21 new stores in the quarter, ticking along nicely now at that one to two stores a week that we've set ourselves as a target. And overall Convenience grew at 25%, both those new stores but of course the strong underlying like for like dynamic reflecting the changing customer shopping behaviour we've commented on much before.

But our business is diversified further, not just supermarkets and convenience, we also have a strong and growing online business, and our groceries online business grew just short of 20%, delivering a record 160,000 orders with, as in the supermarket business, record levels of availability and customer service. Of course it follows, because we pick in-store, so if we have record levels of service and availability for our customers in-store, we do online as well.

And we've commented in the past on our fast roll out of Click and Collect, very pleased to report we got to 870 stores ahead of Christmas and 75% of our online general merchandise orders use Click and Collect in the final Christmas week.

Looking forward then, I think you would expect us to say we have more of the same really in 2012. We expect customers to tighten their belts in the next couple of months as they did last year, indeed many January and Februarys before. And that's at least in part because they look forward as do we to the rest of the year and there are some reasons for customers to be ensuring they keep a little bit of money by to celebrate the special occasions that are the Jubilee, the Olympics and the Paralympics, and we do believe that each of those will be occasions where customers will join in the celebrations, provide opportunities for us at Sainsbury's, particularly of course the Paralympic Games, of which we are the first unique sponsor, and very proud of that of course.

So that's all I have to say. We'll hand over to questions in the usual form. Thank you.

<u>Question and Answer Session</u>

<u>Question 1</u>

Andrew Gwynn, Bank of America

Good morning all, and Happy New Year. Just coming onto the competitive tension in the market, obviously we've seen more in the way of big price drop and so forth, and we obviously get that usual message in January. Is there an element that the consumer is almost moving away, almost ignoring price now, because there is just so much noise about it it's almost taken as a given?

The second question I have is just on the Christmas hangover comments. Last year obviously we had a lot of using leftovers and so forth in calendar Q1, do you think a similar trend, or even a greater trend, could be continued this year? Indeed we now have 11 days of

January, have we seen a similar trend to previous years, given the VAT annualisation and so forth?

Answer: Justin King

Thank you Andy. I'll ask Mike to pick up the first, but just before I do I'll talk to the hangover point.

Well of course our figures are bang up to 7th January, so anything that has been happening since New Year is largely included, so I'm certainly not going to comment on the three days of trade that have taken place since then. But I think, as ever in these things, for it to be a year on year effect it has to be greater than it was a year ago. And the impact a year ago was very significant, more significant than we'd ever seen, I think, as a transition from December to January. There are a couple of big reasons for that. I think firstly the VAT change was well signalled, and of course in non-food, and in some parts of the grocery basket because things like alcohol are VAT-able, did cause a bit of a pull forward, so you had a little bit of a pull forward last year driven by VAT.

I think secondly we've commented many times on the impact of fuel prices on the weekly grocery shop, and during January last year there was a very significant step on, something in the order of 20 pence a litre through January, and that added an extra pressure.

So I think if you look this year, there aren't reasons for it to be a bigger step down than it was a year ago, and therefore I don't think we would say anything other than we expect it to be the sort of normal step down to the extent people do all of those things you touched on, loving their leftovers and so on, they'll do all of that, not least of which because they rather like the behaviour, as I said at the half year, customers have learnt to waste a little bit less and they're rather liking that, and they'll stick with that I'm sure.

Mike, do you want to talk about whether they're ignoring price?

Answer: Mike Coupe, Group Commercial Director

Hi Andrew. I'm not sure they're ignoring price and as usual there's a huge amount of noise and activity in the marketplace. But I think you're probably right in the underlying analysis, that increasingly price as a sort of weapon is getting neutralised by a lot of the stuff that goes on in the marketplace and the underlying transparency. The reality is if you look at Tesco Price Drop, if you take the last nine weeks their prices have gone up. So customers aren't stupid and they kind of get what's going on in the marketplace, there is an underlying drifting up of price from Tesco. And I guess the other point we make is Brand Match is all about making sure that we're able to reinforce our positive value position and also continue to differentiate ourselves with the quality of the products that we sell, whether that's Taste the Difference or whether it's Basics, and clearly that underlying strategy in the marketplace has worked well for us over the last few years, and particularly in the quarter that we've just had.

Further question

You say Tesco's prices are going up, I think all your prices are going up, it just seems to be Tesco's that are going up at a slightly lower rate. With the brand price match do you think there's a need to follow them in the first instance on price, or do you think it's covered off by the price guarantee?

Answer: Mike Coupe

Your assertion is wrong, your fundamental start point you're coming from. Our price position is as good as it's ever been, relative to the market and relative to our major competition and relative to Tesco. So the idea that somehow they are lowering prices faster than other people is just completely not true.

Andrew Gwynn

Okay, difference of opinion, but we'll leave it at that.

Answer: Mike Coupe

Well no, it's not a difference of opinion, it's a fact.

Andrew Gwynn

Well, I think it depends how you measure these things, doesn't it. But we'll leave it at that perhaps.

Question 2

Gillian Robb, Morgan Stanley

Good morning everyone. I was just wondering if you could provide us with a bit more colour on non-food, because you've indicated it's still growing faster than food, but are there any categories that have performed particularly well in this quarter?

Answer: Justin King

We're very pleased with Clothing, we're very pleased with Home, we're very pleased with our seasonal performance overall. So we've done very well, on those categories we've grown share and we've outgrown the business essentially. Gifting has been very strong as well, so we've seen a significant out-performance on Gifting. And you'd have seen in the marketplace the areas under pressure are things like Entertainment, where we've grown market share substantially but nevertheless the market has been pretty challenging, and Electricals, where last year there were a lot of brought forward sales because of the VAT increase. So those are the categories which have been under a significant amount of pressure. But actually in reality it's the more profitable categories that have been in good growth for us.

Question 3

Caroline Gulliver, Execution

Morning guys. I've also got a couple of questions on non-food, and specifically online this time.

I was wondering if you could tell us what the online non-food sales growth in the quarter was? I think you said food online sales were up 20%. And what percentage of online non-food sales are Click and Collect, not just for the last Christmas week but for the actual entire quarter.

Answer: Justin King

We don't break out online non-food sales in terms of growth, not least of which because I think it would be somewhat disingenuous, it's a relatively small number and I wouldn't want to claim anything other than that's a growth business, spectacular there was a growth but from a low base, so that's why we don't break it out.

On an ongoing basis it's between 30% and 40% that's Click and Collect. I think the particular urgency of Christmas drove that up to 75, which we commented on, because we do offer a next day option. But the trend line is up. If you ask me that question in six months time I wouldn't be surprised if I was giving you an answer that said 50% Click and Collect.

Further question

Okay. Just one other question if I may. You've mentioned in the last line of the statement that you will continue to invest in the customer offer, obviously given the outlook. Is that continue to invest sort of the standard 100 to 150 basis points that you normally talk about as the pay to play, or is that something over and above that?

Answer: Justin King

Yes, it's funny because I can't remember the last time we had a conversation about pay to play with everything that's been going on. But, yes, that actually hasn't changed much. It's got lots of different manifestations over the last two or three years, with the activity that we've already commented on earlier. But the underlying dynamic of the grocery industry and grocers' P&Ls is to drive out about 100 basis points from cost of goods a year to invest back in the offer. Of course you don't necessarily invest it back directly in pricing, you invest it where it's most productive in your P&L, and that's what we spend a bit of time at the half year talking about, the different places in our P&L that we could invest money versus our competitors to drive top line growth. And I still think one of the most notable slides we presented back then was the one that showed how we'd stepped away from some of the very significant increases some of our competitors were making in advertising expenditure. We have much more powerful ways to spend our money, underlying price, of course, Brand Match, and Nectar promotions are all great ways of spending our money. But, yes, that sort of underlying dynamic's still absolutely there.

Mike, do you want to add anything?

Answer: Mike Coupe

No, I think the point's well made. In the end the market is hugely competitive and we continue to invest in all aspects of our offer, and I guess on top of what Justin's already talked about we're continuing to invest in the quality of the products that we sell.

<u>Question 4</u>

Sreedhar Mahamkali, Macquarie Securities Group

Good morning. A couple of questions please. Can you tell us what the contribution of extensions was in the quarter?

Answer: Justin King

About 1%.

Further question

About 1%, okay, very good. And then you talked a little bit about your largest supermarkets' performance was especially strong. Are you referring to the stores over 55,000 square foot, around about 60 or 70 stores, that you have, or is that what your...?

Answer: Justin King

Yes, I don't think we'd be that specific about which particular footage. But, yes, the bigger stores, typically those north of 50,000 square feet, I think some of that, because there was much commentary, as you know, last year, that bigger stores suffered in the snow. So some of that, I'm sure, has been a reversing out and you can clearly see in Asda's data in Kantar yesterday that that reversed out for them in December. As we said there wasn't... bigger stores were penalised in two ways: 1) whether you cleared the car parks; and 2) whether people could drive on the roads.

But I think also what we saw this year was customers – this would for me be the sort of underpinner of Christmas coming late – was that Christmas also for customers was a one big shop occasion. Now, of course that's in a way contrary to the trend that's existed the rest of the year, which is a move away from a big weekly shop to a slightly smaller big weekly shop followed by lots of top-up shopping. For the last week to ten days we saw the reverse trend, which is people waiting ready to do the big Christmas shop, and then doing a big Christmas shop. You know, Morrison's earlier this week commented on the fact that both the big Christmas shop didn't happen in quite the same way, and that people didn't treat themselves. We don't recognise either of those observations, it's clear that the big Christmas shop did happen and people did treat themselves. Our champagne sales were up 10% over Christmas.

Further question

Last question, in terms of Brand Match, you're extending it clearly, and if you're spending more on Brand Match what part of the mix gives to accommodate into your overall spending on promotions and advertising and price and so on. How do you accommodate more on Brand Match?

Answer: Justin King

Well, we're not going to comment in detail, I think that's competitively confidential. But I alluded earlier to the slide we showed at the half year that showed that we'd stepped away from some of the very significant step up in advertising, particularly TV advertising by our competitors. So we've said very clearly that Brand Match, as a cost, is in the mix of all the other things that we spend money on, whether it be underlying pricing, coupons at the till, and our advertising expenditure, so it's well manageable within that. And in the end, as you would expect, we'll spend the money where it's most productive with our customers.

<u>Question 5</u>

Alistair Johnson, Citigroup

Morning all. Just coming back to general merchandise. You're saying that general merchandise is growing faster than food now. Is there a multiple you can put on that? You used to say it was two times, three times, is it one and half times now? If you could give a bit of colour on that that would be great.

And then just a very...

Answer: Justin King

Yes, between one and two, there you are!

Alistair Johnson

No decimal points? Okay. And then just a background question. How big is general merchandise now, as a sort of percentage of non-fuel sales, and as a percentage of your space? What proportion of the business is non-food - general merchandise specifically?

Answer: Justin King

It depends on your definition but the most widely used one it's about 15%. And of course the sales densities are... Well it depends which one you're going to take. Most people include Health and Beauty. If you're talking pure general merchandise and clothing it's less than that, but I'd say around 15%. The reason I paused is that the pure general merchandise is about half the sales density as well as the Health and Beauty bit typically, as grocery levels of sales density.

Alistair Johnson

Okay, so if it's 15% of sales it's what...

Answer: Justin King

If we include Health and Beauty I've not looked at it that way but I suppose it would be between 22 and 25, something like that.

Answer: John Rogers, Chief Financial Officer

I mean, if you took out Health and Beauty I think about 7% are sales and 15% of overall space Health and Beauty would take that up to about 15% of sales overall.

Answer: Justin King

And 22% to 25% of space obviously.

Further Question

And then just another quick question on calendar effect in the first quarter. You've got Easter in the first quarter, I think so typically what will the calendar effect from that be?

Answer: Justin King

There won't be. Easter falls into Q1, as it did last year. It's really sort of marginal in the roundings in that I think Mother's Day falls into this quarter, doesn't it, Mike? This year and last.

Answer: Mike Coupe

Mothering Sunday is the first day of the next quarter, just to put it into context. So, we get a slight benefit of Mother's Day being effectively a week earlier. But it's marginal.

<u>Question 6</u>

Tom Gadsby, Matrix Group

A couple of probably housekeeping points probably. The VAT boost, is that still about 0.9%, I think, given the higher food?

Answer: Justin King

Yes.

Further Question

That has not moved too much.

And then to let us make a comparison, could you let us have a like-for-like figure for the six weeks to 31st December? I mean, Kantar tells us it's better; it just might help a bit.

Answer: Justin King

No, in a word. Perhaps you should just ask everybody else what their full quarter's performance is.

Look at Kantar yesterday you can clearly see that the last quarter's made up of, for the market essentially, two flat months, followed by all of the quarter's growth in December. Shape wise, that's our shape but of course we've got 2.1% growth, which is a good beat to the market. So our shape is similar to the market. The absolute numbers are higher each month, as they are in December.

We've done our own internal re-basing against all of our competitors' trading statements, and we believe our performance on a like-for-like basis to beat them all – and that includes M&S and Waitrose.

<u>Question 7</u>

David McCarthy, Investec

I just wanted to look at the like-for-like figures. You've done 1.2% ex-VAT, 1% of that is from extensions if we then strip out maturing space, which is a good half percent, you've got growth in Convenience above that. What that tells me is you've got negative sales – and this is common across the industry so it's more of a general question – you've got negative sales in your core estate, the stores where you've had no re-fits, extensions and that are older than two to three years. We strip inflation out of that, and the volume sales must be substantially negative for the industry, not just for you. I'm just wondering can you give a comment on how sustainable you think that is over the long term or medium term and whether it causes you any sleepless nights and causes you any concern that this is the new norm?

Answer: Justin King

I think we had estimated last year, Dave, probably about 2% volume decline over the industry. I talked about that at the half-year. And that's a significant change on a 30-year trend. Only time will tell whether that was a kind of one-time re-basing or whether there's further for customers to shoot at because I think it's largely connected to a reduction in waste, as I commented on at the half-year. And as you know, what I said was I think there's probably another year's worth for customers. If you take the view – I think most data would point to it – that across Groceries 7% to 8% is wasted, they probably take a 1% to 2% out of that. In the last year customers on the whole have enjoyed doing it they enjoy putting less in the bin why wouldn't they? So, we think there's another year's worth, and that's certainly our sort of underlying planning assumption for the market.

In terms of whether it causes sleepless nights I think that in the end it creates an even greater imperative for outperforming the market because if there's less to go round winning, even if it's only at the margins, becomes very important. That's why we're pleased that that's precisely what we're doing. And that's why we focus our commentary time and again on the tools that we have that allow us to productively outperform. Because outperformance if it's won at a great cost is fairly empiric. But out performance if it's won productively through tools like Brand Match, Coupon at Till and so on, is worth having. And I think of course there is an implication in your question about the implications for industry profitability; well, I'm sure when 2011 is added up the total industry profit pool has shrunk. There will be only two major participants in our industry, if they and us, Morrison and us meet expectations, as we and they have both said we expect to for the market, there will be only two that have grown their profits in a meaningful way year-on-year, and the industry profit pool will have shrunk. And that is a clear demonstration of the power of outperformance even in a tight market.

Further Question

Just following up on that, do you think the industry profit pool will shrink in 2012? I go back to my sort of core question, that the profit growth may have increased but there's a lot of capex that has gone behind that, either in extensions or in the impact of maturing space coming through, and the benefit of that. So I go back to the core assertation (*sic*) that if we have got, in the untouched estate, something like, I don't know, -4% or -5% volumes, how sustainable is that before the industry has got a real problem? And I mean a real problem not just tweaking around the edges.

Answer: Justin King

I think that speculation will be for your next note, David. It's not for me to comment on what I think will come to pass. Clearly if everything were to happen in 2012 that happened in 2011 then the same output would happen. But of course the fact that the industry profit pool has shrunk in 2011 will no doubt cause those with shrinking profit to relook at the things that they're doing. So I'd expect to see changed activity from those that have seen their profit performance go backwards. But only time will tell whether that will come to pass. As we've said many times, ultimately we can't speak for total industry decision making we can only speak for our own. And our own capital investment programme remains highly accretive in the long term for our shareholders, and we're very pleased with the performance of our new investments, be they convenience stores, extensions or new stores. Of course next year we'll do a little bit less we're stepping down, as we've already said, from about 1.4 million square feet this year to about 1.2 slightly greater focused on those more instantly accretive investments that are convenience stores and extensions, as we commented on at the half year.

Question 8

Andrew Kasoulis, Credit Suisse

On your customer count comments you said you had 26 million customers in that Christmas week. What exactly is that number? Is that excluding fuel? And perhaps just to help us, can you comment on what's happened to your like-for-like customers versus the growth in like-for-like in store of 2.1%, please?

Answer: Justin King

Yes. The customer count is a transaction count, but it doesn't include fuel alone transactions. And it's the consistent basis that we've reported customers on for years and years and years.

In terms of across the whole quarter, John?

Answer: John Rogers

Yes, in terms of transaction overall, as we said, up around 5% to 6%, as the numbers show for the week to Christmas. That is a typical number across the whole quarter on a total basis.

And in specific response to your question on a like-for-like basis, a couple of percent up on a like-for-like basis. So a very pleasing performance.

Further Question

And then just one more question sort of following up from what Dave was asking. If volumes are sort of flat, negative in the industry, I don't know what your outlook is for inflation, but does it mean as a sort of working planning assumption you are expecting industry like-for-likes to come down in 2012 versus 2011?

Answer: Justin King

Industry like-for-likes are, I guess, probably are made up of something like 2% volume decline and 4% inflation. Every participant says that they don't recognise the inflation numbers that either the government or Kantar publish. And I guess that's what, when the numbers are all added up for 2011, we'll see. I think our central assumption would be a little bit less volume decline and a little bit less inflation, and probably will be a little bit less than that too therefore as a result.

<u>Question 9</u>

James Tracey, Redburn Partners

Two questions. It seems that there's more pressure on gross margins than last year with the Brand Match that you're doing and Tesco's Big Price Drop. Do you agree that there's more gross margin pressure this year? And are you offsetting that by less investment in other areas?

And the second question is what was the exact contribution of extensions into the like-for-like for Q3?

Answer: Justin King

Well, extensions is around 1%, as we said earlier.

The first half of your question, James, that is always true; it's always the case that this year the pressure on gross margins is greater than the pressure a year ago, because that's the whole nature of the competitive dynamic. The question is how you are able to cope with those pressures. Of course I should remind all listening that what actually happened with the Big Price Drop is that Tesco took 350 million off their customers through the withdrawal of Clubcard 2, and are trying to invest it back in underlying pricing. That's then doing nothing different from what I've been saying about ourselves; you invest in those things that you think are the most productive places to invest your money. There's a clear implication, therefore, in Tesco pulling out of Clubcard 2 that that was not productive spend for them, and they believe spending in underlying will be more productive. We have more tools available to us and we commented on Brand Match, Coupon at Till and so on. And we'll keep focusing on those things most of which are very measurable. When we do things supported by Nectar, of course, we can measure the precise productivity of that expenditure. And that is by most the effective way to relieve gross margin pressure, which is ever present in this industry.

Further Question

Do you think that the industry is back-solving less than this time last year, at the moment?

Answer: Justin King

No, I don't think… well, yes it must be if the profit pool has shrunk I suppose is probably the honest way of answering that question. Clearly it's not been as good at back-solving if the profit pool has shrunk.

<u>Question 10</u>

James Anstead, Barclays Capital

Two questions. Firstly, on Brand Match you've obviously decided to extend that into 2012. I just wondered what sorts of metrics you were looking at internally when you decided to extend that. My impression is that you're not expecting price perception to have shifted dramatically within a month or two. So were you able to see perceptible changes in that metric or were there other things you were looking at? And also on that one, is the extension definite, or is there a theoretical expiry date, as there was with the first phase?

And then also, as a supplementary, I don't know if you can comment at all on what you think are the regional differences are right now, if there is any difference that you can see?

Answer: Justin King

Yes, on Brand Match, self-evidently we wouldn't have extended it if we weren't seeing a positive improvement in the metric. So, the awareness is very high. In fact the last measured awareness was higher than the equivalent schemes run by a competitor so that's very pleasing. And perception has moved. And in the end seeing a translation from perception into reality is at the core of the Brand Match proposition. And customers like it. If you listen to what our customers are saying it is very much on their lips, they get the proposition, and particularly our most loyal customers. And there is something in getting a voucher which creates a bit of a buzz. So we're very, very pleased with the way things are going, and self-evidently we wouldn't have extended it if that wasn't the case.

Indefinite is a long time in my book. So certainly for the foreseeable future, indefinite sounds like forever so certainly we're pleased with it and pleased enough to run it into the foreseeable future.

Answer: John Rogers

James, it's John, just in terms of your question on regional differences: we obviously look at this very closely, but we're not seeing any discernible patterns there between the various regions of the UK; it's pretty consistent across the board.

<u>Question 11</u>

Sam Hart, Charles Stanley

You've touched on this already, but can you possibly give us a bit of commentary on the food price inflation during the period, and the outlook for food price inflation in 2012? Maybe if you could go into a little bit of detail in terms of which categories you're seeing the greatest inflationary pressures in? Thank you.

Answer: Justin King

We read food price inflation a bit north of 3% for the quarter. I think Kantar yesterday were showing it at 5.8% or 5.9% for the quarter. And I suppose fairly consistently we read food price inflation 2% to 3% below what Kantar do, because of course they don't back-adjust for changes in volume. And of course one of the most striking aspects of the last two or three years has been customers changing what they buy when there are differential levels of inflation. Most notably in things like protein; if one area of protein inflates significantly ahead of another customers switch around to dial that inflation out. So, we read it a little bit north of 3%.

In terms of the outlook, I think all one can really say is the pressures that caused last year's kick-on in inflation, although they were by no means as strong as back in 2007/2008, have largely either abated or annualised. So, it will require new pressures to come to bear if inflation is going to stay. All other things being equal inflation will drop out over the next quarter or so. But all other things are never equal. The long-term trends in terms of pressures on food, which are to do with world commodities, some of them food direct, or oil obviously less direct, most of those pressures long term are considered by most commentators to be upwards. So, there will be periods of very low levels of inflation, if not deflation but, overall, the trend is clearly that some level of inflation will remain.

Answer: John Rogers

And price inflation is primarily driven in primary agriculture in the last year. Particularly things like beef have been reasonably substantial. We have seen a coming off of the wheat price, which is one of the primary drivers of a lot of primary agriculture but it's almost impossible to speculate. If you take the last week wheat has gone back up again. So, there are other pressures on a week to week basis, which are just impossible to foresee going forward.

<u>Question 12</u>

John Kershaw, Merrill Lynch

Just a quick follow on, given what's asked. Just in terms of the consumer though, obviously there's not a regional difference, but are you seeing a split in the haves and the have-nots? Because A, you've got people drinking much more champagne, Morrison's clearly haven't; Asda suddenly seemingly getting a burst of performance, which looks beyond just a bit of an easy snow comp, Aldi obviously doing much better. Is there a split in the haves and have-nots? Or is that actually a concern that there is a further leg-down in consumption? And perhaps as a supplemental to that in terms of driving business, have the likes of Asda bought some business perhaps with their £5 off, because our 10% cheaper is not enough?

Answer: Justin King

I don't think there is a split between the haves and the have-nots.

Further Question

Apart from retailers, obviously.

Answer: Justin King

Yes, well clearly. But in terms of consumers, Ken Morrison once famously said, “The poor need a deal; the rich want a deal”. And I think that we’re seeing – I think I quote him about right – and I think we're seeing customers of all levels of affluence shopping in a savvy way. And the individual performance of the individual retailers that you quoted to I think has a lot more to do with individual performance factors of those retailers. I think the snow is a huge part of Asda’s year-on-year comparison. And of course Netto is all a bit blurry in Asda’s data as well. If you look at the Kantar data they’ve actually gained less market share than was the size of Netto a year ago which raises some interesting questions about the conversions of those businesses.

Further Question

They sold a few stores in fairness.

Answer: Justin King

Yes. They sold about 40 of 180; so they sold away probably 0.2 of a point of market share, that’s true. So I think you have to look at individual retailers.

And, of course, whether it be us with 22 million customers in a normal week, Asda would be probably around 20 million transactions in a normal week we all are universal in the context of the UK population, you can’t be that scale and only selling to a small niche of consumers. So I don’t think it’s right to characterise it that way. Richard said on Monday customers didn’t treat themselves in Morrisons, well maybe some of them treated themselves with us.

Further question

All right, but do you think those trends, is it the Christmas island of people treating themselves, trading up to Waitrose, Sainsbury’s, M&S, or do you think there is something, I suppose to Andrew’s initial question where people are looking for more than just price?

Answer: Justin King

Well, maybe it is, and if it is, obviously our challenge is to use the powerful tools that we have flowing from Nectar to ensure that those customers, if they did give us a try for the first time in a while, or for the first time ever, that we lock them in for the rest of the year, that opportunity’s still there. Of course as I said earlier, ours was growth on growth so it’s clearly even more people treating themselves, and it’s just about the treat. But M&S had a lot of stores closed for a day or two at a time through the snow last year, I think you just have to dial out quite a lot of noise, and of course people are reporting different time periods and you’ve really got to look at a whole quarter, and fortunately Kantar came out yesterday so you can see real underlying levels of performance across the quarter.

I mean, don’t forget it’s only a year ago that several of those of you currently listening were very happy to accept the idea that those with shorter reporting periods had worse sales because they were particularly affected by the snow, so it seems to me to follow they’re likely to have had a bit of a bounce back as there was no snow this year.

Answer: Mike Coupe

John, it's Mike. I guess the million dollar question which you're kind of alluding to is if you look over the last 18 months as we're already talked about, volumes in the industry have been in decline and the question is whether that trend will continue or flatten out or even reverse, and who knows?

Further question

Well, I don't expect you to make a commitment on this call, but for 2012 let's assume we're all miserable and it does get a bit worse, the world is a different place when you all set your space ambition targets, how much will you see through that, how much do you accept the world's changed and you need to do something slightly different?

Answer: Justin King

Well, it's not a question of ignoring the world changing, it's a question of whether we can continue to invest productively, notwithstanding that change, our shareholders' money. And I think we've been very clear time and time again that we're very comfortable with the investments that we're making in Sainsbury's. We're investing in parts of the country where typically our market share is very low, we're investing in extending existing assets and making them significantly more productive as a result, and we're investing in convenience stores, which is clearly in line with the change in customer behaviour. And let's be clear, one of the reasons why we continue to outperform them is we have a convenience business which we've worked very hard over a ten year period to develop because our customers can enjoy the Sainsbury's brand, whether it be in our main supermarkets, convenience stores or online, and that's a key part of our current success.

Answer: Mike Coupe

But, John, just also to be clear, I mean we're not stuck in the mud in terms of our investment strategy, we look at it on an ongoing basis, we do detailed drilldowns by quarter into the performance of those investments that we're making, both this year, last year and two years ago to give us confidence going forward that our investment pipeline will deliver the right returns, and we flex our programme year on year accordingly. So, as Justin says, it's about finding those right investments that we know will deliver the returns for our shareholders and we look at that on a very active and constant basis.

John Kershaw

Okay, well good luck for what's going to be an interesting year ahead I suspect.

<u>Question 13</u>

Nick Coulter, Numis

Hi, good morning. Two follow ups from me. Firstly on inflation, should we take it that low single digit inflation is around about, or broadly the right number to expect for the grocery market this year? And then secondly on space, and following up on John and Dave's question, you've talked to a small reduction in your space pipeline for next year, taking the points on flexibility and the current outlook, should we expect, or perhaps suspect a multi-year trend to develop in terms of that reduction in space pipeline and allied to that point, I think I'm right in saying your pre tax returns tick back in the first half, what sort of time frame should we expect them to tick back up? And I guess that sort of ties in to the space point. Thank you.

Answer: Mike Coupe

Well, Nick, I can probably take all of those actually. In terms of inflation I think we've covered that already, but certainly low single digits I think for the coming year, 2% to 3% would be my guess, but we'll wait and see how the year unfolds. In terms of our space pipeline going forwards I think we've been pretty consistent with what we set out going forward. We said we'd do 1.4 million, 7% to 8% growth this year, absolutely on track to deliver that. We said we'd do about 1.2 million next year and each year thereafter, and again we're not changing that guidance today so we have been very clear on the future pipeline.

In terms of the comments on pre tax returns and return on capital, you're absolutely right, we did take a step back at the half. I said I expected that to improve in absolute terms by the year end, albeit year on year we may take a little step back which is what I said at the interims, and we'd expect to see the benefits of maturing new space come through in the 12, 13 numbers, so a little bit of a tick up in '12/'13. And again, very consistent with the guidance that I gave at the interims.

<u>Question 14</u>

David McCarthy, Evolution Securities

Hello again, guys. Just a couple of follow up questions. Obviously with inflation you're talking about that ticking back and we've got the impact of the VAT dropping out, so are you expecting to have for yourselves and the industry negative cash like-for-likes, at least for the first half of this year?

And then a second question. When we look at the Nielsen data they talked about it being a disloyal Christmas, and that there's a lot more shopping around going on than ever before, and we're seeing that because everyone's saying we've got more shopping visits but average basket size are fewer, less items going in the basket etc, all of which suggests shopping around. So do you think there is any change in attitude towards loyalty?

Answer: Justin King

Well, I think I said earlier, in terms of I guess if you sort of do the industry math we'd expect industry like-for-likes in cash terms still to be positive but less than the sort of one and a half I guess they probably will be when we add them all up for 2011, but still positive, but not much clearly, anything less than one is not much.

In terms of, I mean I just don't agree with Kantar's observation about a disloyal Christmas, I think it's a headline grabbing comment, customers are shopping around a lot more, that doesn't make them less loyal, it means they're looking around for the deals, but it also means that they're managing, not that customers call it this, but they're managing their cash flow, they're doing their weekly shop across a greater number of transactions. And that's why the point that I made about online and convenience is important because we provide that opportunity for those multiple touch points to our customers.

And of course with Nectar data we can clearly see when our customers are spending money with us, but spread over multiple transactions and sometimes of course in different shops. So we don't see more transactions as inherently being about less loyalty, and Mike you might want to comment?

Answer: Mike Coupe

Yes, I was going to say in the realities in the run up to Christmas our loyal customers became more loyal and our less loyal customers also became more loyal, so in the round I guess I understand the point that's being made but that's not actually reflected in the way that our business is performed.

Further question

Okay. And just going back just in to the maths behind what you said, that if industry like for likes, cash like for likes are around one and a half and we've got the impact of the VAT falling out and let's say that's kind of 0.8, and then we're going to see you've suggested inflation coming off further as well another 1% or 2%, doesn't that suggest that industry like-for-likes are going to turn cash negatives or is there something I've missed?

Answer: Justin King

Well, it's up to you to do your own maths, Dave. I mean VAT is inflation, that's what it is, as experienced by customers, and one of the reasons inflation is going to be lower in 2012 is that VAT won't be contributing to it. As I said, I don't think we'll see the volume decline that we saw in 2011, but I think we'll see some. I don't think we'll see the inflation that we saw in 2011, but I still think we'll see some. The net effect is that I still think it'll keep it a bit above the line that is nought, but you can come to your own view.

Justin King

We're going to take one last question which I think, if you're still there, is Clive.

<u>Question 15</u>

Clive Black, Shore Capital

Yes, I'm not sure how Dave got two in and I had to wait for him, but there we go…

Answer: Justin King

Yes, you've been waiting for Dave for years Clive.

Answer: Mike Coupe

We save the quality for last, Clive.

Clive Black

I guess that's my first question. The last time you spoke about football, Mike, you said England would get to the semi finals of the World Cup, I'm just wondering if you thought they'd do the same this summer?

Answer: Mike Coupe

No, I didn't! I think you're misquoting me, I said we budget for the quarter finals. They're the fifth best team in Europe and almost always they've performed in line with the statistical chances given by, I think it's Think Tank that actually do it in *The Times* and they're the best indicator I've found of England's football performance.

Clive Black

Oh well, your stores in the west of Ulster might do better then. Second question if I may. First of all, trading up versus trading down, could you just give us a feel of how you see mix, because there is somewhat mixed indications there?

And then very quickly, John mentioned 1.2 million square feet going forward of space, are you not thinking about reappraising what you need for non-food, bearing in mind what you've said about the multi-channel nature of your business, how many people are looking online and then Click & Collecting and all the rest?

Answer: Justin King

Well, as far as the first question's concerned, I mean we commented that Taste the Difference is up 10%, basics up high single digit, but both of those only make up between them about 10% of our total sales, so we aren't looking at shifts overall that are massive that would lead you to conclude there's some kind of trading up, trading down thing going on, it's savvy shopping, it's the same shoppers sometimes buying basics, sometimes buying by Sainsbury's, sometimes buying Taste the Difference and of course also buying brands. We've had a particularly strong Christmas on own label in general, all three of our major own label brands growing faster than the business. By definition therefore you'll know what that means for brands, but Christmas is very focused on fresh foods and brands have lower levels of penetration in fresh foods and we've had a successful Christmas, so to some extent it's driven by the maths of the mix of our business.

So no, I don't think we see any fundamental change from the behaviour that we've been commenting on for a couple of three years. As far as the space is concerned, John?

Answer: John Rogers

Well, we're always looking at our overall investment programme, so we're always looking at the mix between extensions, new stores and Convenience. I think the thing that we take a lot of comfort from is the extensions that we've put down in the last couple of years and indeed, in this year have performed well and certainly exceeded our expectation, which gives us confidence going forwards that the types of extensions that we're doing are delivering strong performance. And again we saw that in the Christmas period, particularly over the Christmas week and a few weeks before that, our larger stores performing very well.

Answer: Justin King

But I think to the wider point… Sorry, Clive, just let me add, remember our centre of gravity of non-food is the footprint of 20,000 to 30,000 square feet, our very biggest stores, the small handful of 100,000 square foot stores, we then have a 50,000 square foot footprint. But even that is smaller than that that, for example, ASDA and Tesco would do in a similarly sized store. So the central thrust of your question is are you laying down a lot of space in non-food that in a few years time is going to look redundant if the whole thing shifts online? No, we don't believe that, that's one of the reasons we've taken the view to centre non-food around 20,000 to 30,000 square feet, because we believe the substantive element of non-food in grocery will remain in shops because the substantive element is bought as a relatively impulsive purchase grafted onto the weekly grocery shop. And that's why 20,000 to 30,000 is our centre of gravity.

Answer: Mike Coupe

And if you look at one of the key components of our non-food offer which of course is clothing, and given the relative price points of the supermarket clothing offer compared to the market we feel that that's absolutely something that's very sustainable in a bricks and mortar format, and indeed at our pricing points would be quite challenging and difficult to do through the online medium. So again I think that supports the rollout that we have in place.

Concluding comments – Justin King

Okay, well as we said, Clive was last up, so thanks for coming on, we'll be speaking to you in, I think it's only about ten weeks now because this is a slightly shorter quarter, just before Easter. Speak to you then. Cheers.

End