J Sainsbury plc

Interim Results

Wednesday 13th November 2013

Justin King, Chief Executive

David Tyler, Chairman

Good morning, Justin, I'm glad to see you're here. Anyway, as everybody knows this is our presentation for our Interim Results at Sainsbury's for the 28 weeks to 28th September, and this, as you can see from your press release, has been another successful six months for our business during a period in which consumer demand has remained under significant pressure. Sales here are up and so are market share profits, return on capital employed and indeed our dividend. And in fact during this period Sainsbury's is the only one of the four big players in the market which has grown its market share, and I believe there are very good reasons for that. One is the way that we look after our colleagues here, and indeed uniquely among food retailers 'Investors in People' have just given us their Gold accreditation, and that's the second time they've done this.

I believe that our colleagues are motivated by our values and our culture, and this I am sure means they provide excellent customer service, and our customers appreciate that quality of service and the values that we stand for. And our performance has also just been recognised by other company leaders throughout the FTSE 100. Last night we were delighted to be given the FTSE 100 'Business of the Year Award' at the National Business Awards, and that's a great tribute I feel to the outstanding commitment demonstrated every day by all our 157,000 colleagues all over the business, and I say this morning thank you very much to all of them.

So this has been a good half year for us, all the profit figures are moving in the right direction, with management again achieving an increase in our underlying return on capital employed. We've also made good progress in our strategic agenda, we continue to invest heavily in our convenience offer, in our online operation and in our non-foods' business, and we are well advanced too in the transition period for Sainsbury's Bank, that goes into 100% ownership now within three months, and we look forward to that. So with that I will now pass over to John to take you through the financial. John.

John Rogers, Chief Financial Officer

Thank you, David. Morning everyone. So straight into the financial highlights for the first half. We've got sales up 4.4% to just £13.95bn, delivering an operating profit of £440m, up 6.5%. Net finance costs in-line with the same period last year of £58m, and a share of profits from joint ventures just down a little tick on last year at £18m – and I'll talk about that in a bit more detail later on – delivering a profit before tax of £400m, up 7%, and with the tax rate at 21.5% that delivers a basic earnings per share up to 16.6p, up 9.2%. Of course that's in part driven by the lower Corporation Tax rate, although for balance it's fair to say that we are seeing an increasing tax burden above the line, particularly for example in things like Business Rates where we're seeing annualised inflation of about 5% or so. An interim

dividend of 5p, and again that's the mechanical calculation of 30% of last year's full dividend. Items outside of underlying of £33m – and as usual I'll come onto talk about that in detail later – delivering a profit before tax of £433m, up 9.1%.

So moving on now to sales, and these of course numbers we presented in our Q2 trading statement. Like-for-like sales growth in the half of 1.4%. Sales from net new space of 2.6% delivering overall sales growth of 4%, and that represents an outperformance to the market. Contribution from extensions of 0.3% in the half, and therefore like-for-like stripping out extensions of 1.1% versus the 0.9% that we delivered for the same period last year, so again represents some good growth coming through in the underlying estate.

Guidance for the full year remains the same. We guided at the prelims to a like-for-like of between 1% and 1.5%, and we maintain that guidance for the full year. But of course given the relatively tougher comparables in the second half, particularly in Q4, we are guiding that the like-for-like in the second half will be slightly lower than that that we saw in the first, albeit we'll still see the overall guidance of 1% to 1.5% for the full year. And again the contribution from net new space similar to last year, '12/'13.

Moving now from sales onto profit. Underlying EBITDAR of £996m, up 7%, and that represents an accretion in our EBITDAR margin of 19 bps up to 7.85. Underlying operating profit of £440m, again up 6.5%, and that represents an accretion of 7 bps year-on-year. If you remember, we guided at the prelims to a flat margin expectation for the full year. We're changing that guidance today on the back of the strong results that we've seen in the first half, so we're expecting for the full year to see mid-single digit basis point growth in our operating margin.

So how have we delivered that operating margin? Well of course it's often about cost management, and we've seen cost inflation of around 2.5%, perhaps a little bit below that, 2.4% also in the first half, and we've delivered savings of £55m against that inflationary increase. Again those savings always come from a very broad range of areas, so logistics, our new depot picking system has delivered savings, our consolidation down to one depot in Bedford for clothing has also delivered savings, we've had various waste initiatives in our supermarkets' business, and our convenience business delivered savings as well as our energy saving programme. So it all comes from a multitude of areas that's delivered that £55m of savings in the first half. And we maintain that guidance, so the cost inflation similar to the first half for the full year, and efficiency savings of around £100m. There's a possibility that it may exceed that slightly so there may be some upside for that efficiency savings' number.

Moving on now to our joint ventures. Bank delivered £12m of profit in the first half after tax – that's our share of it – that's bang in line with what we delivered for the same time last year. Property joint ventures shows a similar pattern, so £8m of profit, again in-line with last year. And we're reporting this time round on two additional joint ventures: I^2C, which is a joint venture with Aimia; and *Mobile by Sainsbury's*, which is a joint venture with Vodafone. Both of those are incurring start-up costs at the moment and therefore we're recognising a £2m loss in the first half. Bank acquisition remains absolutely on-track, so all the guidance that we gave to you at the prelims still holds true.

In terms of guidance for the full year, again we said that we expected to see a similar level of profit in the Bank for the full year as we'd seen last year, that guidance still holds true. Of course given the completion date anticipated for the end of January in terms of your models – although it probably won't make much difference – we expect you to treat that as a joint venture for 46 weeks of the year, and then for the remainder of the year obviously on a fully

consolidated basis. And in terms of property joint ventures, we expect a similar level of profit in half two.

Coming now onto our finance costs. Net interest of £58m in the first half, again in-line with last year, delivering a net interest cover of 7.9x and a fixed charge cover of 3x. Capitalised interest at £15m, which is lower than for the same period last year of £20m, principally driven by the slight slowdown in capex that we saw in the first half, and also a lower capitalised interest rate. Full year guidance remains the same, finance costs remain broadly flat with the prior year, and last year was £111m so that gives you the detail.

Coming on now to pensions. IAS 19 Revised, obviously a new accounting standard for pensions. I'm not intending to go into that in any detail today you'll be glad to hear, but there is guidance in the back of the pack in terms of a couple of slides showing how those statements impact on the numbers. The Defined Benefit scheme, we talked last time about the consultation with our colleagues in relation to closure of that scheme to future accrual. We basically closed the scheme to new members in 2002, and actually as a consequence of auto-enrolment we now have 80,000 plus colleagues in what is effectively a defined contribution scheme. So we've taken the decision to close that scheme to future accrual, transfer those members into the DC scheme; so we've levelled the playing field, we've provided a consistent pension benefit to all of our colleagues.

The consequences of that are of course that we de-risk the balance sheet going forward, and we do see a one-off past service credit net of some compensation payments of £158m, and we recognise that outside of underlying of course. Now that's important to highlight as an accounting entry, it's not a cash item.

The Triennial Valuation, if you remember last time we deferred updating you on the Triennial Valuation as a consequence of the consultation on the Defined Benefit scheme. We've now concluded those discussions. The actuarial valuation is actually significantly reduced from the £1.2bn we saw last time, to £592m. Largely the consequence of course of the property partnership that we put in place, but also there's a benefit within those numbers as a consequence of the closure of the scheme to future accrual, and we're going to maintain our cash contributions into the scheme. So we agreed back in 2009 to inject £49m a year into the scheme to make up the deficit over time, and those cash contributions will remain the same going forward.

The full year guidance, obviously there'll be no further defined benefit service cost in the P&L going forwards, that will be replaced in effect by Defined Contribution payments, and there are some further transitional payments that we'd expect to see in the second half of around £11m that we'll take outside of underlying, and indeed in '14/'15 we'd expect to see a further £17m of transitional cost come through as well, again we'll take that outside of underlying.

Coming on now to growing space and creating property value. Again the value of our portfolio has increased to £11.8bn from the £11.5bn that we last updated you on, mainly as a result of an improvement in the yields of course. That represents a circa 50% premium to book value. Given the current planning regime and the move away from a town centre first policy as a consequence of a change in the use of a Needs Test, we've done an extensive review of our property pipeline. We've identified about 15-20 sites that we consider to be no longer economically viable, so we've taken an impairment on those sites in the first half of £92m. That is a one-off exercise, we don't anticipate making any more impairments going forward. We've also realised about £100m through sale and lease backs in the first half giving property profits of £18m. A little bit lower than we saw for the same period last year, but again principally driven by within those £18m we made the sale of an edge of town site where we crystallised a loss.

Coming on now to the items excluded from underlying. I've already talked through the property disposals, you see the various other adjustments, and then at the bottom there you'll see the impact of IAS 19 Revised and in terms of the pensions financing charge, and also stripping the pension scheme expenses outside of underlying. And here we'll go on to talk about one-off items, of £36m which I'll break down, in more detail on the next slide, but overall delivering profits outside of underlying of £33m.

Coming on now to those one-off items. I've talked about the pension already, talked about the impairments already. Bank transition costs of £17m in the first half, and other costs of £30m. Now I've already had a couple of conversations with you already, there's been speculation as to what's in that 'other'. I can guarantee you it's nothing to do with our challenge on the ASA ruling. It is to do with another commercial issue where we feel as though we've got a very robust defence, but we think it's sensible to provide for it nonetheless. Unfortunately I can't go into too much detail for commercial reasons.

So the full year guidance, pension transition compensation payments of £11m, which I've already stated, and further transitioning costs on the Bank in the second half of £25m. So if you add that £25m to the £17m that we've seen in the first half, that's £42m. If you remember, we guided at the prelims to transitional payments in this year of £50m, so we're coming in a little bit lower than that that we guided to.

Moving on now to the margins, we've seen good growth as already mentioned on the EBITDAR margin, the operating margin, return on capital employed including the pension deficit has improved by about 60 bps or so, of course it's right to strip out that improvement which is principally driven by an increase in the pension scheme deficit, but even stripping out that pension deficit movement we've seen an accretion in ROCE of about 20 bps or so, 19 bps.

Growing space, six new supermarkets in the first half, two extensions, 30 refurbs, most of which were convenience refurbs, and 50 new convenience stores delivering overall net new space of 389,000 square feet, bang in line with where we expected to be, and again we can just confirm the guidance for the full year of a million square feet of gross new space and we expect to open around two convenience stores per week. So no change to our space guidance there.

Capex, core capex of £449m, offset by the disposals and sale of leasebacks of £122m, delivering net capex of £332m, a little bit down year-on-year due to the phasing of the schemes and also there's a higher percentage of leasehold schemes in the first half than there would have been last year, and again of course they require less capital. However we expect to catch that up in the second half, we've opened lots of new space, particularly in the last few weeks or so, all of which is performing well I should add. So our full year core capex of around £1.1bn, we maintain that guidance for the full year, of course that excludes the investment that we're going to be making in Sainsbury's Bank to buy the remaining 50%. And we expect the capex to sales ratio to be similar this year to last year, reducing of course to less than 3.5% over the medium term.

Coming on to cash flows, we've seen an increase in cash from operations of 9.1% up to £695m, you'll see various other adjustments take place there which gives us a net debt position of just below £2.2bn, very similar to where we were last year, so I think a good performance in relation to managing the balance sheet and the net debt position.

Coming on to the balance sheet, we talked about the property value already, the net debt £2.2bn, we've got overall facilities of £3.6bn supporting that and talking about the pension scheme deficit of course that's increased to £658m despite the benefit that we get through

with the closure of the scheme for future accrual, largely as a result of a reduction by 0.1 in the real discount rates.

Guidance for the full year on net debt, we're changing the guidance here. At the prelims we argued the net debt would be £2.4bn, excluding the investment in the Bank, £2.6bn including the investment in the Bank, we're now notching that guidance down a little bit to £2.3bn, excluding the Bank and £2.5bn including the Bank, and of course we've already talked about the consolidation of the Bank at the year end.

So coming to the balance sheet metrics, again consistency year-on-year, particularly with adjusted net debt to EBITDAR which of course is a key balance sheet measure, it hasn't changed over the last year or so, a balance sheet gearing, again consistent fixed charge consistent. You'll see the core capex as a percent of sales, lower in the first half but as I said we'll catch that up in the second half so we would expect to see a similar number, the 4.3 for the full year that we saw last year.

So as a summary, continued outperformance in the market, 35 quarters of like-for-like growth, we delivered operating margin accretion against what has been a very tough industry backdrop, so we're very pleased with the overall performance of the business; key metrics going forward as David mentioned, ROCE operating margin underlying profit before tax. And again the balance sheet, the balance sheet the key metrics remain stable and of course we've de-risked the balance sheet going forwards as a consequence of closing the pension scheme to future accrual, and again all of the balance sheet of course is underpinned by the property value that's increased to £11.8bn.

So that covers the financial review, I'll hand over now to Justin to cover the operational review.

Justin King, Chief Executive

Thanks John, morning all. Well as you've already heard from John a strong performance in our first half and so I'm not going to repeat most of the key messages that John's delivered on sales and profit, but I am going to talk to some of the customer story behind that but also the business story. In particular I want to reinforce the messages around values, we think it's pivotal to our competitive point of difference and has been actually a raised level of conversation and debate in recent months.

I want to talk about the competitive advantage we derive through Nectar coupon at till, allowing us to deliver customers value for money in a way that they want it, it allows us to drive sales in a competitive market in an affordable way, and of course the various other parts of our business development, be it our own brand, the development of general merchandise, or our channel strategy through convenience and online, all of which are contributing to our market outperformance.

So 4%, 1.4% like-for-like as you've already heard from John, and clearly market leading performance consistently over a long period of time, a good notch ahead of our grocery competitors and the purple line being the market a good notch ahead of the market, the only one of the major grocers in fact to be growing our market share. But of course there's an obvious point in this slide, the market growth actually is greater than that of three of the four big players, so there must be something else going on, and you don't need me to tell you the something else that's going on is the right hand side of this chart, albeit that Aldi, Lidl and Waitrose are smaller in terms of their absolute market share, they're where market share is being accreted fastest at the moment.

And that's, in my experience in the 30 years that I've been in this industry, that's a unique slide, so we're very proud of the fact that we're the only one of the major grocers growing market share in that context, but we can see quite clearly the opportunity that's presented by the market share growth that's being achieved over on the right hand side of the chart. And that's a key part of course of the competitive dynamic that all of the major grocers over on the left hand side of the chart are dealing with and we would argue demonstrates the robustness and strength of our competitive offer that with that challenge we're still growing market share.

In terms of the consumer backdrop, I heard somebody a week or two ago describe it as a feel bad recovery and I suppose the left hand side of this chart in a way is the articulation of that. There is no doubt that the backdrop in terms of commentary largely in the media is a positive backdrop, or at least it is more positive than it's been, that's great news from a consumer point of view, I'm not going to knock that at all. If the headlines change and are more positive they create a greater sense of the possibility of something positive happening in the future, that's good for the outlook of our customers; but we have to remember that they are still net negative. If you were to string that chart back 20 years we would still be talking about an outlook that is pretty pessimistic by historical standards, and the practicalities of this downturn is that consumers have less money in their pocket, household incomes have grown slower than inflation, that remains the case today even with the 2.2% inflation announced yesterday, that's still a notch ahead of average pay rises at the moment. And pretty much every forecast, even the more optimistic ones has that situation persisting for two or three years into the future. Indeed the central tenet of our business plan is to assume that this situation persists, so that average household incomes are flat to declining for the next two or three years.

It would be remiss not to talk about performance in the last six months without touching on the issue of trust, of course we touched on this at our prelim announcement, the big shock to trust that was horsemeat happened in the early part of this calendar year, not within the financial year that we're now reporting, but I think two key points to take from this slide. We have a leadership position, we maintain that leadership position through the downturn and we're making good progress at recovering the position that we once enjoyed. But I think the second point is also self-evident, when trust is damaged in the industry it's damaged for us all.

I know one or two people questioned whether given that Sainsbury's didn't actually have any products affected by the horsemeat scandal why we – why I – put my head above the trench talking about the issue. Well, that's why, because that kind of issue that challenges customers about the whole of the supply chain rubs off on us all. I would argue that we've done as good a job as any, if not a better job than any in recapturing the trust of our customers in the post-horsemeat period; and at least in part that flows from being open and honest about what we're doing about it. So it's no good just standing up and saying we're already the best, we were, no one was doing more DNA testing than us, nobody had been doing it longer than us and also following it up by saying that that doesn't mean that we can do more, and we are of course doing more.

We have seen in the last six months though a very public debate over whether sourcing and the integrity of sourcing is part of the competitive mix. We of course, you'd expect me to say this, believe that it is. Our values are part of our long term strategic point of difference, they are incredibly difficult to replicate and it's right therefore that we fight to defend them when we see them challenged or in the case of the particular issue that we're fighting with the ASA, ignored. We think it is wrong that the current adverting environment in the UK allows provenance, quality, country of origin, to be ignored in price comparisons, because that's what the ASA's position currently is. It kind of doesn't matter what we think, 84% of

customers think it's wrong. And given that Pedigree pet food managed to do an advertising campaign for at least 20 years on the basis of eight out of ten cats preferring we think eight out of ten customers saying that this is important is a pretty good basis for taking the argument to the courts.

Underpinning all of this of course is real stuff that we're doing. I'm sometimes not sure that people understand quite how far and in quite how detailed a way we reach back into our supply chain in the long term to give us real points of difference. In recent months you've had the opportunity to see that, and if you haven't seen it I'd encourage you to see Supermarket Secrets, you'll see the story of our new Norfolk Black chicken, you'll see the story of our new strawberry, you'll see the story of our new apple orchards; all examples of where our suppliers are investing but only with our commitment and support could they make that investment in creating a real point of difference. For the fifth year running we've sold more British apples and pears than any of our grocery competitors and that's more cash, not relative, more cash. Years and years of work went into that, and it represents years and years of competitive advantage as a result.

We will announce next week our annual update on our 20x20 commitments, they're really starting to get traction as you would expect now two years into the nine year timetable that we laid out, major achievements under each of our major headings in recent months. As you know we led the charge on front of pack nutritional labelling some seven years ago, and we are now leading the charge on the new standard on the front of our packaging. I would encourage you to go and visit grocery stores and see quite how slow some of our competitors are to start doing this. We think that's against customers, it's certainly against our customers because they tell us that they really value multiple traffic light front of pack labelling.

Lots of notable leadership positions, I've mentioned here marine stewardship and RSPCA Freedom Foods, both of those organisations publicly supporting our challenge through judicial review because of course it challenges their reason for existence if you can assert that a fish that isn't MSC is the same as a fish that is, then clearly for these organisations that's a very big concern.

Great stuff on environment, and you'll see some fantastic announcements on that next week in our 20x20 and I want to touch on Active Kids because it's really picked on again in the post Paralympic world, it has been the vehicle that's allowed us more than any to talk about legacy. It perhaps won't surprise you to know that the level of vouchers collected and redeemed this year were a new record, I think parents and teachers throughout the country sparked on by the Paralympics and Olympics last year. And of course we've just closed out on our support for the Royal British Legion, around 10% of all the money raised by the RBL is raised by Sainsbury's customers and colleagues in our stores, it's something our colleagues are passionate about. We'll celebrate our 20th year with them next year as the Royal British Legion celebrates a hundred years of raising money in remembrance of the start of the First World War.

And David's already mentioned Investors in People, there's a stat for this which I kind of almost can't believe, the Investors in People measure 177 different measures and I'm not quite sure how you come up with 177 different ways of measuring these things, but we passed 174 of the 177 measures, which to use their words is unprecedented in their reviewing of large companies. So something that we're very proud of.

Moving on then to our offer, Living Well For Less is what our customers are trying to do and that's what we are helping them do. Brand Match continues to fly, half a billion coupons, it remains the case that over 50% of our coupons demonstrate to our customers week in,

week out our pricing is competitive. And indeed as you'll already have heard myself and Mike on various media outlets today saying our pricing position today is stronger than it has ever been, very sharp and Brand Match proves that.

Again under the heading, and I mentioned earlier in terms of supply chains, how much have people really understood how far down we reach, well I think Nectar is another example. We're always a bit circumspect about talking about Nectar because we do think it's part of our competitive advantage and we don't think we should overly lay bare how we're able to use the data to really help our customers with the challenge of a tight and constrained budget. But I think there are two or three things that it's important that I land. Firstly how personalised it is, we talk to customers on a one by one basis, other discount cards segment and pool perhaps 20 or 30 or 35 customer groups, we come at it completely the opposite way, every customer is an individual and if they exhibit a particular individual behaviour we are able to reward and incentivise them. So it's a full data pull.

We use it for ranging. It was initially quite a blunt tool for ranging, it's really quite a precise tool now, it's really helping us make use of our space because ranging is a double sided coin. It isn't just about getting the range right for the customer but it's also about freeing up space by not ranging stuff you don't need which allows you to get different and more customer facing range in. So real progress there and that lesson learnt best within our convenience estate. If you can get it right in a 2,500 sq. ft. store the impact of making those kind of changes in a 25,000 sq. ft. store can be really quite material.

We also use it to cross-sell, directly related to Nectar data is our ability to offer fantastic value for money on banking products, for example, and indeed that will be core to our premise in taking over 100% ownership of the Bank. And where cross channel shopping doesn't exist between our convenience business, our online business and our supermarket business we understand the power of that cross shopping, we understand how 2 + 2 can equal a number more than 4 and as a result provide incentives. I know people are sometimes surprised to see that you might get an online voucher when you're shopping in one of our grocery stores, but we do that because we understand the impact on the total relationship of our customer and we understand that of course because of the Nectar data.

Now John's talked about cost savings and the first question that usually follows up on cost savings is, is the customer paying a price for the cost savings you're achieving? In Sainsbury's I think we can assert very clear that that's not the case. By our own measures we're achieving the highest level of in store standards that we ever have. That was reflected, for example, in the highest ever bonus pay out that we made back in May as a result of our achievement last year and we continue to kick on. But importantly every external measure reinforces that fact.

I've mentioned the Advantage Report. I think most of you will know this, it's a survey of suppliers done confidentially of their view of grocery retailers. That report tells us that we, better than any of our competitors, executes agreed activity. So things like promotions, new product listings, nobody executes better than we do.

Of course you've seen the story of Grocer 33, that goes on, 15 wins out of the last 28, an unprecedented run, and any number of awards, of course cumulating last night in the FTSE 100 'Business of the Year' which David has talked about. So we measure it of ourselves but others, I think, observe it of us too.

So moving on to our strategy and much of it of course I've already really touched on in talking about trading but let's just check in on each of our five areas of focus. Firstly are we continuing to lead on food? Absolutely. It's a constant process of reinvest, relaunch and

develop because that's what our competitors are doing too. Keeping leadership on this metric is vital and important to our business. And you can see all time high figure and of course it would need to be an all-time high figure because others are undoubtedly making progress too, we need to preserve that gap. How are we doing that? A particular focus in own brand. In recent times, in the six months we're reporting today very much about *by Sainsbury's* and then also the *Taste the Difference* range which tends to be how we lead in our run in to Christmas. *Taste the Difference* growing double digit at the moment.

Again coming back to this idea that perhaps the characterisation of this market is some kind of race to the bottom where only price is important, nothing could be further from the truth. And *Taste the Difference* leading the charge, a £1bn brand for us now.

And big investments in sourcing. I've touched on most of these earlier but one I will draw out is our desserts factory. Again a supplier making an investment on our behalf but with a commitment from us to source. Two really big important messages flow from that. The first is that all British raw materials, particularly milk, most of the desserts sold in the UK today are made abroad and are made with foreign milk as the input. You may have heard Owen Paterson, for example, talking about how much more British sourcing could happen if we sourced and made everything ourselves. This is a great example of that.

Secondly by providing the commitment and supporting the capital investment technology that is unmatched by any other supplier we think in Europe. So the quality of the desserts, the quality of finishing, the value for money that we're able to deliver, a real notch up and on from what we've done before and from what our competitors are able to do. So real competitive advantage which is difficult at least in the short term to match.

General merchandise. Well Tu is now the number seven brand by volume in the UK. That doesn't mean that we're resting on our laurels, it's been relaunched in the last quarter to give it a kick on and we expect to take a record position in market terms in our Back to School event which of course we are now a mainstream Back to School retailer.

But some of the bigger successes now starting to be seen within general merchandise, particularly in areas like homeware and cookware, rebranding everything *by Sainsbury's* historically our non-food business has used the Tu brand but in homewares now *by Sainsbury's* and particularly allowing us to play off trends in home cooking, home baking and of course providing our customers with the solutions as they start to change the way they cook and prepare food at home has been something that we can credibly do because of our food credentials.

Just a little thing I think I'm right in saying, Mike, are we now the number one retailer of Kilner in the UK? I think we are. We're there or thereabouts, if not. I'm sure someone's told me that but I haven't verified so just for the avoidance of doubt. But the scale of the business that we have grown with Kilner from almost nothing in a two or three time period shows quite how our customers are engaging with the idea of back to basics if you like in their food, something we've called New Fashioned Values, doing the things that our parents did but perhaps in a slightly more modern way.

Our convenience business growing strongly, 50 stores so we're absolutely at the top end of that one to two stores a week range. John talked about productivity improvements, Thameside Depot, our old Charlton Depot, now relaunched as a dedicated convenience depot, over 100 stores. The advantage of the scale of our business means that having invested in the facility we were immediately operating at productive levels of capacity by being able to put 100 stores in there straightaway. And I chose the word, evolving, in terms of our formats deliberately. We've got 15 years of experience now. John mentioned the fact

we'd refurbished 22 convenience stores in the first half, that's because we've got a lot of convenience stores that are ten, 12, 14 years old so we have to invest in them. But we're learning all the time about how we can take our offer forward. This is a picture of Cobham, some of you I've no doubt will live in leafy Surrey, pay a visit, it's the next evolution of one of our Fresh formats for convenience stores.

Online 15% in the half. You'll have seen our announcement of a fulfilment centre reflecting our expectation that within about 18 months we'll reach capacity in a number of our stores that we pick from at the moment in London. So that's a 2015 sort of opening. And big changes going on in the background, sometimes visible to customers, sometimes visible to you as we roll out our new improved website. The challenge of these things is always that however much we as observers might say the old website is past its sell by date actually customers are familiar with it and love it. So although the new website we're confident is better it is a big change for our customers. And just recently, and we are playing catch up of that there's no doubt, we've launched our annual delivery pass, it's become really much the sector norm for how a delivery is now paid for by customers.

Not a tremendous amount to update on the Bank because the hard work is really in the background at the moment working towards the transition plan, the full conversion to wholly owned as you heard from John week 46 is when we start to consolidate. But I think it's worth reinforcing why we're so confident that once we wholly own it we can really start to grow the business strongly. Firstly three quarters of our customers don't know we've got a Bank. We have an opportunity to do something about that. And secondly our position of trust is already delivered by the Bank. Look at the complaints data there. That's because even within the joint venture environment we have ensured that the customer service approach in Sainsbury's Bank reflects the Sainsbury's brand, the expectations that customer have of a bank with Sainsbury's name over the door. Obvious pointers to the opportunity that lies there.

And that will give us further opportunities to drive this chart. I've showed you it before, none of the numbers have changed but clearly with things like the Bank and new businesses that we're launching like *Mobile* and our pharmacy business the ability to deepen and broaden our relationship with customers to the benefit of our core relationship with customers, which is what this chart really demonstrates, grows still further. So very confident that this, as I said earlier 2 + 2 although we've shown it in here as 1 + 1, opportunity is there for us in the future.

Small beginnings, our pharmacy, *Mobile*, some of what we're doing on digital, small businesses all in investment phase, a couple of those of course are joint ventures and John pointed in his run through the P&L to the investment phase, investment of course is code for losing money at this stage; but they're all great potential for the future and working hard to grow those to scale and profitable businesses quickly.

And John summarised a lot of what's going on in the space he's taking you through the impairment we've taken on some of our property pipeline, but we're still confident that we're able to invest in an accretive way. Supermarkets will continue to be focused largely in parts of the country where we're not. But I think and I've put the chart underneath there really to make a point and hopefully answer the question that then won't need asking, although I suspect it will be anyway, about the so-called death of the hypermarkets. I've said many times before we have never subscribed to the view of giant stores, 100,000 sq. ft. plus dominated by non-food.

There are a small number of exceptional locations where we trade over 80,000 sq. ft. but even in those locations food is the dominant proposition in the store. And our centre of

gravity remains 20 – 50,000 sq. ft. where food is 80 – 90% of the proposition in store. Of course that tells you the opportunity that exists here through extensions, still only around one third of our customers within 15 minutes of our non-food offer, growing strongly even so but will grow stronger still when we're able to present it through extensions to more customers.

And convenience stores, as I've already mentioned, rattling on now pretty much two a week, every week. You've heard an announcement I think as you were walking into the room this morning, it was a rare announcement because it had a supermarket in it in Penzance, it had an extension in it in Cameron Toll and it didn't have a convenience store which is a pretty rare occurrence these days when we announced in the building our store development.

So that's me largely done, reinforcing the messages from John of strong sales and profit performance against what I know you know to be a challenging market. We can't say enough times to you and to our customers that we believe our values make us different; but I hope I've added today a little bit more flavour on how deep that advantage is, whether it be in the way that we trade, using the tools available to us, supported by Nectar, or the long term commitments that we have made to invest in our channel development of convenience and online, or the long term commitments and investments we make within our supply chain to give us real points of competitive advantage and they all come together in the performance we've been able to deliver for the last six months.

So it's traditional at this time of year to show you the Christmas ad, we're the last to break, we always are because we never break our ad before Remembrance Day and it's something a bit different this year. There will be the usual range of products and price promotions, a refocus on our values making us different in Christmas, but the particular different thing we're doing is we've created a film with the director Kevin MacDonald. This is a year in the planning because last year we said to our customers, "Send us your little films of what makes Christmas special for you," that's been made into a 45 minute film which we'll premiere in a couple of weeks' time, but three and a half minutes of golden moments from that film have been brought together in our Christmas launch ad. It's our customers telling us about what makes Christmas special for them. It's three and a half minutes long, it breaks in Coronation Street tonight, so the whole of the central ad. I know you're all avid Coronation Street watchers so make sure you're watching tonight, but you do of course get the advance preview.

<u>Question and Answer session</u>

<u>Question 1</u>

Niamh McSherry – Deutsche Bank

You mentioned that sales of the Basics range had declined marginally. Maybe you could help us interpret this? Should we think that your customers are trading up? Or are they buying basics somewhere else?

The second question is about the online fulfilment centre. Maybe if you could tell us how large it's going to be and how much it costs? I'm just wondering, given that you're growing at 15%, 20%, is 10% additional capacity enough?

And the third question is around the EBITDAR margin improvement of 18 basis points. Again, can you help us understand why it has improved? Is it pricing, promotions, cost saving or format mix for example?

Answer: Mike Coupe, Group Commercial Director

Of course our own label share of our business has grown overall and our own label share of the market has grown overall. So, I think the first point to make is the fact that we've done a fantastic job, particularly in *Taste the Difference*, which has grown by almost a third over the last couple of years and of course the relaunch of *by Sainsbury's*. And the nature of our own label development programme is that we invest in these products and we relaunch them cyclically. So, we're in the process of doing that on Basics. And actually the evidence would seem to support that customers broadly speaking are trading up into *by Sainsbury's*. We are doing a lot of work on the range on Basics and you'll see that coming into the shops, in fact you will already see it coming into the shops and you'll see that into the future. I've got some examples upstairs if you're interested in having a look but as you can imagine they look fantastic.

Answer: Justin King

Probably not much I can be helpful about in terms of the online fulfilment centre. We've taken the opportunity to acquire a site because we foresaw that a couple of years hence we would have a capacity issue which it could serve and the site was there to be acquired now. We haven't even taken decisions of what technology we'll put in it precisely yet that's all to come.

But to the point about capacity, the very fact that we're acquiring this now in anticipation of the challenge I think demonstrates how much more capacity we believe we can drive out of the existing network of in store picking that we have. Even, as you make the point, the capacity increase that it gives us, although it's more significant if you put it in the context of the part of the London that it will serve, is still relatively small in the context of our total pick operation. And that's because we remain committed to in-store pick as our preferred model where we have the store estate with the capacity to do it. And we've continued to drive productivity there to the point that we still believe that particularly, if you take the view on return on capital, that the best use of our capital is to leverage that that is already invested in stores that can take an online pick operation productively.

Further question

Can you give us any idea of what additional capacity you have from the store pick model?

Answer: Justin King

Well, you've said how fast we're growing, and I've told you we're not opening it for two years so it's just the back solving of that mass. We're very comfortable that the next couple of years, with the new stores that we're opening – because of course many of the new stores, we opened Tottenham a couple of weeks ago and that's given us an online pick operation in a part of London that at the moment we're stretched in terms of capacity – so new stores also give us the opportunity to increase the capacity.

Answer: John Rogers

And in terms of the question on EBITDAR margin it is all of the above really. We've always said that the biggest driver of margin accretion is like-for-like outperformance of the market. So those like-for-like sales accrete through to the margin. Of course a big contributor to that outperformance is convenience, and that tends to be a slightly higher margin business. We talked about the underlying performance, like-for-like stripping out extensions being 1.1 versus 0.9. Again, that is good quality sales coming through pushing the margin forward.

We said inflation was a little bit lower than we anticipated, so a nudge below the 2.5%. Cost savings a little bit ahead of where we thought they might be. And also for the full year we're pretty confident on £100m; could be a little more than £100m. So, the impact of all of those things dropping through the bottom line explains the accretion in margin that we've seen.

Question 2

Alistair Johnson – Citigroup

Three questions please. First of all just a technical one on depreciation. It was up 6.5 in the first half is that going to be the run rate through the full year?

On the store space growth in the industry, can you give us some colour on what the geography of space growth is? Is there pretty equal space growth in London versus say the north of England? Because obviously that has impacts on your store estate.

And third question just on the gross margin environment for the industry and maybe for yourself if you want to disclose it. Ex-fuel is gross margin creeping up still in the industry across the first half of the year?

Answer: John Rogers

Guidance for the full year on depreciation: expect a figure of around 540m, perhaps just a little bit below that. I think I said that at the prelims, so we maintain that guidance for the full year.

Answer: Justin King

Space growth: I think it's an interesting way of asking the question in terms of geography as far as the industry is concerned because clearly one of the inputs to the second slide that I showed that shows that market share accretion is strongest amongst the smaller retailers, Waitrose, Aldi and Lidl, is that I think if you're to answer that question from a market point of view you have to add the space in that those organisations are adding.

And I think if you do, notwithstanding the fact that we have yet to see a step down in space growth from Morrison's, and I'd argue in large part yet to see it from Tesco, I think you'd say across the various channels there isn't a particular geographic bias; if you take it channel by channel there is. Clearly supermarkets broadly speaking are not being opened inside the M25 ring, but it's where the lion's share of convenience stores are being opened. Actually there aren't a tremendous number of supermarkets being opened in the northern strip of England in terms of Manchester across to Leeds. Indeed we announced one of the stores that contributed to that impairment only last week in Bingley that we wouldn't open. But what you are seeing in that strip of land is quite a lot of discount space being opened.

I think if you take it across the mix of all the channels actually I don't think there is a significant geographic bias. If you look at it channel by channel you can see some quite significant differences.

For us the spread is – in the end you have to look at it one store at a time because it's where we've opened the six stores that we've opened – but the spread remains biased towards the areas where we have local low levels of market share. But you'd expect that because that's where the mass is most compelling in terms of incremental sales opportunity.

Answer: Mike Coupe

Of course we never comment on gross margins. One observation about margin generally if you look at the growth of own label and non-food of course that for us is slightly margin accretive. And of course the growth differential, as Justin has already referred to, allows us to enjoy probably our best price position relative to our major competitors that we've ever had.

Question 3

James Tracey – Redburn Partners

Three questions from me. The first one is a technical one: what do you think the underlying impact on EBIT will be of your change to the Defined Benefit pension scheme?

The second one is on the industry dynamic. You saw that Aldi and Lidl and Waitrose are gaining the most share in the market, which is a change to what we've seen over the past ten years or so, what strategic response are you going to take to that?

The third one is on Justin King: do you intend to be the CEO for the next couple of years?

Answer: Justin King

I think I'll take the last one. I'm not going to comment on time lines. That just becomes invidious and all that happens then is you play swap numbers, whether it's one year, two years, five years or ten years. I've said clearly that I enjoy my job and I see myself here as part of the future. That has always been the case and it remains the case.

John, do you want to talk about EBIT margin?

Answer: John Rogers

In terms of the impact of closure of the DB scheme to future accrual we would expect to see a single-digit benefit come through in terms of underlying EBIT in the second half.

In terms of next year say a circa 10m or so benefit, 5m to 10m or so benefit. But of course you can't forget that we are taking compensation payments of 11m in the second half and 17m next year outside of underlying. So, it broadly plays a draw for a couple of years, and then thereafter will be a net benefit. Albeit of course, as you all know, with the impact of auto-enrolment coming in we'd expect those auto-enrolment costs to increase from about 2017, 2018 onwards. So overall in the longer term we'd expect it to broadly play a draw but in the short to medium term there is a short upside if you don't take account of the compensation payments.

Answer: Justin King

To the question of market share accreting in the smaller retailers and what's the strategy I think, without being flippant, the answer is: the strategy is what our strategy is. That's why we're able to grow market share, notwithstanding that that's happening.

To make a specific point of that, a big part of what's driving those retailers is it's not as it's sometimes characterised a consumer racing to the top and racing to the bottom and abandoning the middle, it's the consumer de-constructing their weekly shop, doing a smaller

weekly shop, topping up when it makes sense to them. And that plays strongly to any retailer whose history is a large number of customers buying a small number of items. Because the opportunity to convert just an extra item from those customer transactions gives you fantastic like-for-like momentum. And of course strategically our response to that trend is the convenience business we already have and the fact that we continue to develop that convenience business.

Of course if the question is asked tactically the first answer is broadly we won't tell you because I think that is commercially confidential. But I think suffice to say that through Nectar data we have very clear insight into our cross shopping dynamic and a very clear understanding of how to spend money profitably, incentivising our customers to keep a larger proportion of their shop with us.

And I know simplistically a lot of observers say that we are suffering less from the switch to discounters, largely because of geographic mix. I think if you look at the detail that doesn't really stand up as an explanation. We are, I believe, switching less proportionally than others because we are better able to compete because we can see our customers at a granular level.

As far as the top of the market, Waitrose and M&S are yet to enjoy that dynamic but they're talking about adding more stores. The competition I think will be largely competition for sites. You've seen only recently an announcement of the acquisition that Waitrose – I'm not sure it's been announced actually but we've read about it in the press so that may account for an announcement – of the stores that they've acquired from the Co-op. Clearly a lot of the sites that they're looking to open in are sites that we would find attractive too. So there is the real estate competition. But you will notice that Waitrose acquired the sites out of the Co-op, not us. We've said many times before that we're not in the game of buying bundles of stores, several of which may be quite poor, to acquire one or two flagships. We would place the recent purchase by Waitrose firmly in that territory from our perspective.

Question 4

Andrew Gwynn – Exane

Two questions. The first is on the trading performance. Is there a marked difference between an older store, say ten years, and maybe one that's relatively new, perhaps three years? Obviously taking out the normal maturity profile you would expect.

The second question is maybe to ask Alistair's question in a slightly different way, and it wouldn't be a Q&A session without asking about back solving: is back solving going on in the industry and do you expect it to persist?

Answer: Justin King

As far as the second question is concerned, like-for-like declines leading to profit growth clearly means something else must have changed in the P&L. But you would have to ask the retailers concerned what they've changed in the P&L to achieve that. And Mike I think has already answered as far as we will go in terms of our own margin, albeit the like-for-like at 1.4% is not in excess of gross cost growth, of course it is in excess of net cost growth with the savings targets that we're achieving. And of course it isn't just the absolute level of growth and whether it's ahead of cost growth, but it's also the relative level of growth because it gears the P&L for the marketing activity that then drives that sales growth. So, that's what is going on in our P&L.

In terms of age of stores, no it's not an age issue you have to look at it store by store, which would be the poorest performing stores in our estates, it would be those that are landlocked, difficult for us to invest in, that have had other competitors turn up in a better location a mile down the road, and I don't think I'm giving away any secrets in saying that. And that's not the exclusive preserve of old stores, that sometimes happens with new stores, and indeed, it's what lies at the core of the impairment we've taken, we looked at the property pipeline to those stores that we believe, whilst they may still be viable today, if you believe nothing else will happen, we think that there's real opportunity of a much better located out-of-town store turning up, meaning that the overall cash flows – and we have to take a 25 year view – of that store are vulnerable, and that's why we've impaired.

But in terms of age, the biggest kick-on that you get is refurbing the investment, and as you've seen, 22 convenience stores, eight supermarkets, I think by any measure we have the best invested store estate, the average length of time since it last received an investment of the major grocers, we would clearly have the shortest period of time.

Answer: John Rogers

I think we showed you that chart last time round, which said that about 90% plus of the overall portfolio has been invested in the last ten years, and so that's why we don't see marked differences between older stores and new stores, because they're all trading well, because they're all invested in well, and we have this on-going cycle of the refurbishment programme to make sure that every single store gets touched once in ten years.

Further question

And just as you've brought it up, the 82 or 92, I forget the number, write-down you've done on the property, you've given a number of stores, what was the book value of that? Is it a significant write-down, or are you just trimming round the edge?

Answer: John Rogers

It's a very significant write-down because effectively we're now valuing them at alternative use, which is, in the main, sometimes resi but otherwise nothing much, and so the write-down itself was fairly material, given the alternative use-value of those sites.

Answer: Justin King

And of course included in the latest property valuation. We'll go back over to there.

<u>Question 5</u>

Unidentified Analyst

Three questions please, sir. Justin, can you talk about the death of hypermarket. I was going to go there, the death of the hypermarket again. But three questions please. And number one: in terms of the convenience store profitability you've talked about, slightly being accretive at EBITDAR level, can you confirm that actually flows down to EBIT level as well, despite probably slightly higher rent, given they're all predominantly leased?

Secondly, in terms of freehold level, where are we now percentage of estate? And thirdly, you've talked now for a little while about capex coming down to 3.5% or below, mid-term, and do you have a better view when that mid-term actually happens to be?

Answer: John Rogers

Yes, 62% and three to four years!

Answer: Justin King

That's why you're the Finance Director, John!

Answer: John Rogers

So we said in the past that convenience margins are slightly ahead, so we're confident it flows through on convenience stores, that's absolutely fine. Freehold/leasehold mix of supermarkets, so not including our convenience stores, is currently at 62%, and of course most of our convenience stores are leasehold. And the capex, as I said, in three to four years' time we'd expect to get down to that 3.5% level.

Justin King

And you've guided 4.3%.

Answer: John Rogers

4.3% for this year, so similar to last year.

<u>Question 6</u>

John Kershaw – Bank of America, Merrill Lynch

Given you seem to be in dry on questions, I'll have a go! Can you go faster on convenience? Two weeks is obviously impressive, but it's clearly where the growth is, so what percentage of your space could come from convenience going forward?

And, Justin, given the trends we all know about, growth coming from discounters and Waitrose and you taking a bit of share, how do you see the industry in three to five years' time, because value-for-values differentiate in that, but if we've got a structural shift in the mix of the industry and a new price setter in town, where do you see the shape for the industry in its profitability?

Answer: Justin King

I suppose the answer to convenience is we go faster if we thought it was prudent so to do, so we guided one to two will be at the top end, one to two a week.

Answer: John Rogers

We guided to two a week.

Answer: Justin King

Yes, we have for this next second half I think you'll find. Anyway, whatever! Fifty in the first half, a similar number in the second half, hence two a week! And that's a reflection of we're not holding ourselves back, but we are keeping the bar high in terms of the quality of sites that we go for. We've not participated in any of the unbundling of other non-food businesses,

and back to my earlier point, we're not in the market to acquire 30 sites just to hit a number and get five good ones and 25 average ones. To some extent we will always therefore be constrained by what the market brings to market. You remember a couple of years ago, we did come up short on our target, and that's just because the quality sites weren't out there. On the whole, we are seeing quality sites coming forward now, because there's a lot more small development activity going on, and it's typically the kind of knock down a petrol station and build a small block of flats and a couple of shops type of development activity that brings those opportunities forward. So we think two a week is a prudent number but we're not going to only do two if there were more opportunities available, but we'll keep the bar high.

One of the reasons for keeping the bar high, apart from our learning of where the sweet spot is in terms of profitability, is we need the better sites to deliver a fantastic fresh food offer, and our customers' expectation of a Sainsbury's convenience store is different from that of some of our grocery competitors, they have a very high expectation of the quality and the quantum of fresh food, so we need to be in the right locations that we can deliver that level of fresh food, get the right levels of stock turn, to be able to have that fresh food. It's very difficult to do. Tesco have kept a whole load of stores in the One-Stop brand, because actually in a £20,000 a week store that's mostly fags, booze and confectionary, you can't do fresh food well and we don't see that as being our market.

In terms of what colour could I add about the structure of the market, I think that we've touched on a lot of it already. Clearly part of why the right-hand side of that chart is the fastest growing is proportionately they're the people that are adding the most space. Actually if you were to look at the top 10 retailers in the UK at the moment, we're probably proportionately adding the third lowest level of space in any of the top retailers, which I'm not sure is quite understood when people look at the dynamic. Now clearly two of the major grocers have said they're on a journey to that number coming down quite significantly, but proportionately they will still add more than us in the year that we're currently talking about. Of course Waitrose, Aldi and Lidl are adding double digit to their space on an annual basis, and that feels like that's got a good few years to run, and so the space dynamic of what those three retailers, possibly with Marks and Spencer joining in if they achieve what they've announced in recent times, is going to be a big part of the picture, and clearly we play in that space in part with our convenience store opening.

In terms of trading proposition and pricing, I think it was buried in the Basics question earlier. Actually the quality and price positioning of discounters is not where Basics or indeed entry price point is, in fact their positioning and the core of what they assert is their customer proposition is like brands but better, and their positioning is absolutely where *by Sainsbury's* sits.

So our challenge has to be to demonstrate that our own brand more than beats their own brand, because that's what it is, and part of that will be values as part of the value positioning, because there's no evidence at all that consumers, when they walk into any particular retailer, leave their values on the doorstep; they don't say, "I'm bothered about fair trade when I'm shopping in Sainsbury's or Marks and Spencer, and I'm not bothered about fair trade when I'm shopping somewhere else". So we have to make that core strategic advantage play competitively into that sector too. But if you're really just asking the question: are we going to see convenience as a bigger proportion in the market in five years' time? Yes. Are we going to see discount as a bigger proportion of the market in five years' time? Yes. Are we going to see online as a bigger proportion of the market in five years' time? Yes.

Further question

I suppose just one final way is given the price cap's perhaps 20%, when you do your surveys what proportion of the population is prepared to pay 20% more for values?

Answer: Justin King

Well I don't recognise the 20% number, you'd expect me to say that, I don't think that's where our price gap is at all. I'm not sure who you think it's against. Our Basics we would measure as being close to 10% cheaper than where the positioning of discounter own brands are positioned, so Basics would be 10% cheaper. Our own brands are between 20% and 40% typically cheaper than the brands that they compete with in our stores, and we think the pricing of our own brand reflects the extra values where it's appropriate to reflect it, so we sell bananas at the same price as anyone else, you get fairtrade for free, but particularly when you get into protein, provenance high level husbandry does come at a price premium.

We'll take these as the last two on the basis that Al's going to be a second bite. We'll let Al be last as a second bite.

<u>Question 7</u>

Mike Dennis – Cantor Fitzgerald

First question. On the OFT probe into pricing on fair pricing, what do you think that'll do for inflation and promotional mix going forward? And secondly, we've talked a lot about the internet. What are you doing in your stores because of the internet, are you taking out tills and staff, is that why store ROCE is getting better?

Answer: Justin King

I'll let Mike talk about the first part, although I will just set that up by saying there is no OFT probe, but Mike I'm sure will add some colour. As far as the internet is concerned, it doesn't play into store in that sort of direct way. I mean obviously as a higher proportion of the total number of transactions in the marketplace takes place outside of supermarkets, whether that be the internet or convenience, you're seeing fewer number of transactions in-store, except that the key dynamic is fewer items in the transactions rather than fewer transactions. Actually transaction numbers, as we've commented on in the first half, are slightly up, so it doesn't immediately play to that.

By far the biggest productivity change we've made in the last five years was moving to self-scan, and you see that in the spike of saving on the chart that John showed earlier three years or so ago, and depending on store type anything between a third and half of our customers choose to use self-scan. Of course the technology is interchangeable, so with internet shoppers you don't necessarily have to get new tills to scan the food through for our in-store shopping, we can use the assets that are in-store. So it isn't just the physical four wall assets that we leverage when we do in-store pick, it can be the IT assets, it's the warehouse of course typically too. So I think that's the way the dynamic plays. Pricing Mike?

Answer: Mike Coupe

First of all as you say it's not a probe, there are some guidelines which have been agreed with the OFT which I think is very important. The basic principles of which are the headline

price from which you promote has to be a justifiable ongoing price. And secondly what's called the one-to-one rule, which is basically for every week of promotion you have to have sold at full price for a week. It's fair to say that those rules, if you look at some of our competitors, you'd be open to some interpretation as to whether or not they're sticking to those rules. I did notice a better than half price deal in the market last week which I suspect if you were trying to justify the ongoing retail price might be a bit of a challenge, and that's certainly one of the dynamics within the industry. I think if you looked at the industry overall we're certainly not seeing a reduction in the level of promotional intensity, indeed I would suggest that one or two of our competitors have increased their level of promotional intensity.

For ourselves – and I think you made the observation – we don't run what we would call disingenuous pricing, we're very careful about the way that we price our products, and we were largely adhering to the rules that were agreed by the industry previous to them being agreed by the industry, so we don't see it an issue for our business, and we continue to do the things we've always done, which is to price fairly and make sure that our customers can see the value within the overall offer.

Justin King

I'll take Al as the last question then.

<u>Question 8</u>

Alistair Johnson – Citigroup

I hope you don't mind it's the last three questions! New business development costs. Can you remind me whether you've disclosed a number for that, and how can we expect it to evolve over the next few years, is it going to get bigger, smaller etc?

On the £13m 'other' charge, have you taken the maximum potential cash outflow there, or is just a reasonable estimate, so is it a sort of a central case?

And finally just inflation outlook. Do you see food inflation coming down quite hard over the next six months?

Answer: John Rogers

Just on the new business development costs, we're probably taking a charge of around £10m or so in the P&L on the basis of the impact of that development. Going forward it's difficult to say really, frankly, as to how that's going to change depending on of course what decisions we decide to take, but £10m for this year. The £13m, we think it's a reasonable estimate of the overall potential liability, albeit as I said when I went through the slides, we think we've got a very robust case to defend against the position.

Answer: Justin King

The point being it might be nought.

Answer: John Rogers

It could be nought.

Answer: Mike Coupe

And on commodity price, if you look at some of the commodity prices they've started to come down, but of course things like energy prices are going up, so I suspect we'll see sort of same level of inflation in the marketplace that we've seen historically.

Concluding remarks: Justin King

Okay, we'll call it a day there for the questions, thanks for coming. We don't see you again until the prelims so have a great Christmas, but we will of course be speaking to you about Christmas in a couple of months' time. Thank you.