J Sainsbury plc

Preliminary Results 2013

Wednesday 8 May 2013

David Tyler, Chairman

Good morning and welcome to this presentation of Sainsbury's preliminary results for the year to 16 March 2013. As we all know, this has been a very challenging year for the grocery market, and so I would like to start by thanking all of our 157,000 colleagues, and in particular the senior management team, for all their hard work, both strategically and operationally during this year, because they've delivered to shareholders a number of real achievements in the last 12 months.

A 6% increase in underlying profits before tax, a 9% increase in underlying earnings per share, modest improvements in operating margin and in return on capital employed, and a further 20 basis points gained in market share. All this has been achieved while enhancing our reputation with consumers as a business that they can trust, and also while making considerable progress on our strategic agenda, which we believe will add considerable value to shareholders in the years ahead.

Clearly with that in mind I would like to make special mention today of our decision to take our 50% ownership of Sainsbury's Bank up to 100%. This is an important step for our business. We've got clear evidence that bank customers spend more in our stores than non-bank customers, and we believe that that connection can be even more beneficial to us if the Bank is run entirely in the interests of Sainsbury's and its shareholders fully aligned with our strategy.

So we believe there are significant benefits of taking full ownership of the Bank, and we believe that the huge amount of preparatory work that we've undertaken in the run up to this decision will ensure that we'll be able to manage the business well. Sainsbury's Bank will have its own governance structure, and that's one which has been approved by the Prudential Regulatory Authority.

We have a highly capable team at the Bank. It's led by Peter Griffiths, its CEO, and we announce today the appointment of a new Chairman of the Bank, Roger Davis. He was previously at Barclays, where he ran the UK retail Bank, and he'll be the ideal person, we feel, to oversee the development of Sainsbury's Bank for the future.

In addition today we're also announcing the appointment of a new non-executive director for the plc Board. Our new colleague is Lady Susan Rice. She's worked in Natwest and in LBG through most of her career, and she now sits on the Court of the Bank of England and on the Board of Scottish and Southern Electricity. So we welcome both Roger and Susan today to the Sainsbury's Group.

So this is an important day on our strategic path, but at this point let me pass over to John to take you through the financials. Over to you, John.

John Rogers, Chief Financial Officer

Thank you, David. Morning all. So straight into the financial highlights for the year. So we're reporting sales today of £25.6 billion up 4.6% delivering an operating profit of £829 million up 5.1%. Taking account of net finance costs and our share of profits from our joint ventures, that delivers a profit before tax of £756 up 6.2% and a slight beat to consensus. A tax rate of 23.7% in line with guidance and of course that reducing tax rate means that we've delivered a growth in earnings per share of 9.3% to 30.7p; and a full year dividend of 16.7p up 3.7% and with a cover of 1.8 again in line with our dividend policy. Profits outside of underlying, and I'll break this out in a bit more detail later on of £32 million delivering a profit before tax of £788 million. So a strong set of results in what's been a tough market.

That's principally been delivered through strong sales growth so a like for like of 1.8% for the full year, again a significant beat to the market. Within that 1.8 of course there's a contribution from extension of 0.7%. Contribution from net new space of 2.5% slightly higher than we guided; we guided to around 2% and that was principally because we were able to bring the opening of a number of stores forward against our plan so beating expectations in that area to deliver a total sales growth of 4.3% for the year.

And for your models for guidance for '13/'14 we expect a full year like for like of between 1% and 1½% reflecting very similar market conditions this year to last year. And of course with a reduced contribution from extensions, so down to 0.2% from the 0.7% that we delivered in the last financial year.

Contribution from net new space expected to be similar this year to last year. And of course all this guidance absolutely in line with the medium term guidance that we give which is an expectation that we'll beat the market by circa 1% in like for like terms.

Moving on now to underlying profits. EBITDAR of just over £1.8 billion up 4.8% delivering an EBITDAR margin of 7.83 up 3 bps. Underlying operating profit of 829 as said previously and an operating margin of 3.56% up 2 bps. Again we think very strong performance in the context of a market where clearly some of our competitors are going backwards in profit terms. So a little bit of a beat to the guidance, we gave guidance of flat margins year on year, so a couple of basis points above that.

Again for your models guidance for '13/'14, no surprises here. Expect operating profit to grow in line with sales, so flat year on year margin.

Coming on now to cost savings. We see cost inflation for the last year of around 2½%. Slightly lower than we guided. We said it would be at the upper end of our 2-3% range. So cost inflation not quite as high as we'd expected, and we've offset that, of course, with cost savings of over £100 million, £104 million to be precise.

Guidance for your models for next year; we expect cost inflation to be in the middle of the range, so similar this year to last year, and then we expect again to offset that with efficiency savings of around £100 million.

Okay, you heard David mention the announcement in relation to acquiring the remaining 50% share in the Bank, so I'm going to break out the Bank in a little bit more detail over the next three slides. It is worth just highlighting a couple of attributes of the Bank. First and foremost a low acquisition cost model, particularly through our in-store marketing, and also of course our ability to leverage our Nectar data to reward and incentivise customers; particularly helpful here, of course, is our double Nectar point credit card. It's been very

successful in the market and a very clear way of how we can tie the banking business into our supermarkets business.

All of this has resulted in a very strong track record of growth over the last five years and we see the underlying profit before tax numbers on the slide ahead of you. We see an increase in our customer accounts this year by 8% to 1.5 million, and of course as David mentioned, we've strengthened the management team, particularly with the appointment of Peter Griffiths, the new CEO. So some really good progress being made in the Bank over the last 12 months.

Of course the rationale behind this is really underpinned by the opportunity for growth that the Bank presents to us. So today only 1 in 20 of our customers actually holds a Sainsbury's Bank product. We think there's significant opportunity to increase that number over time. And the real advantage of course with the Bank is what we see when customers take out a banking product is they actually spend more money with us in-store, so it's a real win-win for us in terms of the banking model. And we feel that we can tap into that loyalty, tap into that synergy, by owning the Bank in its entirety so we can design our systems and processes in a way that works better for our banking customers. We are able to unlock loyalty benefit by designing products, so like the credit card with double Nectar points, much more efficiently than we could do under the previous joint venture relationship. And of course all that results in a transaction in our minds that delivers a very good cash payback within eight years. Very similar, actually, to the sorts of returns that we're getting in our supermarkets business and a return above our internal hurdle rate.

The nature of the transaction is that in the early years we have to invest cash to build the new state of the art banking platforms, but once we've invested that cash and once we've overcome the double running costs of the Bank in the early years, the transaction very quickly becomes highly cash generative. And also of course, as David said, we're expecting to complete on this transaction at the end of January 2014. So we've got a bit of a lead into completion, but that allows us to do plenty of preparation in terms of designing and putting more detail on the transition plan going forwards.

So again just for your models I'll cover some of the key headline terms. There are actually a couple of slides, two or three slides, in the appendices to your packs that break this out in a little bit more detail, but just to cover some of the key headlines: acquiring 50% for £248 million. That's broken down between the shares and also some loan notes that we're repaying; represents just over 1x the tangible net asset value of the Bank. And also there's a capital injection required into the Bank over the next three years of a net 40 million in order to support the capital ratios at the right levels and allow the Bank to invest in its new banking platform and to take it through transition.

In terms of the actual performance, underlying performance, of the Bank itself, we expect profit before tax to increase in the high teens as a CAGR over the next five years or so, so not quite the 40% average that we've seen over the last few years, but certainly very respectable headline profit growth over the next five years or so. That said, at the same time, we're going to be incurring double running costs as we transition off LBG banking platform onto our new banking platform, and as a consequence of those double running costs we expect profit before tax to be broadly flat in the first two years; and as those double running costs fall away then we see a sharp increase in profitability going forward. And of course the Bank in and of itself has to invest in the new banking platform, so £170 million of transition costs and £90 million of capital investment by the Bank to build its new systems and transition off the old ones from LBG.

So coming back then to overall performance on joint ventures. Again here reflecting the strong performance we've seen in the Bank year on year, and again the property joint ventures delivering a profit in line with the previous year, again in line with guidance. For future, for '13/'14, the guidance of the Bank, as I've just said, is underlying profit before tax broadly flat year on year, and of course we will have in effect 46 weeks of joint venture accounting for the Bank in this new financial year, and then six weeks of full consolidation, so I'll let you do the maths on that, but we can break that out in more detail for you if you like. And of course in terms of the property joint ventures we expect a similar level of profit this year to that that we delivered last year.

Coming on now to finance costs, so finance costs of £111 million, again in line with guidance, delivering a net interest cover of 7.8x improved year on year and a fixed charge cover of 3.1x in line with the previous year. Capitalised interest a nudge down year on year, reflecting the step back in our capital investment programme, so 32 million in '12/'13 compared to 35 the previous year. And again for the new financial year, '13/'14, we would expect to see a further nudge down in capitalised interest. And guidance for underlying net finance costs for '13/'14, again we expect them to remain broadly flat year on year.

So now onto items outside of underlying, of course the principal of which is the property profits: so £66 million of property profits on sales of £200 million, compared to £83 on sales of £300 million for the previous year. Again the various adjustments that you'll see going through, and of course one off items which this year includes some of the transactional costs attached to the Bank transaction that I made reference to previously; overall delivering profits outside of underlying of £32 million.

Pensions accounting, I know this is one of your favourites. Obviously we're in the process of doing the triennial evaluation, so we'll expect in the ordinary course of business to report on that in June, but that process remains ongoing. And of course we are now currently in a consultation period vis-à-vis the closure of our defined benefits scheme to future accrual. That process is still ongoing, but if that is to be accepted then of course that is expected to reduce the defined benefit pension cost, and of course conversely increase the contributions into our DC plans as members transition over from the DB into the DC. And of course that in and of itself will reduce the defined benefit pension liability.

Guidance for next year, and this guidance is in absence of the impact of the closure of the scheme, for which we will update in due course, but outside of that, assuming that doesn't happen, then guidance for the underlying service costs, we expect that to be about £64 million, and that's driven by a new accounting standard, IS19 Revised, and again – there's a page in the Appendix that breaks it out and explains it in a little bit more detail.

So where does that leave us all in terms of margins? Again the appreciation on margin that I talked about previously on both EBITDAR and operating margin, we feel again this is very positive in context of a very difficult market, so seeing appreciation in today's market is difficult, particularly when you've got your competitors going back by 25/30bps and in some cases more than 50 basis points. Return on capital employed, again we've moved that on a notch 12 bps year on year, albeit to be fair part of that is driven by the increasing deficit on the pension scheme. If you stripped out that deficit then there would be a move back year-on-year. So, certainly more to do on return on capital, and that's very much the focus of management's attentions to drive that return going forwards.

Space growth bang in line with plans: 1 million square feet, so 14 supermarkets, eight extensions, 87 convenience stores, so a step on. In '11/'12 we did 73 convenience stores; last year we did 87, so a good step on. And today we'll be announcing that we plan to open about two convenience stores per week. So, last year we said one to two; this year we'll be

saying two a week. And of course that contributes to our overall million square feet that we plan to deliver this coming year.

So, property value and property profits: I've already talked about the £66 million of property profits generated this year. Property value has increased from £11.2 billion to £11.5 billion; that's reflective of £0.5 billion that we spent of course on property this year investing in new stores, extensions, convenience stores etc, offset by the £200 million that we realised through our sale and leaseback programmes; so net-net a 0.3 accretion. And if you look at property profits overall over the last five years, as I said this year's was £66 million, but over the last five years we've delivered £350 million of property profits – again, a real key component of shareholder value for our business.

Important to note actually, if you look at the value of our property over the last five years, five years ago £7.5 billion, today £11.5 billion; so that represents clearly a valuation gain of £4 billion. On top of that of course we've made various proceeds over the last five years of £1.3 billion. So, a total value accretion in property terms of £5.3. Now, clearly we spent money on that; clearly we spent capital to build those stores. That land and build out capital is of the order of £2.5 billion. But that means in practice there's £2.8 billion of latent value that's been created through that development activity over the last five years. I think it's important to remember that: the capital that we're spending year in year out is adding to our overall property valuation in quite a significant way, above and beyond what we're actually spending. And of course when we perform our sale and leasebacks we're able to unlock and release that value, as we have been doing successfully over the last five years.

Capital expenditure in line with guidance: £1 billion at the core capital level; £875 reflecting the sale and leaseback programme. Guidance for next year will be a little bit of a tick-up to £1.1 billion and of course that excludes any investment in Sainsbury's Bank, the 248 million that I referred to previously.

What's important to note though is the mix of that capital, and that mix is changing over time, so we're rebalancing the capital spend. If you look at this chart here you'll see what we spent in '11/'12 and how that has changed over the last couple of years and how this is this year's expected spend. Clearly we're spending less on new stores than historically. We're spending more on convenience as we step up that programme. We're also spending more on IT, reflecting the investment in our new digital platforms etc. So, again changing the nature of spend.

In terms of capex over sales, '12/'13 was 4.1%. We expect for this coming financial year that ratio will be broadly the same as last year's. But going forward we're going to target a reduction in capex as a percent of sales from the 4.1% to less than 3.5% over the medium term. So, targeted reduction in capex as a percentage of sales in the medium term.

Cashflow: again strong operating cashflow. Slight increase year on year in working capital. Interest in line with the previous year. Again, tax, we've seen a bit of a step-up in cash tax last year to the year before; principally driven by the fact that the year before we had the protection of the offsetting of the investments being made into the pension scheme under what we call Project Castle. Everything else broadly in line to deliver a total net debt number of £2.16 billion, slightly below the guidance that we gave of £2.2 billion.

So, balance sheet maintained a strong position. Covered the property, covered the net debt. Pension deficit, as I referred earlier on, has increased slightly as a result of the decrease in the real discount rate. Guidance for '13/'14 we expect, if you take out the impact of the investment in the Bank, net debt to land at £2.4 billion; if you include that investment, the £248 million, again you can do the maths as well as I can, we expect therefore a net debt of around £2.6 billion, including that investment. And of course, perhaps it goes without saying, we'll be fully consolidating the Bank into the business in the new financial year.

So, balance sheet metrics remarkably steady over the last three years; in fact exactly the same in relation to lease adjusted net debt to EBITDAR, and again, exactly the same in relation to interest cover, so real stability in the balance sheet. I mentioned core capex as a percent of sales last year being 4.1%, and again you'll have seen the guidance to reduce that over the medium term going forwards.

Dividend, we've spoken about already, 16.7 cover 1.83, absolutely in line with our policy of increasing our dividend year on year and increasing our cover to two times over the medium term.

All of which leads to the summary, which I think is a really strong performance in the context of a challenging market: 33 quarters now of like for like growth; operating margin accretion against what is a very tough industry backdrop; continued focus on ROCE – that is one of the measures we must drive forward over the coming years; underlying profit before tax above consensus at 756; property profits as discussed. And of course all supported by a very strong balance sheet, very stable metrics, and underpinned by the property value of 11.5 billion.

That's it from me. I'll hand over now to Justin to cover the operating review.

Justin King, Chief Executive.

Thanks John. Morning everyone. John has covered the ground pretty well. I'll spend the next 15 minutes or so talking through the operating side of the business.

What lies behind all of my presentation I think is one simple idea, which is that the business is outperforming because of some inherent strengths that it has and we're playing to those strengths. John has already taken you through the delivery of sales and profit growth, which in the context of the competitive environment we think represents very strong performance.

And our core advantage starts with own-brand. It represents over half of our sales. We've been through a process of significant re-launch, and I'll touch on that. And then we have tools such as Nectar, coupon-at-till and then most recently in the last 12 months or so Brand Match, which all have been key to our success.

Now, no sales growth number is complete without driving online and convenience, and clearly that's part of our success, both longstanding parts of our longstanding strategy. John has taken you though in great detail the Bank transaction; but let me add my overall thoughts that we think it represents a big step in the direction of serving our customers the way they want to be served with banking products.

Now, market context is known to you all. That is a plot over the last year: 4.3% sales growth, underpinned by 1.8% like for like. And that is material a beat to the market, a market that absent us was flat to slightly down in the last 12 months. And you can see that reflected in this chart: nip and tuck in a couple of 12-week rolling periods but pretty much a full year of outperformance with a couple of very significant spurts around the Paralympics in the middle of the year and obviously into the back end of the year, the quarter four statement that we made a few weeks ago.

These charts bear repetition, but they do look very like the ones we've shown you for two or three years, and that's because the consumer backdrop remains pretty much where it's been. Consumers' view of themselves today and indeed the outlook for the future remains pretty downbeat and whilst some commentators have done the maths and said that looks like a little bit of up-tick over the last year, I think we have to remind ourselves that is still at a level of net minus 30 in terms of outlook. So, consumer confidence remains low.

Although there's significant disconnect for consumer incomes, there has been a step down. No forward forecast, I think, have average wages inflating faster than inflation. So, I think there is no realistic expectation of average household disposal income doing anything more than being essentially flat. And that's the basis on which we've run our business in recent years and continue to plan to run our business going forward.

This chart reminds us that the big change we saw nearly two years ago now of consumers doing a slightly smaller weekly grocery shop and then topping up more frequently, particularly at convenience stores, but of course at supermarkets too took place; it annualised and broadly speaking has stuck. We've not seen further change. So, that dynamic was a step change in consumer behaviour that has stuck, but has not gone back but nor is it kicking on still further – which in a way I think makes the performance of our convenience business at 17% last year all the more commendable.

It is worth making the point, and you can see that in that blip in the middle of last year of our like for like performance, that the year just gone was truly for UK consumers and for Sainsbury's in serving them a year like no other. We played our part in the Diamond Jubilee, the Olympics, in particular the Paralympics, that generated tremendous pride within our business; actually pride amongst our customers – it's the first word that the customers use when talking about the Paralympics is their pride that Sainsbury's, the place where they shop, played a full part in it. And that drove customer awareness not just about brand, which of course is always high, but of our part in communities up and down the country, because it allowed us to tell a story of the contribution that we make store by store, employing and representing the communities that we serve; and has won many awards as a result.

But although we see that as a once in a lifetime opportunity, we've invested already with legacy programmes with the British Paralympic Association, by investing in training in schools, and most recently now Sainsbury's Anniversary Games, through events culminating in the first, really the only event that will take place in the Olympic Park as we will remember it before it starts to change to West Ham – already a sell-out event. And importantly for us in our involvement an integrated weekend of able-bodied and Paralympic athletics. And interestingly all three days, the Friday and Saturday meetings and the Sunday para-athletic event have all sold out; which tells you I think that the public at large are still very engaged across the piece.

I touched already on own-brand. The key part of the story for us in the last 12 months has clearly been the re-launch of *by Sainsbury's*; own-brand sales growing faster than our core business. But *by Sainsbury's* is around 40% of our sales, and the re-launch of that, which is essentially a two-year process now complete, has been driving our business.

And of course we've seen tested in anger in the last quarter or so the whole question of supply chains and the involvement that retailers have in their supply chains. I should say, and I've said this this morning in interviews, nobody can say 100% for sure that they wouldn't be as affected by something as far-reaching as horse meat; but we knew we could fall back upon our long-term investment in supply chain. And indeed for example, as noted on the slide, we've been DNA testing for ten years; for a number of our competitors that was a new process they've had to introduce in recent months. And those investments pay back at times of challenge like we experienced earlier this year: building customer confidence that you have already asked the questions that they're now starting to ask.

But it isn't just about the quality of our offer, it's the value too. Brand Match are now 18 months old; roughly 5 million coupons a week, 350 million therefore. Really important to note, Brand Match works because it's true: we sell our brands at broadly speaking the same price as that of our grocery competitors. There are ups and downs in terms of promotional mix from time to time, of course there are but that's why we win 50% of the time. And reinforcing that message, you really don't have to shop around for brands, has been a

pivotal part of allowing us to tell our own-label story, because then that's the reason that you can choose to shop with us versus somebody else.

And we combine that in a unique way with what we're able to do at the till with Nectar, which of course, gives us the insight, and then coupon-at-till, the technology which allows us to respond to that insight real time. And being able to give customers coupons that they want to use that reflect the shopping that they are doing and that they want to do is a key part of our value proposition; it's how indeed we help our customers Live Well for Less.

Of course for many of our customers Nectar in itself is the motivation, incredible figures in terms of the savings and for many it is a Christmas savings club as we've seen there 110 million of Nectar points were redeemed in the run up to Christmas in our stores so it does work on several levels. It works as a collection and loyalty scheme but it also of course provides us the data for so much of our communication with our customers.

And I think more than ever in the last 12 months this slide has come to be appreciated as a real part of our competitive difference. I've had to say in previous years, I'm going to keep putting this slide in even though a lot of you don't think it makes a blind bit of difference, I hope I'm in the position now where the vast majority of you do actually understand and accept that this drives the point of difference in our business versus grocery competitors and remains a key reason for our success. Under each of our five areas of focus, for corporate responsibility, big achievements in the last year, we've been at the forefront of the debate around healthy eating with front of pack labelling and we're starting to use our pharmacies now to drive that healthy living message with our customers.

Leadership positions in all of the major trends in ethical sourcing of food: Fairtrade, MSC, Freedom Foods, to name but three. The environment's interesting because it's absolutely part of the corporate responsibility programme; 82,000 solar panels, the biggest solar array in Europe. John touched on the amount of money we're investing in programmes which drive cost savings, while that's a capital investment that, in addition to being environmentally sound, is also a cost saving capital investment.

You'll have seen, and I hope every single one of you played your part in the £10.5m contributed to Comic Relief this year, the new record figure, I think reinforcing something that we believe to be true which is as times have become tougher for the consumer at large they have become more, not less, concerned about the world around them and the ethics of the purchasing that they make.

And of course no issue is more on customers' lips than how you employ and develop your people and I think we've been able to demonstrate a strong record there, 5,000 new jobs, the apprentice places, the management training schemes that we've launched, a great track record there too.

And all of that recognised by our industry. This is a victory slide, it's us patting ourselves on our own back and I understand that; but in an industry as competitive as ours I hope you will recognise that for the industry five times in seven in supermarket, in the last three years in convenience, to vote us the best is a recognition of the real difference that our customers are seeing in store week in, week out. And delivering for customers consistently is the core to our sales performance success. And other awards noted there too.

So onto the delivery of our strategy and once again worth me reminding you, it's essentially the same slide we've shown you since 2007, it's the same slide because it works, it's a consistent strategy in the long term and that is indeed part of our competitive advantage. It starts with food, the quality of our food and particularly our fresh food, the number one

reason for choosing Sainsbury's over our competitors. We've never lost sight of that and we will never lose sight of that. As I said some years ago we thought there was a misread of the economic downturn that there would be some kind of flight to grams per penny, that we felt was a misread and so it turned out to be. We kept investing whilst some of our competitors did not. The advantage that we enjoy in quality perception has, if anything, widened over the last 12 months so it's an advantage that we preserve and protect vigorously.

And as I mentioned our core own brand, 40% of our sales *by Sainsbury's* now almost complete, many products revised for the first time in many, many years so a real point of difference now for our customers. But also fresh food at our counters you know claims are made about who has the biggest counter business – we do it's well over 500 stores.

We established a couple of years ago our food colleges, seven of them, six general ones and one specifically for bakery and this is about training butchers, bakers, fishmongers and the assistants you see across the deli counters more generally providing a real point of difference for our customers.

And you're seeing an increasing conversation about British food where we already have a leadership position in British food, our farmer development groups, some of which have been established for over five years now are core to that success and in many areas, I've noted apples and pears, despite our relative size we are the biggest retailer of British in the UK. I know for a fact my mum has never bought a French apple in her life and she was delighted that we continue to have a leadership position in apples and pears. All good businesses should be run for the benefit of the chief exec's mother, we know that don't we?

Now general merchandise has been a fantastic story in the last 12 months, outgrown our core food business by times two. And I know, or at least it's very likely we'll be asked questions about the death of the hypermarket and big stores in food and big stores we just don't think those questions reflect the reality of what we've been doing in Sainsburys, that's delivering a complementary non-food offer bolted on to a compelling food destination store. Even in our very biggest stores food remains the centre of the offer. But if you get that right your customers will love your non-food offer too. We're now 7th by volume in clothing, 12th by value - an extraordinary achievement from a standing start of just nine years ago.

And GM just past the £1 billion milestone, again a business we only really started nine years ago, went through £1 billion in the last quarter and by value now is 7th largest retailer of homewares in the UK. So big businesses, of scale, driving the growth.

And that's down at the bottom right is our Kings Lynn store, I think most of you had the opportunity to see that. Interestingly a philosophy we approach when we do model stores is we try and test things that we can roll back into our business. It's one thing to have a flagship store which is only going to touch five or ten stores in the next two or three years, the learnings from Kings Lynn can be rolled back into the vast majority of our non-food estate that's already out there.

Convenience we've touched on £1.5 billion business, 17% year on year, so a lot of that of course to new space but also strong underlying like for likes too, 87 stores so hitting at one to two a week, and pretty consistent now and of course you heard one of the of I think three stores that we're opening this week in convenience. It's a fairly regular ticker tape hearing that bell in the morning now. But I think nice to note, that during this year the number of convenience stores will overtake the number of supermarkets in our business. So they're clearly a big part of what we do.

The other big part of our growth story, convenience and online between them are about 50% of our sales growth. Of course we run our grocery business as an in store pick model, we attribute the sales to our stores, it's heading towards that iconic billion mark. Key again to understanding how you drive this business and understanding the real profitability of online is Nectar, understanding those different touch points, customer to customer.

And we've driven some incredible productivity improvements led by Jon Rudoe and our online team, our colleagues in store delivering fantastic results, picked rate up 10% year on year, the productivity of our vehicles up 15%. Both of those of course contributing to the big cost saving that John talked about earlier, but doing that at the same time as improving our customer metrics.

I know there's some commentary about the productivity initiatives we have in our business, clearly some of our competitors in recent times have had to say that productivity was actually impacting on the customer experience, we are vigorous in our measuring of customer metrics alongside productivity improvements, and we're confident on online, as we can say in the core of our business, that there has not been a customer price to be paid for the productivity improvements that we have achieved.

And I've alluded to this slide as did John earlier several times but it does bear repeating, as our customers shop in more channels with us their value to us increases. We know and understand this, both as a point in time but also a journey over time because of Nectar data. This incredibly important dynamic that a customer who's shopping in store, that starts shopping online, gets to a place where their combined shop is more than where they started from. It is one plus one equalling more than two.

And the only extra comment I want to make on the comprehensive build that John gave you on the Bank is the bottom bullet in this slide. What we know from our existing bank experience is that this acts, if you like, as a third dimension to this chart. It would be difficult to show it graphically because it sits over the top of this, whatever relationship our customers have with us, be it supermarkets, online, or convenience or a combination thereof, when they extend that relationship to banking products they increase their spending with us and that's pivotal to why we wish to have 100% ownership so that we can focus on investing for our customers. As you heard for John only one in 20 today overlay that bank product relationship with their supermarket relationship so much potential there we believe.

We continue to invest for the future, worth reminding this group that of course all investments that we make on this slide we treat as an underlying investment to the business, we don't consider these to be exceptional, they're investments in our future. Of scale now our Pharmacy Business but as you can see there a lot of the debate in recent months has been around digital, the reality is that all of this at the moment is a cost not a revenue or profit driver, but we're staying close to how our customers are changing their shopping and some interesting opportunities that I'm sure will be scale and profitable in the future.

You've already heard from John our space guidance, another million square feet or so in the year ahead, we believe that our space programme is well tried and tested, a good property pipeline as you heard John say earlier. It starts of course with our supermarkets and a few years ago we showed you a slide of a diagonal line across the UK and said simply put we've got 20% market share south and east of it and 10% market share north and west. But if you go to another level of granularity I think it's important to note over a third of the country, there are 125 or so postcodes in the UK, a third of those we have less than 5% market share. So there are real opportunities to continue to add new space where we are not.

Extensions clearly are part of the success of our non-food business, a remarkable achievement I would suggest over the last five years, we've brought our non-food offer into reach of a third of the UK population, that's up from 11% five years ago. But of course that does mean two thirds are not yet within reach and the opportunity remains to invest in our existing estate to bring that to even more customers.

And a bigger part of the picture has been the convenience estate, the most accretive investments, a cash payback of two years or so, I think the story of convenience and why it reflects customers' changing shopping habits is well told. Our business, and we've just celebrated the 15th anniversary of our first convenience store, so it's a long standing business and remains a great growth prospect.

So I hope in that quick run through I've reminded you of what I hope you already knew which is that we have a clear long term growth strategy focused on five key areas and we're delivering it consistently and well, which of course brings me to a close. So a quick summary. Good sales performance, is converted into a good profit performance too. And I think set against the market context in particular a strong performance.

Own brand key and increasingly being able to identify those things beyond price that bring customers to you, that mark you out, give you a real point of difference and own label-wise at the core of that will be the key to competitive success. But with our other tools, Nectar and the way we combine it with coupon at till and brand match that gives us further points of difference.

Multi-channel in our scale businesses, around 15% of growth as I touched on earlier in the last 12 months with much future opportunity to grow and of course with today's announcements we've added an extra string to our bow if you like with the growth potential of the Bank.

And once again I finish by reminding you that this is the delivery of a consistent, long term, and successful strategy for growth.

We now move to questions, John and Mike are going to join me on the stage and we'll cover as many questions as we can.

Question and Answer session

<u>Question 1</u>

Caroline Gulliver, Espirito Santo

I just had a couple of questions on Sainsbury's Bank please: you mentioned that 5% of customers currently have some sort of product with Sainsbury's Bank what do you think the potential is for that to go to the Sainsbury's Bank under full ownership?

And also why don't you think 95% currently partake? What's really going to change is it just Nectar and double points or is there something else going on?

Answer: John Rogers

Well I think in terms of potential penetration as we said today that 4% to 5% currently own a product, I think if you look at some of our banking peers it's fair to say that that potential

could be 12% or more. So we see significant opportunity to grow that penetration over the coming years.

I guess the opportunity really rests in our ability to design products in a way that particularly are tailored to our customers, and I think over the last five years we've been very successful at growing the penetration of customers in the bank in our joint venture with LBG. We feel that in order to grow that going forwards, having the ability to design bespoke products tailored to our customers' needs, which is something we can absolutely do with a new banking platform which allows us to design very flexible banking products; also of course allows us to align our customer data systems to our supermarket systems so we have a single view of the customer. All of these things will allow us to increase that penetration going forwards.

Question 2

James Anstead, Barclays Capital

A follow-up on that question. Given that the purchase of the other 50% is quite expensive and it's going to be quite a complex transaction, I'm just not completely clear of the kind of things you're going to be able to do going forward that you can't do at the moment. I think you do offer Nectar points and use customer data already, so I don't know if you could just be a bit clearer about the kind of things you'll be able to do going forward that you can't do at the moment.

Then just two clarifications perhaps from John. I don't know if you can be a bit more clear in terms of you talked about medium term capex to sales getting down to 3.5%. Is medium term two years after this coming year or what kind of date?

And also, I don't know if you can be more precise on the timeframe for improving ROCE.

Answer: John Rogers

In relation to capex over sales, timeline three to five years to get that beneath 3.5%, capex as a percent of sales. In terms of ROCE accretion, I think it's fair to say for the new financial year we're expecting ROCE to be broadly flat year on year in line with our guidance on operating margin. I think it reflects what is clearly a tough industry backdrop. If growth does return to the 3% to 4% level that we've seen historically in this market in like-for-like terms, then of course we would expect to see both the operating margin of 10-20 bps that we've guided to previously start to come through, and also the ROCE accretion start to come through. But for the time being I think we're being very prudent in guiding to flat ROCE year on year.

In relation to what we think we can do differently, James, I can only refer to what I said previously, this transaction in taking 100% ownership of the Bank, allows us to be able to design products in a way absolutely tailored to our customers' needs. It's fair to say that with the current banking platforms that we operate off with LBG we don't have much flexibility, it's quite difficult to make changes on these Legacy systems, we're not fleet of foot in relation to how we can design our products. On the new systems we're able to do that.

Also in relation to how we tie all our data together, we are getting better and better at integrating the data on our customers across our business, but we don't have a single view, a fully unified view of the customer at this point in time. Clearly this acquisition will allow us to move at pace in that direction, and we really feel that that is indeed where the synergy lies. As we said, the real synergy of this transaction, which is customers taking out banking

products and then spending more in our stores as a consequence, is the real value add. I've always felt that the irony, of course, is that there are more synergies between the supermarket sector and the financial services' sector than there are within the financial services' sector itself, and that's really the key rationale for the transaction that we're announcing today.

Question 3

Andrew Gwynn, Exane

Two questions if I can. First again unfortunately for John. I'm just reading on the balance sheet you've given a couple of indications, but we're generally seen net debt creep up every year, and obviously with the Bank purchase as well we'll see that go up even further. Are there any sort of targets you can give us on the balance sheet maybe to reduce net debt over time, or are you broadly comfortable with the level of gearing as it stands?

And then, Justin, I guess we're constantly hearing a speculation about your potential departure. For completeness I don't know if you can say anything or indeed the process, but any sort of help hopefully put that to bed would be rather useful.

Answer: Justin King

I'll deal with that as best I can. It's speculation and it appears to be entirely circular amongst a relatively small number of journalists and occasionally joined in by one or two members here in the room. I'm on public record my commitment to the business. I hope it's clear from everything I've already said how excited I remain about the future prospects of the business. We're not going to comment directly on speculation because that's purely what is. That's not unique to my position, we don't comment on speculation more generally, but I remain committed to the business and I see the future prospects here as being far and away the most interesting prospects of any retail business across Europe. I said that once before and was harangued for asserting it but I believe that to be true.

Answer: John Rogers

Andrew, in relation to your question on the balance sheet, of course the key metric that we look at is not net debt in absolute terms but adjusted net debt to EBITDAR. I think that is absolutely the right way to look at the strength of the balance sheet. What those numbers have told you over the last three years is we've been very, very consistent at that metric, 4.1 for the last three years, and if you were to throw forward that metric, excluding the impact of the investment in the Bank for now, you'd see that metric remain very consistent over the next five years.

Now you did make a comment on the impact of the Bank. What the impact of the Bank will do on that metric in the first year is likely to lift that from 4.1 to 4.3, so it will tick-up a little bit, but then the following year it will go down to 4.2, 4.1, and then down to 4.0. So in fact what the Bank does over time is it allows us to accelerate a reduction in that metric over time above and beyond where it would have been had we not made the bank transaction. And again we're very comfortable with those balance sheet measures very consistent year-on-year.

Question 4

Dave McCarthy, Investec

I just wanted to look at the capital expenditure charts that you gave. I notice that there's what appears to be at least a doubling of your logistics and commercial initiatives' expenditure. You didn't mention that and I just wondered first of all what that is, and should we be seeing some benefits of that flowing through into margins?

Answer: John Rogers

You're absolutely right, we are investing more capex year on year and what I describe as being sort of quick pay-back commercial initiatives. A big component for example this year is we've historically invested into energy saving initiatives, carbon reduction initiatives, there's a big step on year on year in those initiatives in these numbers; and in fact if you look back historically that investment would have typically paid back in four to five years. The programme that we're signing off this year I'm pleased to say is destined to pay-back in three to four years, so it's looking even more accretive. In order to of course deliver year-on-year the £100m of savings plus that we talked to, we have to make some investments to deliver that, and this is a key component of that.

Obviously in terms of logistics again we continue to invest in our networks, so we've invested historically in the convenience network, we added a depot this year, also investing in non-food as well. These are important components that are driving obviously the key growth parts of our business, convenience and non-food. And of course online, again I commented about the step-up in the IT capex again reflecting the investment that we're making in our digital sales, so again consistent with what I've said historically.

Further question

So just taking what you've just said, if you are getting a quicker pay-back and you're investing more, are you now saying that you'll be getting over £100m/£150m of cost savings per annum?

Answer: John Rogers

No. The guidance that we've given is consistent, the £100m saving we're predicting for this financial year is the same as historically. What I'm saying is we're having to invest in order to deliver that saving pay-back the £100m.

Further question

Sorry, but you've just said that you're going to invest more so it's a better pay-back.

Answer: John Rogers

Of course, but then what we've done over the years – and we've said this before – is that we've delivered £700m of savings over the last five years, some of those early savings are what I would describe as being quick wins. As we evolve the business many more of those savings are looking at cross-functional savings, so end-to-end process savings, so we're investing a lot more in that. We're also having to invest more in capital spend in order to deliver those same savings. So it is becoming tougher year on year to deliver those savings but we're absolutely confident that we can maintain that consistency going forward.

Question 5

John Kershaw, Exane

Talk on online a bit Justin in terms of there's a lot of change in the market, it is very fast moving, you're sticking currently to a store picked grocery model. Do you see a future of yourself more with click and collect? And what about automation, is that an area you think you're going to have to dip your toe into á la Morrison perhaps?

And then perhaps John, just help us understand a bit better the economics of convenience, you say they are superior. Can margins fully costed or lease adjusted remain higher for a sustained period?

Answer: Justin King

As far as the online is concerned, at least in part the various different approaches that the grocery retailers are taking reflects a where you're starting from position. Our view is that a store picked model is still our preferred model, it works very well for us. We've made significant productivity improvements over the last 12 months as I showed. And, of course, with a well distributed store estate the opportunity to reach most of the UK population is quite high. That said, if online keeps growing at the pace that it's growing with a particular south-east focus, which is where the strongest growth frontline remains, very likely if one takes a three to five year view, we'll have to look at a dark store model. But of course that's more a reflection of capacity rather than us viewing it as being a preferred model.

There is a trade off to be made, one which we're very clear on in terms of not being prepared to impact on the customer experience in-store. Certainly Tesco have said they believe that they've hurt the customer experience in-store with their online and that's one of the reasons they're accelerating dark stores. We don't think it's necessary, in fact we have many examples where by investing in dedicated online in-store pick models like for example in our Beckton store, you actually can improve the in-store customer experience, so you get a win-win. So we believe in-store pick is the right model and for the foreseeable future will be the core of our model and it has plenty of capacity in it.

As far as click and collect, we have a click and collect operation in 1,000 stores for our non-food. We're not testing and we don't believe it's the right model for food, but it's not a particularly high barriers to entry if it turns out to be that. If you look worldwide where click and collect has had most traction it's been in France. I'd argue that fundamentally click and collect for groceries is about addressing the inappropriateness of your core model to a lot of the shopping visits for customers. If you've got a 150,000 square foot hypermarket in an inaccessible location and it's going to take you eight or ten minutes to fight your way through the shopping mall and the non-food offer force flow before you can find fresh food, there's a big pay-back for click and collect in the car park.

Therefore I think it's not all together surprising that the people that are testing click and collect first in our marketplace are Asda, because they broadly speaking have the biggest most inaccessible stores, so it may be the car park pickup benefit is greatest there. But as I said we'll watch the developments of others, if it proves to be a winning model for customers it's relatively easy to fast follow, but we don't see ourselves doing it at the moment.

Answer: John Rogers

And, John, just in terms of the convenience returns; our operating margins slightly higher than they would be in supermarkets. Obviously our price file is on average about 5% or so

higher, there's clearly higher distribution costs, but that all drops down to slightly higher operating margin contribution. Then in terms of the asset turn, the ability to sweat the assets, typically, you've got a much higher trading intensity in a convenience store than you would have in a supermarket, so the asset turn is remarkably higher. When you multiply those two together of course that gives you your overall return on capital. And as we've guided to previously we typically expect to see return on capital about 1.5 times that that we would see in a supermarket business. And of course that's already lease adjusted. If you reflect the fact that the vast majority of our convenience stores are leasehold, then in terms of accounting returns you typically expect to see that being 3 times, but of course there's a bit of smoke and mirrors in that number.

Question 6

James Tracey, Redburn Partners

I'm just wondering if you could explain the impact of increasing use of promotions similar to the Brand Match. So Tesco's have got the Price Promise and Waitrose has something similar. Everybody seems to be doing this price matching thing that you started with. Can you explain what it means for your business and do you see a competitive threat from Tesco doing the same thing?

Answer: Mike Coupe

Thank you for that question. I think some of our competitors wouldn't necessarily credit us with being first to the market, because Asda were running their Price Promise well ahead of us and Tesco followed Asda, albeit it was an online version rather than an at till version. I guess the new news in the market is firstly that other people have joined in the fray, but secondly Tesco effectively have matched a similar mechanic to the mechanic that we run, by issuing coupons at till for the price differences or registering where they're cheaper.

The difference is our own label. I think we've talked a lot about our concerns around comparing our own labels with their own label products. We would clearly notice and recognise a difference in our products compared with theirs, and we've talked about that extensively. And in terms of the problem that they are trying to address, I'm not sure we would recognise that. The reality is that our challenge is around our underlying price perception, and we have clearly addressed that through our use of Brand Match, particularly on brands, where our branded prices we know are a match to our competitors. We don't recognise that they have necessarily the same challenge within their business. But you know, we watch closely and we will see how it goes.

Answer: Justin King

I think the thing I'd add is a kind of a general point, which is that if everyone spends a lot of money telling every consumer in the market that all prices are the same, that must be our agenda, because it moves the conversation away from price as a differentiator onto quality as a differentiator. So the more price is neutralised, the better the competitive agenda for us.

Question 7

David McCarthy, Investec

Previously, Justin, you'd said that the full economic cost of a home delivery order is £15. Obviously you've had some productivity gains, but then you've got inflation. Ballpark do you still think that figure is about right?

Answer: Justin King

Yeah, I mean, I think in terms of looking at the maths of our home delivery operation, that's not a bad figure to think in terms of, I mean clearly there are productivity opportunities. There actually isn't a big difference between a well run in store pick model and a dark store model now, we don't think. Other than of course one is using existing assets largely and the other clearly you have to invest in new assets which have no other productive use. And given that the average delivery charge is probably somewhere between £3 and £5, the question is always where that extra £10 in value comes from, which you're effectively giving away in the service that you provide. And that's where the whole issue of Nectar, understanding the relationship between online and in store shopping, becomes important. It's part of an investment in some of our most loyal or harder to reach customers, and that's why it makes sense.

Of course clearly if you're not a multichannel business, then you have to make sense of the investment in isolation, and if you don't have the data, this is quite a scary conundrum, because there's £10 going missing and you're not absolutely sure where you're making that £10 up in your total relationship with the customer. We're confident about that. We know where it is and we know why it makes sense to drive online. And I've said before that we can, through data, see where there are customers that are likely to be an online shopper with one of our competitors and target them; indeed see our customers shopping in store when they either have or are likely to become an online shopper and incentivise that too. We actually incentivise in store shoppers to start shopping online with us. And you'd have to understand that dynamic very well to go down that road.

Concluding comments: Justin King

Okay. We'll call it a day at that. Thank you very much.