J Sainsbury plc

First Quarter Trading Statement

Wednesday 12 June 2013

Justin King – Chief Executive Officer

Good morning everyone and thanks for coming on the line. I'm joined by Mike Coupe and John Rogers. As you'll know this is our first quarter trading statement for the 12 weeks finished last Saturday 8th June.

As you'll have seen we delivered a solid sales performance to start the year in what remains a challenging market. Our total sales up 3.6% or 3.3% excluding fuel, and our like-for-like sales up 0.7%, or 0.8% excluding fuel. A strong contribution there from new space, as you'll see, and the underlying performance reflecting challenging comparatives, particularly of course the Jubilee last year. Our market share continues to grow, latest market data showing it up 0.2% to 16.8%, and we remain the only one of the big five grocery retailers to be growing market share.

Underpinning that performance is the great service and availability in our stores. As you will have seen last night at the Grocery Awards we won both the customer service and availability awards over the last year. A great testimony there to a fantastic job being done by our 156,000 colleagues.

Of particular note, in the quarter, is the performance of our own-label ranges: *by Sainsbury*, the re-launch now complete, up 7%; and *Taste the Difference* up 10%, driving our own-label penetration to a recent times high.

In a separate announcement today we update on our *20x20 Sustainability Plan*. I encourage you to read through that announcement to see the progress that we're making. A couple of highlights we've drawn attention to today: the joint investment we've made with our supplier Dunbia in Wales, securing around 600 rural jobs, but also supporting the Sainsbury's Land Development Group, primarily welsh farmers who provide almost all of our new season lamb.

And we also reached an important milestone, part of our Paralympic legacy, our 2000th disabled colleague secured through our partnership with Remploy.

Looking at other legs of our growth strategy, general merchandise which continues to focus on being complementary to our food offer, is growing at twice the rate of food. And particularly noting homeware: kitchen electrics, up 34%, cookware up 23%; reflecting the fact that the offer is complementary to the weekly food shop, showing market contrasting growth.

Convenience driven by good underlying like-for-like plus 19 new stores, up 20% year-on-year on the quarter, and online continuing to grow in the mid teens just in excess of 16% in the quarter. As I've already mentioned, 19 new convenience stores and 13 refurbished. Of course our first convenience store celebrated its 15th birthday in the quarter, so some of our older stores requiring refurbishment, and one new supermarket with six refurbished, bringing our total new space in the quarter to 82,000 square feet. You'll note reduced level of extensions now contributing just 0.2% to our growth figure.

As we look forward we believe our continuing advantages through helping our customers *Live Well for Less* through the use of our own-brand ranges, through *Brand Match* to reassure on price, the unique technology that is coupon-at-till combined with Nectar means we remain well-positioned to outperform the market in what we expect to remain challenging for our consumers.

With that I hand over to questions.

<u>Question and Answer session</u>

<u>Question 1</u>

Edouard Aubin – Morgan Stanley

Good morning gentleman. Regarding the private label growth, you mentioned the re-launch driving the good performance; could you provide a little bit more colour as to why you are so significantly outperforming the market? Because a number of your competitors have also done re-launches recently. And what is the ceiling for you for private label participation in your mix?

Answer: Justin King

I'll ask Mike to talk a little about the detail of the re-launch, but just to nail the headlines:

By Sainsbury's is about 40% of our sales so it's the main event when it comes to own-label, as I said up around 7%. Our overall own-label penetration now at around 52%, that would be the highest certainly in the last five or six years. And probably, we would measure that as about a 5% delta to the market; the market of major grocers would be around 47%. And importantly that's a couple of per cent more than it would have been in the quarter last year, so it was around 50% in this same quarter last year. Worth making the point by the way that own-label penetration varies quarter to quarter because of the different seasonal purchasing. That 52%, that 2% increase of course worth pointing out would deflate our sales a little because own-brand is significantly cheaper, around 20% to 30% cheaper than the equivalent brands; so it's a great way of putting money into our customer's pockets at no cost to the P&L.

As far as the success of the launch, Mike?

Answer: Mike Coupe

It's a slightly glib answer but we would say that our products are better than our competitors', so in the end that's what drives our major point of difference. And we've invested very, very heavily particularly in *by Sainsbury's* over the last couple of years. But of course we re-launched *Taste the Difference* in September 2011 and that's also helped to drive our business. *Taste the Difference* has grown by roughly 10% compound for the last couple of years; it's now £1 billion sales in its own right. So, it's a significant business. We're seeing significant growth.

We've reporting today that we've completed the re-launch of *by Sainsbury's*. And it's underpinned by a marketing programme which makes sure that we follow it through the line. So the merchandising in the shops, the advertising you've seen recently for *by Sainsbury's*; the quality of the products – it all flows through. A good example of that is our fresh ready meal range: significant re-launch, big re-merchandising, alignment of prices, investment in quality; and all of that has come through in the sales growth. And of course it's underpinned by our values: we make a big play of making sure that we reach right the way through the supply chains, we know where the product comes from, that we source the ingredients responsibly and sustainably, and that works in the overall mix.

Question 2

David McCarthy – Investec

You've obviously produced the best like-for-like amongst your competitors, but you're disadvantaged yourselves or you're disadvantaged because of the timing impact because you've got the Jubilee comparison in there. To give us a feel for your relative outperformance can you tell us what the run rate was maybe for the first ten weeks of the period and just exclude that Jubilee weekend? Because that would give us a more direct comparison with your competitors; just a feel would be helpful.

Answer: Justin King

Well, you don't need us to do that for you, David. If you look at the Nielsen data which came out last week, which is for the 12 weeks to 25th May, which is the 12 weeks that Tesco reported last week, and therefore excludes the two weeks of the Jubilee impact, you would see they pick us up just a little bit short of 2% like-for-like. Whilst of course there are always slight ebbs and flows in Nielsen, we wouldn't demur significantly from that.

David McCarthy

That's really helpful. Thanks and well done.

Question 3

Clive Black – Shore Capital

You talk about a challenging economic environment, Justin, but a lot of the secondary data on the UK economy over the last six to eight weeks has been more fundamentally positive than it has for some time. I just wonder to what extent you would be expecting to be more positive about the consumer in quarters ahead as opposed to where you are now. And in particular what you took from the consumer confidence data last month, which had its largest upward move for some time.

Answer: Justin King

Yeah, I think there's a difficult balance to be struck here Clive, because what the data is actually showing is that people are less negative than they once were. Of course it's absolutely right, and indeed it's in our interest to have a more upbeat backdrop to the consumer environment, I think it's helpful that that is the commentary that we're seeing in a lot of the news media. But I think we have to be realistic that still almost every measure of consumer sentiment remains negative, albeit less negative than it once was. And that's a good thing because clearly it's been resolutely downbeat for a long time.

If you look at the realities of household budgets, there has been an easing in pressure in recent months. If you look at fuel, I can't remember the last time we reported a quarter sales where fuel was deflating the headline figure, because we actually saw fuel I think an average of about four pence a litre cheaper in the quarter than it was a year ago, and it's been a long time since that was true. So there are some real reasons why people might have a little bit more money to spend. But in terms of behaviour, we see the behaviour of the last two or three years as being very ingrained; and that is that when there are special occasions, more recently for example the prospect didn't turn out to be a reality, but the prospect of a sunny weekend, we can see consumers have kept enough money by to enjoy. But when there isn't a good reason to spend, they're being very circumspect with their expenditure. We think that dynamic will remain for a good while yet. They'll need to feel a good bit more positive, and feel when they look at their bank accounts a good bit more wealthy if you like, before they start splashing out a lot more. But the direction of travel's helpful, I agree.

Answer: John Rogers

Clive, one of the key drivers we've always looked at is of course consumer disposable income, and that does seem to be quite well correlated with like-for-like performance in the market, and if you look at most economic forecasts they're not projecting a material uplift in disposable income in this current financial year. It may come through the following year, but the next 12 months looks broadly similar to the last 12 months.

Further question

Just by way of a quick follow up if I may. Would you see any reason as to why the big four or five supermarkets wouldn't capture an improvement in consumer confidence and expenditure, i.e., do you believe that that expenditure could actually go elsewhere as opposed to supermarkets?

Answer: Justin King

Well, what's the line here, rising tide raises all boats. That will definitely be true. In terms of going elsewhere, I think that there are two aspects to that question. One is that clearly if people have a little bit more money to spend when the celebratory times come along, I think that's when they'll spend it. So if you were looking at the Christmas quarter, for example, it would make you more optimistic about what people would spend in the last two or three weeks before Christmas, not optimistic necessarily about the whole of the quarter. But there's no doubt that non-food is more geared to disposable income. But that's why we make the point again in our Statement, that notwithstanding the pretty downbeat noises from non-food retailers and some of our competitors about their non-food business, our non-food business remains very strong, and if there is to be an uptick in expenditure in that area, we think we've positioned our non-food business very well to capture that.

Answer: Mike Coupe

Clive, it's just worth reinforcing John's point. If you look at the trends over the last couple of decades, there's a direct correlation between disposable household income and market growth overall. Now, as you guys often say, past performance is not necessarily an indication of future performance, but if householders' disposable income increases then as night follows day the chances are that the growth of the market will increase.

<u>Question 4</u>

Andrew Kasoulis – Credit Suisse

Just to square the sales circle a little bit, what was your branded grocery sales growth? I'm guessing it was sort of flat to small negative, and if there's any colour on that please. And what was inflation for the quarter?

Answer: John Rogers

Andrew, you're broadly right, on branded growth we're roughly flat to make the numbers add up, so that's correct. And on inflation, we saw inflation come off a little bit, so about 2.5% in the quarter.

Further question

Thank you. Any colour on branded grocery? Was it just the outperformance of own label, or was there something specific to branded grocery that led it to lag a bit?

Answer: Justin King

I think if you've been watching us week-to-week you'll see once we completed the re-launch of *by Sainsbury's*, we did a very major promotion in-store, it was a big cycle for us, as Mike talked about it was a through the line execution from TV, direct mail activity and then in-store execution. So to some extent you do a big promotion in a 12 week cycle you're going to have that effect. It does make us, if you look at the market data, somewhat less promotional in the quarter than has historically been the case, a good bit less actually than the average in the market in the quarter, because obviously own brand tends to be less promotional and slightly more – well EDLP's an over statement of the case – but slightly more EDLP.

<u>Question 5</u>

John Kershaw – Exane

Two related questions. One of you mentioned promotion intensity coming down. Clearly we've seen quite a lot of let's say untargeted activities and the likes of Tesco with £5 off £40. There are two related on this. One, what's your sort of giveaway from coupon-at-till done in terms of perhaps more targeted promotions in terms of uptick or downtick year-on-year?

Secondly, notice in terms of online, what is your game plan there? Because seeing a plethora of £15 off £60 spend, which is clearly a big discount and an untargeted discount. So perhaps talk around those two.

Answer: Justin King

I think there's very little colour we're going to be able to add on coupon-at-till. As you'll know, we've always reported our sales performance both in our quarterly trading statements and prelims and interims compliant; and for the very simple reason that we think the ebbs and flows of what we're spending on coupons are commercially and competitively confidential, so we report as if it were cash in till and therefore don't reveal and won't reveal effectively our marketing investment.

But what we can say is that as we learn over time we think we get better at spending that money, we understand what motivates customers, we have an underpinning objective which is that the more customers use the vouchers we give them the better the vouchers must be. We don't subscribe to the view of some that somehow printing lots of vouchers that don't get used is a good idea, we like customers to use the vouchers, it means we've given them vouchers that they want and that change their behaviour. So we're very comfortable with our developing understanding there and with the level of investment that we're making. Of course more widely we've long since annualised on brand match, so that doesn't represent a material incremental investment as it did of course through most of calendar 2012.

As far as online is concerned, again it's much the same thing. I think we much better understand now the value of a newly acquired online customer, someone that's shopping in-store, but we believe from their shopping patterns that they're probably online shopping elsewhere. Or indeed we understand quite clearly when people tend to start online shopping – this won't give away much – but you won't be surprised to know that a baby entering the family is a key trigger for online shopping. And of course we can see when a baby's arrived and we can encourage and reward customers for moving their shopping online with us at that time. So again, I think we would describe the level of activity on online at the moment as being very high, we're participating in that, but we would argue that we're more targeted than anybody in where we're spending that money.

Answer: John Rogers

John, just to follow up. The key point is over the last three or four years the balance between headline untargeted stuff in our business compared with the more effective targeted stuff has changed pretty significantly. So, for instance, our weight of press advertising is roughly half of what it would have been say three or four years ago, and that money is recycled into more targeted marketing, and of course as we learn about that targeted marketing we get better and better at it, it becomes more efficient, it becomes a much better way of spending the money. And that's particularly reinforced in online where I would argue that we don't have to be quite as route one in our approach as some of our competitors, we are able to pick the right customers, the customers who are more likely to change their behaviour towards an online offer.

John Kershaw

Okay, it just looked pretty untargeted on the online in contrast to the other stuff, but perhaps you could tell us…

Mike Coupe

Have we been sending you lots of vouchers then, because I can get you switched off?

John Kershaw

No, there was a plethora of coupons, of £15 off 60 basically in the till receipts by the bins in store, because we thought you might be targeting them but they clearly were generic.

Justin King

Well of course this is the direction of travel, we also always make sure that we're competing at a headline level with all of our major competition as you can imagine. I think it's an important point though because the key to success is that consumers are shopping in multiple channels for their groceries, we showed you this chart back, I think the first time at our interims last year that showed you that the sort of two plus two equals a number bigger than four effect, particularly between supermarkets and online, it's less dramatic when it overlaps with convenience, but it still works. And if you can identify in store shoppers who are either likely prospects to be shopping online or likely to already be shopping online elsewhere there's a huge benefit to the business of locking in their online shopping too, it ultimately gets them to spend more money in the grocery store as well. So you will absolutely see in retailers with data who have stores and online operations more not less of that activity.

Question 6

James Anstead – Barclays Capital

Thanks, just one question from me. Just about your non-food, I know your offer's designed to be complementary and you're clearly much less exposed to big ticket electrical items, but I wonder nevertheless, are you taking an active look at whether you might want to change the non-food space allocation at the margin or do you think that's just really a non issue for you?

Answer: Mike Coupe

Well, if you go to our Kings Lynn store you get some sort of flavour of the future and that's basically changed the balance of space towards more home products, home textiles, home electricals, kitchen utensils those kind of categories; paper shop, so cards, wrap, higher margin categories and is playing a little bit of a balance between that and high ticket electricals and of course entertainment which is the other sort of big space item. Our view of entertainment is that we'll be selling physical products for a good few many years yet, but clearly in a market which is in not insignificant decline rebalancing the space is a very important part of the overall portfolio. But you can get a flavour of where we're taking the offer as I say in our latest milestone stores which are Kings Lynn and Weedon Road and that will give you a good idea about what we're thinking about for our future.

Answer: John Rogers

And if you look at the electrical, stationary and leisure category overall it's actually one of our fastest growing non-food categories, within that, as you rightly highlight, big ticket electricals is down slightly year-on-year and that's to be expected, so the mix is changing, but overall across the board that's one of our fastest growing areas.

Mike Coupe

Well of course the industry's annualising the combination of the European Football Championships last year and of course the Olympics, so there's probably going to be some quite tough comparatives for the market in general.

Further question

And just quickly to follow up on that, if Kings Lynn is kind of where your thoughts currently are does that mean you'll be going back to a lot of your existing stores and making changes or is this really very much a gradual evolution?

Answer: Justin King

You'll have to wait and see, but self evidently if it's working we balance the sort of roll forward into new extensions and new stores with a roll back into existing shops, but it's fair to say that Kings Lynn has worked out pretty well and we're pretty pleased with the result. So watch this space.

Question 7

Sreedhar Mahamkali – Macquarie Securities Group

Yes hi, good morning. Just picking up there on non-food, are you able to just give us an idea of how big electrical is as part of the non-food mix, and then if you could give an idea of overall non-food like for like in the quarter.

And secondly, if you can just talk a little bit about convenience, that looks like 20% is faster than what we've seen throughout last year, not wildly different, but a bit faster, is there any change in the underlying like for like dynamic, given that I think the store opening rate seems to be about 19 or 20 stores a quarter? Thank you.

Answer: Justin King

Yes, I mean I don't think we're going to break out sort of individual categories, we don't in the food business and I don't think we'll do that in non-food either. What I would just add to the previous commentary is that, I mean Mike made the point about last year and the European Football Championship and the Olympics which of course provided a kind of reason for chasing flat screen TVs, big ticket electricals. The reality is that one of the quickest and easiest ways to put top line sales into a grocery business is to sell a lot of flat screen TVs at 300 quid and no profit, we've not done that in the past, we don't have those comparatives therefore to bump up against. We will continue to sell big ticket electrical items, we still sell a lot of them, we sell them at fair and competitive prices on a consistent basis, and flat screen TVs just like the rest of our non-food offer can and are complementary to a weekly grocery shop. But it's fair to say that's a category that has been used in the past by some to chase short term sales.

And I'd make sort of a wider point to Mike's answer about Kings Lynn, I guess there's an implied question in those that have been asked about macro space, in other words, have we in total got much too much space to non-food. And we believe the answer for Sainsbury's to that is resolutely no, we've never opened stores, even our very biggest stores of which there are a small handful are dominated by food, we've never opened stores dominated by non-food and we do not believe we have any major macro space issue to address. And you'll see in Kings Lynn it's still a store when you leave it that you think you've been to a fantastic food store first and foremost.

As far as convenience is concerned, a strong quarter, a good step up in the underlying like-for-like, we are seeing more life cycle growth in convenience stores than perhaps historically we thought was likely, I think we've said several times that we expect convenience stores to mature within a couple of years and find their level, whereas a supermarket can take three, four or five years. Actually we're seeing convenience stores having year two and year three underlying maturity in them, reflecting the changing shopping behaviour, people topping up. And it's one of the reasons you're seeing us go back to parts of town where you might have thought we were done and dropping another convenience store halfway between the two that already exist because it's such a strong trend it's giving us the opportunity to put them closer together and they have a nice life cycle growth.

I don't know if there's anything you want to add, John?

John Rogers

No, I think you've covered it all. As Justin said, really strong like-for-like in convenience in the quarter. Without giving too much away it's around the 3%, 3% to 4% level, so a strong reflection of good growth in that sector.

Sreedhar Mahamkali

So non-food like for like? Are you able to give a number there or not?

Answer: Justin King

Twice food.

Sreedhar Mahamkali

Right okay. So that was overall sales growth, right?

Answer: John Rogers

The overall sales growth is more than double that of food. In terms of the like-for-like, again if you include the benefit of extensions, it would be around the sort of 4% to 5% level. If you strip out the extension piece the pure underlying core non-food like-for-like, around 2% to 3%. So a good performance across the board.

<u>Question 8</u>

James Tracey – Redburn Partners

Good morning guys. Just looking through your annual report that you published recently it looks as though your true gross margin increased by around 70 basis points last year. I was wondering to what extent that was due to a non-food mix and possibly increased private level penetration and where you see it going in this year and future years. Thanks.

Answer: John Rogers

I think the analysis that you're probably referring to, James, is the cost of inventory number and I think I would argue that's not really a true underlying reflection of gross margin because it doesn't reflect of course all of our investment into direct marketing, brand match, etc, etc. So I think to look at that number and assume it's a surrogate for the gross margin I think is misleading.

James Tracey

Okay, so where would you see your underlying gross margin them, including all that other stuff?

John Rogers

Well, as you know it's not something that we would ever comment on, James.

James Tracey

Okay, well that's perfect, thank you.

Concluding Comments – Justin King

Okay, well thank you everyone for coming on the line, we're not going to be talking to you now for a little while, quarter two being our long quarter, so enjoy your summer break if you have one planned, and we'll be speaking to you in October. Thank you.