J Sainsbury plc

Second Quarter Trading Statement

Wednesday 2nd October 2013

Justin King, Chief Executive

Hello everyone, thanks for coming on the line. I have John Rogers and Mike Coupe with me. I appreciate you coming on early: we're doing the call earlier today for obvious reasons. This is our Second Quarter Trading Statement for the 16 weeks ended last Saturday 28th September, and as you will have seen we delivered strong sales, market outperformance and market share growth.

Our total sales for the second quarter up 5%, or 4.6% excluding fuel, like-for-like 2.1%, or 2.0% excluding fuel. And that brings our like-for-like in the first half to 1.4% excluding fuel, at the top end of the 1% to 1.5% range we guided to.

As I've already mentioned, market share growth as measured by the key market monitors, the only one of the major supermarkets to be able to say that, and in a quarter where we lapped tough comparatives, particularly during the Paralympic Games last year. Of course we matched some of that activity during the quarter with our support of the British Athletics and Paralympic programme through the Sainsbury's Summer Series. I know some of you got the opportunity to enjoy that, both at the stadium but also on television, a fantastic demonstration that we're continuing to play our part in that Olympic and Paralympic legacy.

Our underlying sales driven in particular by the sales of own-label, growing twice at the rate of branded goods: *Taste the Difference* particularly strongly; and *by Sainsbury's*, the main part of our own-label offer too.

And many first and leadership positions to note. As we start the new British apple and pear season, I am pleased to note that during the '12/'13 season our leadership position, the fifth year in the running, maintained the largest and widest retailer of British apples and pears.

But of course the real growth successes in our business are online at 15% and convenience at 20%, convenience in particular benefiting a little from that summer weather where people tend to top up a bit more when the weather is warm.

But general merchandise continues to grow strongly too, again around twice the rate of food, continuing its long run of outgrowth. We re-launched our Tu clothing brand in the quarter, it's now in around 400 stores, and we've had a fantastic Back to School season with highlights like a million polo shirts, showing that we are now mainstream for school uniforms.

Our sales performance though underpinned by great standards in our stores. We believe that the standards in our store service and availability are the best that they've ever been. And that's recognised by the industry, in the last week or so at the Retail Industry Awards we were awarded Supermarket of the Year for the sixth time in eight years, and a fourth year on the trot for our convenience business, demonstrating that the industry recognise our outperformance on these measures. And of course the Grocer 33, which I know many of you watch, has awarded our store Store of the Week 10 of the last 16 weeks, so we can be confident that our own store standards are industry leading.

We continue to invest in new businesses, of note in the quarter the launch of *Mobile by Sainsbury's*, a joint venture with Vodafone. A great growth opportunity for the future there.

And of course we've continued to invest in our store estate, 31 convenience stores and 5 new supermarkets in the quarter, adding 307,000 square feet of space, meaning we're on-track to deliver the 1 million square feet we've guided for this year.

So in outlook terms we are of course encouraged by improving economic indicators, but our customers' budget challenges remain. Food inflation running at around 3%, wage inflation is a good bit behind that, and so they're continuing with the behaviour that they've adopted during this economic downturn of savvy shopping. And the unique tools that we have at Sainsbury's, be it our Brand Match coupons at till, our use of Nectar data, and of course as I've already mentioned our leading own-label offer, we're helping our customers *Live Well for Less*. We're investing, as you would expect, heavily on unique and innovative products for our Christmas run-in, and therefore we're confident in the quarter ahead that we can continue to out-trade our competition.

And with that I'll had over to questions.

Question and Answer session

<u>Question 1</u>

Edourd Aubin, Morgan Stanley

As you mention, you continue to outperform your main competitors and continue to gain market share. Have you seen any substantial change in any of your main KPIs such as product availability, private label, price perception, explaining this outperformance, or are you just improving your offer across the board?

Answer: Justin King

The answer really is an across the board answer. This is about small incremental notches on many, many measures rather than any one particular spike. I mentioned the wide industry recognition of our service and availability. The delta/gap that we enjoy versus our competition on our measures of service and availability is as wide as it's ever been. To some extent that's more a measure of us maintaining high levels and some others slipping a bit on our measures, but nonetheless it is across a whole wide range of measures where we are maintaining the gap where we have leadership, or closing the gap where we're coming from a bit behind, as of course we are on price possession. But it's little notches across a whole wide range of measures.

Answer: Michael Coupe

And certainly in terms of if you looked at the independent external measures, our suppliers would recognise that we are the best at executing in the industry, and I think that's reflected in our customers' perception.

Answer: John Rogers

And I think Edourd, even in your own report of a few weeks back on price, we were absolutely competitive in the market compared to our peers.

Question 2

Andrew Gwynn, Exane

Just going back to the comment you made on an improved consumer and so forth, obviously consumer confidence is picking up, but as yet as you comment we're not really seeing that in the broader industry, I know your like-for-like is reasonably good, but the broader industry is still pretty flat. When would you expect to see the improvements come through, and are there other forces at work? I mean obviously we hear a lot of comment about discounters, we hear a lot of comment about supplies. I'm just wondering about that relative balance between the demand and the supply side?

Answer: Justin King

I think what I try to balance in my commentary is that there are economic indicators which are more positive, or one might perhaps argue less negative than they've been, but that from a consumer perspective they've not noticed the difference. I guess they've noticed the difference when they open their newspapers or switch on their TV in terms of the drumbeat of commentary, they're certainly not hearing relentlessly bad news which would have been the case a year or two ago. But the reality for consumers is average wages are up maybe 1% year-on-year, inflation's running at about 3%, and that's the reality of what the vast majority of consumers experience. So we're always quite cautious of overplaying the economic indicators because we think the average consumer says if they hear for example me on television saying that, "Well not for me, it's not, I'm still struggling each week to make the household budget add up".

I suppose implicit in your question is, if there were to be a sudden change in consumer perception of how well-off they were, or even consumer reality, would that lead to fundamentally different shopping behaviour? Our assumption is no, we think the habits that consumers have developed over this economic downturn on the whole they quite like. We don't imagine that consumers are suddenly going to wake up one morning when they get a pay rise and say, "I'm going to go back to throwing away food".

So we don't think that you should sit waiting for a sudden change in consumer behaviour to lead to fundamentally different market conditions, we think we're dealing with if you like a new reality, and the fact that we're able to grow within that new reality consistently over the long-term, we believe is a demonstration of the fact that we're understanding that with our customers and giving them the solutions to that problem.

Further question:

You talk about new reality, and I think we probably all recognise many elements of that, but do you think the industry is in the right sort of place? I'm coming back again to that supply side of things. I know your opening space, you're trading relatively well, but everyone's opening space. Is there a broader imbalance do you believe? I'm sure you've read plenty of commentary from us and pretty much everybody else that writes on the sector that our belief is, but what's your belief?

Answer: Justin King

I think I've been quoted in the past as saying that individual space owning strategies can be rational and collectively irrational, but I've also said that if you add up the total for the industry, we have for the last two or three years as an industry clearly been opening more space than has been the historical average. But the question therefore is for individual retailers whether it remains rational for them, and two of our competitors have in recent times said it is no longer a rational strategy for them.

If of course they do notch back or even step back in a big way from their space opening strategy, then the conundrum for the wider industry is significantly reduced. If we look at our space opening approach, we're opening convenience stores, very comfortable with that, I think you would be too with the number of opportunities there are there to reflect customer shopping behaviour. We are extending our existing estate and our new extensions continue to perform very strongly, and the new stores are adding are on the whole in parts of the country where we're not. So we think our opening strategy remains entirely rational and a good use of shareholder funds.

Question 3

James Tracey, Redburn Partners

Can you confirm some external surveys which show your promotional levels are down from a high level last year? And does that help the profit outlook at all for this year? Thank you.

Answer: Justin King

Yes, there's been a slight downturn not just for us but for the industry in general on promotions, and we are basically fundamentally changing our trading strategy, so we are looking at stabilising our prices, but we continue to help drive our promotions as well. So overall that is reflected in the numbers. It's also one of the things that's driving our performance. Our customers see continuous value day-in-day-out, week-in-week-out, and that's reflected in our sales performance.

Further question

Also, it seems as though your like-for-like was better in this quarter than you were hoping for at the beginning of the year, especially given the comparisons with the Paralympics. Do you see any need to increase your guidance for full year like-for-like?

Answer: John Rogers

You're right James, it certainly was a strong quarter at 2%. But if you look over the half, we're reporting a like-for-like of 1.4% for the half. Clearly we guided at the prelims to a like-for-like for the full year of between 1% to 1.5%, so we're currently trading at the upper end of that range. But I wouldn't expect to change that guidance for the rest of the year, I think 1% to 1.5% still remains the case.

Question 4

Frank Walding, Goldman Sachs

I just had two questions. The first of which was just on online, clearly the continuation of good growth in that business. Could you confirm whether you're thinking about dark stores in terms of your investment plans over the next couple of years?

Answer: Justin King

I don't think we've got anything to add on that, Frank, from what we previously said, which is that we think dark stores are likely to be part of the future. But our first focus is to invest on productivity in our existing operations, and we continue to exceed our own expectations of what's possible from a store pick operation, both in terms of the productivity of that operation, but also in terms of the capacity. The key balance in an in-store pick is that you don't want it to interfere with the in-store experience for real customers in the store. The progress that we've made over the last two or three years, both in the layout of our stores but also in the timing and approach of our picking operations, means that we remain confident we've got capacity growth there. But dark stores will come, I don't think that that's in debate, and as we've seen from our competitors the capacity constraint for them will be the same for us, it will be in the southeast.

Further question

Thank you. My second question was just on your pension review. Have you got any updated timelines on when you're likely to communicate that?

Answer: John Rogers

James, we'll say more about that at the interims in a few weeks' time.

<u>Question 5</u>

Andrew Kasoulis, Credit Suisse

I know it's not a results' statement, but could you just comment on full-year consensus please, whether you're comfortable with that? Presumably you are. And second question, what level of like-for-like do you think you would need to see some operational gearing going forward? If 1% to 1.5% doesn't give you any operational gearing in terms of margin going up, what sort of level do you think you would need going forward?

Answer: John Rogers

I'm afraid I'm going to give you the usual comment, that obviously today is a trading statement and we're not going to comment or be drawn too much on profitability. But I would say obviously that we guided the prelims to a like-for-like range of 1% to 1.5%, and clearly for the half we've delivered 1.4% so we've delivered at the upper end of our guidance range, which I think is a very positive story.

Answer: Justin King

The other thing I would add to that, because there is an implication in your question which I don't agree with, which is that the implication of your question is that you need more than 1.5% like-for-like to deliver operational gearing. There is no absolute conversion from like-for-like to operational gearing, the key to operational gearing is of course relative. If you were to look at our operational gearing relative to our major competitor for the last couple of years, you will see that it's fabulous. But our major competitor, against whom we clearly have to ensure our offer remains competitive, has significantly rebased their profit levels. So I think you have to recognise the relative context, rather than assume that any absolute level of performance is necessary to deliver operational gearing.

Answer: John Rogers

I think it's fair to say that in absolute terms we've delivered at the upper end of our range. In relative terms we've beaten the market by slightly more than we would have expected to. But you can draw your own conclusions from that.

<u>Question 6</u>

Jonathan Pritchard, Oriel Securities

Just a quickie on store standards and staff levels. Is it a case of getting existing man hours to work harder for you, or are actually there some more people actually in the stores at the moment?

Answer: Justin King

It's more the former than the latter. Obviously we've, I think, got an enviable track record over the last number of years of both improving our productivity and creating a good number of extra jobs. But when you've got productivity delivering 1% to 2% gains, and underlying sales growing at 1.5% as they are in the first half, that's roughly going to play a draw in terms of colleague numbers.

Answer: Mike Coupe

And also if you think about our shops, we've simplified our offer and our approach quite dramatically, so our stores are a lot cleaner and tidier and therefore more easy/simpler to operate.

<u>Question 7</u>

Keith Richardson, Lloyds

Just a quick one on basket size, or at least directionally. I'm just trying to get a flavour of what you're seeing in terms of online in your stores and convenience, how are people shopping, what are you seeing them up to, and what directionally are you seeing a shift away from one form to another?

Answer: John Rogers

Actually Keith, what's really interesting is that we're seeing a small increase in basket size across each of the channels that you mentioned. So obviously in convenience we've had a very strong quarter for convenience and seen an uptick in the basket size there. But also for our main estate as well we've seen a small uptick in the basket size on a like-for-like basis in our supermarkets. Again, the same is true year-on-year for our online channels. So what's really pleasing is we're seeing growth in basket size across all three areas.

Further question

I just wanted to get a flavour there. Picking up on Justin's comments in terms of how people are changing their shopping habits and cooking from the base position, I was just trying to get a flavour on how people are shopping, so that's very useful, thank you very much.

<u>Question 8</u>

Mike Dennis, Cantor Fitzgerald

I just want to get an idea in terms of your like-for-like food performance, because you base most of your other comments on how your other business is growing relative to that. And I just wondered if you could give us an understanding of the 0.8% to 2% improvement in the total like-for-like, what is the improvement in the food like-for-like? Has it gone up 0.5%, 1%, what has the improvement been quarter-on-quarter?

Answer: John Rogers

As you know, we don't disaggregate the like-for-like number into those different components, but fair to say we've seen growth again in all areas, so there's a good contribution from convenience in that like-for-like, a good contribution from non-food, but also a good contribution from our food business within that like-for-like number.

Further question

Right. But you would have seen the Tesco figure, I think that they inferred they did a 1% like-for-like in food or a 1% growth in food, that's obviously a big improvement from whatever it was, 0.2% or 0.3% in the first quarter. I was just wondering if that was more of a reflection of the industry, or do you think you've outperformed the industry in food?

Answer: John Rogers

Well, I think we're confident that we've outperformed the industry overall in terms of our numbers. If you look at the food business, I think our growth again reflects that. We're not going to break out the detail of that in the like-for-like number, but it is positive, as it is for the non-food area and for convenience and online.

Answer: Mike Coupe

And I'm sure you can disaggregate the numbers in a number of ways, so it depends what you define as food of course.

Further question

Absolutely. Okay, I thought I'd try. Thanks a lot.

Concluding comments: Justin King

Thanks very much. I guess many of you have dashed off to other events this morning. We look forward to updating you on our results in the middle of November. See you then.