J Sainsbury plc

Third Quarter Trading Statement

Wednesday 9 January 2013

Justin King, Chief Executive

Good morning everyone and Happy New Year to you. I'm joined here by John Rogers and Mike Coupe and today we're announcing our third quarter trading statement that's for the 14 weeks to the 5th January, so the full quarter brought right up to date and as you will have seen we've delivered good sales and outperformed in a tough market.

Our total sales for the third quarter are up 3.9% or 3.3% excluding fuel, and our like-for-like sales up 1.5% or 0.9% excluding fuel. Of course that 0.9% on top of a particularly strong Christmas last year our two year figure at 2.9% and that's why, of course, we can say it's a record-breaking Christmas indeed now 32 consecutive quarters of like-for-like growth. And as you'll have seen from the market data released just yesterday we've increased market share - we're the only major grocer that can say that over the Christmas trading period.

Looking at Christmas then lots of records being broken, 27 million customer transactions in Christmas week, a record hour of 16 million between 12 and one on Sunday the 23rd, really testing the ability of our business to deliver - we did a fantastic job, we think, for our customers. And records on Christmas Eve as you would expect with that restricted trading day on the 23rd, over 100 million of sales on Christmas Eve.

Particularly the story of Christmas has been the success of own-brand products growing strongly across the piece, three times the rate of branded growth. A particular note our main own label range, *by Sainsbury's*, over 3,000 products, new and improved, over the year in preparation for Christmas delivering 5% growth. And of course that helped customers manage their baskets. We've noted in particular, for example, champagne and prosecco up 15% year-on-year. Of course every time somebody buys some of our award winning champagne they save perhaps £10 versus a leading brand. So driving own label penetration as you know does clip a little off our like-for-like performance but of course it's fantastic for customers as they're managing their weekly budgets.

Another way they're managing their weekly budgets is Nectar, new records there too 22 billion worth of points, 110 million redeemed during the quarter, a really great way of spreading the cost of Christmas.

And much commentary already about the multi-channel nature of Christmas and our businesses have played their part. Convenience up 17% and our online business up 15% across the quarter delivering a new record 200,000 food orders during the busiest week, the week before Christmas. I'm proud to say that was delivered with the highest levels we've ever achieved of customer service and availability.

And the non-food story, as has been commented on elsewhere, too is all about click and collect. Around 1,000 stores now offer that service and around 60% of our general merchandise orders online are collected in this way.

And general merchandise more generally has done well. It's grown ahead of our grocery business and some particular successes in clothing growing at around 10% and areas that we've relaunched, small electricals up 24, cookware up 15%. Many of those of course being bought as presents not just for general use around the house.

We delivered against our footage plans 496,000 sq. ft. - six new supermarkets and 19 convenience stores. So the 500th convenience store was opened in the quarter in Southsea. And we're on track to deliver our million sq. ft. by the end of the year.

So as we look forward we see the challenging economic backdrop persisting, in particular in the next couple of months. Of course customers will rebalance their budgets following Christmas expenditure but by focusing on our unique advantages, our great food and own label, brand match, our competitive pricing with targeted promotions supported via Nectar and of course our unique combination with coupon at till technology, we believe keeps us well positioned to help our customers live well for less and therefore continue to grow in the quarter and year ahead.

And with that I'll hand over to questions.

Question & Answer Session

Question 1

Edouard Aubin – Morgan Stanley

Earlier this week Morrison blamed its poor performance on the lack of exposure to convenience and online, could you give us a sense of what your like-for-like sales were in the third quarter stripping out the benefit of convenience and online?

Answer: Justin King

Well of course it’s a fairly ridiculous assertion because it’s all part of the business and all part of how we're serving customers. But yes if you strip out convenience and online we would still be positive in like-for-like terms. There are big growths but obviously off relatively small bases. Well over 90% of our business is still within supermarkets and that's what drives the underlying performance of our business.

Question 2

Andrew Gwynn – Exane

Middle of November I think you were guiding to like-for-like for around about 1½ , maybe 1.7 and obviously we've come in around about 0.9 for Q3, the base is more difficult in Q4, I'm just wondering what do you think has changed in the market? Has the consumer really got that much more difficult?

Answer: Justin King

Well I think we've seen of course a couple of things that are unique to us, very tough comparatives and we've annualised against the big surge of extensions that we did in the second and third quarter of 2011 so those, if you like, are unique to us in terms of the comparator.

Then the third aspect that's unique to us I've already commented on which is own label, driving own label penetration does have the effect of clipping your wings a little in terms of like-for-like because it’s less cash in the till. As we've talked about in the past it’s broadly a draw in cash margin terms so it’s good news for the company but great news for the customers. I think you have to remember those three, if you like, unique factors to us.

In terms of the consumer I think the first point to make is you have to think about the quarter as a whole we are reporting 14 weeks, not everybody as you know will do that and you can't really tell the story of the whole of Christmas unless you report the whole quarter because you'll have seen from BRC and other market data October and November was particularly soft and most of

Christmas was about the two or three weeks around Christmas. So it's possible to make it look as if your Christmas was particularly good if you just report three or four weeks but unless you're reporting the full 12 or 14 I don't think you're seeing the full picture; because we've seen this change in customer behaviour, not just around Christmas but every major event. They have managed their budgets, they actually ratchet back a bit in the run up to major events, they splash out during the event and then they batten down the hatches a little after the event. So I think you add that all up and that's why although running into Christmas we would have been clearly aiming for something a bit more than 1% we're pretty pleased with 0.9% when you add it all up and look at the overall backdrop.

And I think the picture we've seen if you take the last 14 weeks as a whole is the picture we would expect to see going forward. If you look at the quarter in prospect it clearly starts for the first four to eight weeks with consumers battening down the hatches post-Christmas but then we've got Valentine's Day, Mother's Day and Easter in quick succession all of which will be major events that we would expect to help our customers splash out in. So again we'll report that as a whole quarter in ten weeks' time and overall I think a customer backdrop not dissimilar to the quarter just gone.

Supplementary Question

You mention the battening down the hatches post-Christmas and this increased seasonality around Christmas is something we've seen for a few years is that something do you think persists because I think if we do a loose bit of maths you probably did a flat like-for-like since your interim results in the middle of November. So could we even slip into negative like-for-like as the consumer battens down the hatches?

Answer: Justin King

I know many of you who take the Kantar data for example try and get inside the four week data and then imply things from it. I think it's always been the case and that's why Kantar will never officially quote the four week data, that four week data can be subject to the vagaries of timing, particularly when dates move, Easter moves each year. But I think with that big change in customer behaviour reading anything from four week data is even more difficult than it ever was. So that's why we do just report a quarter at a time and will persist with that. And I think that if you look at Kantar that's just recorded, we've reported 14 weeks finishing 5th January so I think we can be confident it's the whole Christmas story, even Kantar who reported 12 weeks yesterday it was just the 12 weeks to the 23rd December so you won't really see the full Christmas story in the Kantar data until you see the next report at the end of January. So I would encourage you not to over look at short term data because I think it can be very misleading and I would just take it a quarter at a time to get the clearer read on where the consumer is.

Answer : John Rogers

Andrew just to be clear our expectations for Q4 like-for-like is a similar performance to that that we've just reported in Q3 so that's the trajectory that we anticipate. We certainly don't see it going negative as you suggested.

<u>Question 3</u>

Andrew Kasoulis – Credit Suisse

Just to follow up there; if your like-for-like is say 1% or so for half two as a whole I guess that's slightly shy of your very initial guidance at the start of the year and yet consensus seems to have held up very well. So is that broadly right do you think that consensus will stay broadly where we were pre-Christmas and could you maybe make any early comments about 13/14 and the consensus for 13/14 please?

Answer: John Rogers

The usual response, I guess, Andrew – and this is obviously a trading statement so we're not going to get sucked into talking too much about profit – but we wouldn't expect the consensus number for this year to change. And of course one factor that you might want to look at, as Justin rightly highlighted, is that own-brand sales of course, if we're driving own-brand sales that means that we take a little bit of a hit on the top line. But as Justin also highlighted, the cash margin is broadly the same. So, that's one way you can get to the right answer vis-à-vis the consensus.

As far as '13/'14 goes then we're not going to at this stage start to give you guidance for that just yet. We will start to approach that obviously when we report our prelim results later this year.

Question 4

Clive Black – Shore Capital

Can I ask a question about volumes, please? First of all does it surprise you about the sustained nature of negative food, grocery volumes that the industry is experiencing at the moment? I'm presuming, stripping out convenience, non-food and own-label that your proprietary brand grocery volumes could be materially down. But more broadly perhaps, what do you think it will take for volumes, grocery volumes to turn positive again? And when do you think that will happen, if it will happen?

Answer: Justin King

Let me start with the proprietary brand. Of course we spend the whole of these calls talking about like-for-like; that's a meaningless concept if you're a proprietary brand – they only know what they ship to our warehouses. And of course the first number I read off the announcement was 3.9% growth. So it's all growth as far as the proprietary brand is concerned. We're still growing with proprietary brands. And we're very confident that with our branded suppliers we're in a good place in terms of our relationships, not just because of the growth that we're delivering for them – and many of our competitors are not; but we remain the retailer of choice to launch NPD. I was in a supplier review only the day before yesterday and they were unequivocal about the fact that we were both the best placed to launch new products, but also the best at executing those launches; and that a successful launch of a brand for them absolutely required success in Sainsbury's. So I'm confident that we're in a strong place there.

Volumes always have to come with a health warning, because customers don't always buy the same things week-on-week, month-on-month and year-on-year, and they are more sophisticated than they have ever been at changing what they buy to manage their own level of inflation. So some of the simplistic, taking the top line of the industry, taking off inflation and arriving at a volume figure, misreads the reality of, if you like, the calories, the mouthfuls that consumers are actually buying in their weekly shop.

All that said, there's no doubt that underlying volumes in groceries for the last two years have declined somewhere of the order of 1% to 2%. That's a new state of affairs; it's a remarkable state of affairs; it's off-trend in terms of the last 30 years. I said a year ago I thought there might be a year's worth of legs in it; it's primarily about consumers wasting less. Maybe there's another year's worth of legs in it. It's been surprising how persistent that change in behaviour has been. If there is I don't think it's anything particularly to fear because it's up to us to help them do that if that's what they want to do. And I think if you look at our current promotional offer which focuses on basics, it focuses on helping people with their Sunday lunch and making it go further during the week, we're trying to, if you like, kick the rolling ball of that trend. If you help the customers with what they're trying to do that's how you build loyalty. So maybe there's another year.

If you take the longer-term trend, population is in growth in the UK, likely to remain so, and ultimately therefore we should return to small, underlying volume growth. But we don't need it to continue to grow and to continue to outperform.

Supplementary Question

Maybe just a quick comeback, although this is probably more for the prelims. If we're in this situation in the second half of this year, towards the end of 2013, do you think it would fundamentally cause you to change your medium-term space aspirations?

Answer: Justin King

It wouldn't, no, because our medium-term space aspirations are based on the pessimistic end of that spectrum. We're very prudent in our future expectations when planning capital investments, because they're 25 year investments.

Answer: John Rogers

You've also got to remember as well, Clive, that a key component of those space aspirations going forward is the convenience business, and we're going to see a step up. So whilst overall space ambitions will remain broadly flat, we are seeing a step up in our convenience aspirations, so it becomes a bigger proportion of the overall space programme. And of course that's a part of the market that's growing significantly and delivering very good returns, so that's the reason why we're doing it.

<u>Question 5</u>

James Tracey – Redburn Partners

Two questions from me. The first one is could you quantify the increase in private level penetration? And does that mean that people are trading down more than what they were?

And the second question is on non-food. Could you comment on like-for-like rather than the total sales? And is it growing faster than food in like-for-like terms? Thank you.

Answer: Justin King

I'll get Mike to comment on own-label and the things that we're seeing there. As far as non-food is concerned, yes it is, in like-for-like terms, out trading our grocery business; not much in the quarter, but it is.

Answer: John Rogers

What's really assuring, James, is actually when you strip out the extensions of course, which are predominantly non-food, even on a sort of core underlying like-for-like basis store by store, we're seeing positive like-for-like territory; which in today's market is a very impressive performance, given the challenges that non-food overall have faced. So we're seeing like-for-like at store by store level. And of course when you add extensions onto that, which is part of like-for-like, that adds a further contribution to the overall growth of non-food – which is, as we said in the statement, growing at over the rate of our food business. So good performance in gaining market share.

Answer: Mike Coupe

And on own-label, self evidently, if our own-label sales are outgrowing our branded sales then we're seeing own-label penetration increase. So, it's roughly 50/50 – I'm sure you can back solve the arithmetic in terms of growing the penetration.

I guess two comments. Firstly *by Sainsbury* has seen an improvement in sales growth. And we've talked about that in terms of specific products like prosecco and champagne, blanc de noirs champagne. And actually if you take *Taste the Difference* over three years interestingly that's grown by almost 30% - so quite significant growth. If you remember three years ago we re-launched *Taste the Difference*, and we're still seeing the benefits of that.

So overall the picture is pretty good. But as Justin has already said, it has the effect of ticking down the top line, but it has also the effect of increasing our customer loyalty.

Question 6

Alistair Johnson – Citigroup

Most of my questions have already been answered. Just one from me. We saw in the Kantar data that their 12 week inflation rate was 4.5 in the 12 weeks to 23rd December. I think that was up from 3.5 the previous 12 week period. That seems to imply that December was very inflationary. Can you confirm that? And is that fresh inflation primarily?

Answer: Justin King

Well, as we always say, Kantar tend to over-read inflation; they don't reflect the changing things that customers are buying. Our own rate of inflation for the quarter is a little below 3%. And actually across the quarter, Q3 versus Q2, our rate of inflation stepped down a little. And no, therefore, we wouldn't see what you described, the fresh and the last couple of weeks being dramatically inflationary. But there's no doubt that most inflation, whatever figure you believe to be true – and I'm telling you that ours is a little less than 3% - most of that inflation is within the fresh food part of the basket.

Answer: Mike Coupe

And actually Alistair, it's interesting, if you looked at the BRC data that came out today, actually that suggests the opposite of what you just said: that in fact inflation has come off in December versus November. So I think there are so many different ways of measuring this and different data sources around. Certainly what we've been experiencing, as Justin says, we've seen inflation tick off a little bit actually in this quarter versus last.

Question 7

James Anstead – Barclays Capital

Good morning. Just one question from me, if that's okay. You're clearly very happy with the strong growth you've seen in private label compared with branded. I was wondering if that ratio has really changed very much since the anniversary of the Brand Match launch in late 2012, or generally speaking; it seems a bit counterintuitive in a way that private label should be growing so much faster than branded when you've got that Brand Match tool there. Or is that not really the way that Brand Match actually works in practice?

Answer: Justin King

Well, that's a very good question. It's something that we're still understanding because Brand Match, as you say, is only just annualised. There's no doubt that part of what Brand Match does is reassure on brands and help the performance of our branded range. In fact I think we did comment, I can't remember exactly which quarter it was, that in the early days of Brand Match it had actually help support increased branded penetration.

But by far the biggest thing that drives branded performance, which we've talked about many, many times, of course is promotions. I think if you look at the data that is available you'll see that we actually had slightly lower levels of promotional penetration in the quarter; still high by any measure, around 35%/36%, but not nudging the 40% that it has been in historical quarters. And that, at least in part, is because even on promotion brands are typically more expensive than own-label, which typically doesn't promote as much, and operates a more everyday low prices type approach. So if you look at the pricing of our champagne, that will typically, even on its normal pricing, even if we're not promoting, which we do do of course at Christmas, would be a typical branded promotion. So you've got all of those factors at play.

Overall in the quarter, as we've commented, it's been about own-label growing quite a bit faster than brands. And I think what that tells you is customers are seeking out, notwithstanding promotions, where the real value lies. And for our customers with the quality of our own-label, the right answer to that question is often to buy the own-label.

Answer: Mike Coupe

And I think that's the key dynamic. I mean, if you think about the last 18 months we have done a huge amount of work on upgrading and improving the quality of our own-label, and ultimately improving the value for money of our own-label products – and I think we're seeing the fruits of the labours. And if you take the *Taste the Difference* as a reference point: we went through that piece of work almost three years ago now, and we've seen three years' worth of consistent growth as a result of that. And I suspect we'll see the same with own-label for the foreseeable future.

Supplementary Question

Perhaps just a little follow up on that: if you step down a little bit on branded promotions for the final quarter of 2012, is that something that is just the usual ups and downs of promotional trends or is that something you think might continue? And do you think that's something that has happened across the industry as a whole in the last quarter, or have you moved slightly away from your competitors?

Answer: Justin King

Well, obviously we don't have as clear a line of sight to our competitor's data as our own, but we suspect we've moved a notch away from the industry. I might say a notch, I mean we're only talking about ones and twos and three percents, but nonetheless, a little bit away, because obviously our starting point is a higher own label penetration anyway and for that then to be growing particularly strongly is very likely to be widening our gap versus the industry.

Answer: Mike Coupe

And don't lose sight of our ability to target as well, so more of our money goes into more direct targeting, as a result of the use of the Nectar database, coupon at the till and all the other tools that we have available to us.

Question 8

David McCarthy – Investec

Can you tell us what the like-for-like is in your convenience chain? You've given us a total sales growth of 17%, but how does that split between new stores and like-for-like?

Answer: John Rogers

No, we've seen good like-for-like growth in convenience, probably about double that that we're seeing in the business overall, so circa 2%, again reflecting the fact that this is a channel over the last 12 months that we've seen grow very strongly.

Supplementary Question

And just to clarify, when you talk about your internet sales growth, where does that go, does that go into your like-for-like sales or does that go into your new store sales? Where do we put that?

Answer: John Rogers

Well, the growth is attached to a store and if it's a new store it therefore goes into new store sales, and if it's an old store it therefore goes into like-for-like.

Supplementary Question

Right, so predominantly it's going into like-for-like then, because that's where most of your internet business is?

Answer: John Rogers

Absolutely, yes.

Supplementary Question

Just coming back to, I think it was the first question on the call, there was a question about your growth if you exclude the internet and convenience, and if we do the maths and we say, okay about ballpark 5% of your business is internet, it's growing at 15%, let's assume most of that is like-for-like, that would be contributing 0.75%, you'd then be getting maybe another about ten basis points or so from your convenience business, maybe a touch more. So once we then strip out extensions from your core estate where your like-for-like is then sort of at 0.4%, then your like-for-likes would be negative if it wasn't for convenience and the internet.

Answer: John Rogers

You know, we're not going to get into the issue of breaking the detail out, but clearly you've done the maths. I think your maths slightly overstates the numbers, but the maths are the maths and that's it. But we've always said a sale's a sale, and online and convenience are absolutely key parts of our sector, the fact that we took the strategic decision to make investments in these sectors, three, four, five, six years ago, we're now reaping the benefits of that. Actually what was interesting, what we showed at the interims, if you remember that chart that looked at the overlap of our customers across convenience, across online and across supermarkets, clearly shows the synergies of having a multichannel offer. When customers shop across you multichannel they become more loyal, and that's really the kernel and the rationale for our strategy, and why we want to continue to grow, both online and convenience.

Answer: Justin King

You could disseminate the entire business down to zero if you wanted to, Dave. But Dave, you've been quoted publicly, so I'm going to trust that you've not been misquoted, but in the last week or so been quoted as saying, if you strip it all out, all the grocers are basically growing the same on an underlying basis, whatever maths you use.

Supplementary Question

There's more similarity I think is what I said, rather than growing the same.

Answer: Justin King

Well, you know what the press are like, David, they never quite quote you right, but the reality is, is that there are big differences between the underlying performance of the grocers, however you do the maths, even if you strip out all the stuff, but we're not going to apologise for growing our business having invested for ten years to get ourselves to this place.

Supplementary Question

Yes. I guess the analysis I was doing and what I was trying to look at is what the core business, the core estate across the whole industry is doing. And you've given a figure this morning of 2.9% I think it was for the two year like-for-like sales growth, but when we look at the two year volume figures on the core estate and we strip out the convenience and the internet, and we do that because it's a less profitable business as you have publicly admitted yourself, that your core stores must be taking somewhere between minus 6%, minus 8% less volume than they were two years ago. And that's an industry problem, it's not your problem and that must be having quite a devastating impact on individual store P&Ls, and I guess that's why we're seeing in maths I went through with John a while ago, that you've got £100 million of cost saving, £120 million coming through from your investments this year, and yet consensus is only for what, £30 million or £40 million increase? So if we carry on having those kind of volume declines what's going to happen to the industry? Not yourselves, but to the industry, what's your prognosis?

Answer: Justin King

Well, I mean there's so much in the thesis you've just outlined, David, which I would take issue with. As I said earlier in answer to one of the earlier questions, the simplistic conversion of top line growth minus inflation to a volume figure is simply not possible to do because of the changes in what customers buy.

Dave McCarthy

But that's all you can do when you don't give us the third element which is the mix effect.

Answer: Justin King

David, if I could have a go at answering your question, there's so much in it that I would disagree with, and as I said, there are big differences in terms of the underlying performance of the different retailers, whichever way you cut it. And by the way, I did not say the words you placed in my mouth in terms of profitability. Of course you incur incremental costs in serving customers online, but of course if you have data what you can understand is the nature of the total relationship you have with a customer. Saying that online is unprofitable is like saying the cheapest on display baked beans are unprofitable. Any individual skew may be, any individual touch point may be, there are many shopping baskets because of what people buy which by any measure would be unprofitable. It's about the total relationship over time with customers. And

with the benefit of data we are very clear as to why it makes sense to be investing in our online business, why we're driving it, and how it helps us serve our customers better in the long term.

As to the prognosis in terms of the industry, I believe that we will see, as I touched on earlier, in due course, and I don't think one can be precise about when, small underlying volume growth return, because population growth still exists in the UK, and if the ultimate measure of volume is the number of mouthfuls of food or the number of times you wash your hair in a shower or wash your clothes in a washing machine then that volume growth will return.

Clearly the shape of the industry is going to change over the coming years as a higher proportion moves to online and moves to convenience and it'll be those retailers able to serve customers across the piece that will succeed. And key to being able to do that, whatever the economic backdrop, will be firstly having the ability to serve those customers in that way; and secondly, having the data that allows you to understand the interplays and understand the profitability.

And as to the profitability of core stores, we're very comfortable, we've delivered a tremendous amount of self help over the last five or six years, an average of about £100 million a year of productivity and cost reduction, and we've delivered it at no cost to the customer experience ((audio interference))

Question 9

Sreedhar Mahamkali – Macquarie Securities Group

Hi, good morning. My questions have all been asked, so thank you.

Question 10

Nick Coulter – Nomura

If I could ask about the impact of extensions for Q4, John, I think expectations were for lower than the 50 basis points in Q3, so any help for Q4 would be appreciated. And then secondly, on the Delta and run rates between the quarters, I think you were 20% growth in online grocery for Q2, could you remind us what you were in the C stores for Q2 as well? Thanks.

Answer: John Rogers

So just on the extensions point, as you said we expected extensions to come in a little bit lower in terms of their contribution, so we've been pleasantly surprised by the performance of our extensions in the last quarter delivering net 0.5 contribution to the like-for-like. I'm going to assume that outperformance continues in Q4, so I'd expect the contribution from extensions in Q4 to be a similar number to that in Q4.

Nick Coulter

Sorry, then the Cs question?

Answer: John Rogers

Just to clarify on the convenience side, the growth in sales for convenience in Q2 was around 17%, so very similar to that that we're seeing in Q4.

Supplementary Question

Okay, so online slowed ever so incrementally and C stores were the same quarter-over-quarter?

John Rogers

Correct.

Concluding comments – Justin King

Okay, well thank you everybody for coming on the line, we look forward to talking to you in ten weeks' time with our quarter four and pre close statement. Thank you.