Sainsbury's

First Quarter Trading Statement 2014

Wednesday 11th June 2014, 8:30

Justin King, Chief Executive

Hello everyone, thanks for coming on the line. Of course I'm joined by Mike Coupe, soon to take over as Chief Executive at our AGM on the 9th July, and John Rogers, our CFO.

This is our First Quarter Trading statement for 12 weeks ended on the 7th June, last Saturday, and as you will have seen, we've delivered continued growth in what remains a challenging market.

Our total retail sales up for the first quarter, up 1.0%, and the like-for-like figure reflecting a 2.1% contribution for new space down 1.1%, and if you exclude the fuel, down 2.4%, reflecting material deflation in fuel pricing, 5p a litre.

You continued to see, in the quarter, investment in price and we've maintained our pricing position. In fact, we exit the quarter with the strongest price position that we have measured for some time. You'll know we audit around 15,000 lines every week. And at the same time, of course, we've continued to invest in the value of our offer through quality investments.

Lower food price inflation, there is still inflation but it's lower than we've experienced for some years, and those reduced prices in fuel, of course, are easing the burden on customer finances, but they continue to spend very cautiously, and we've seen industry growth in the quarter the slowest in a decade.

Brand Match continues to work powerfully for us, reassuring our customers of the competitiveness of our price position on brands. Over 50% of the vouchers in the quarter, confirming to our customers their shopping was the same or cheaper than at our major competitors for the branded element of their basket. We've also made *Brand Match* easier for customers to use with a ten item minimum spend now rather than the £20 it was previously.

As I've mentioned, we continue to invest in the quality of our offer, and particularly, of course, own-brand. Of note in the quarter, the strength of *Taste the Difference* growing nearly 10%, and the great success we enjoyed with our first real foray into volume, *by Sainsbury's* Easter Eggs into the main part of the market, doubling our own-brand market share to 40% - a great success there.

And we continue to enhance our Value's credentials, supporting British farmers in our bakeries, 100% British flour and cream in the one million or so products we bake from scratch in our bakeries every day.

We continue to lead the industry on service and availability levels. Just last night at the Grocer Awards we won the Customer Service and Availability Awards for the Grocer 33, a great achievement there, 21 wins in the year, matches what we did in the previous year; a good gap versus our grocery competitors now on those measures.

General merchandise performing strongly. Of note in the quarter, clothing in double digit growth, we're very proud of that performance, and of course just recently announcing our trial of taking clothing online, the logical next step. And entertainment has been strong in the quarter, their biggest release, one of the biggest ever, was "Frozen" and we exceeded 20% market share in release week.

Channels is delivering strongly, continuing their contribution to our growth story, online and convenience now around 15% of our sales, double what they were five years ago. Convenience grew at 18% in the quarter and we've now opened our 200th convenience store in London, one of the 27 we opened in the quarter, and online, post the change of our improved web and mobile platforms, growing at 10%, and of course an announcement there that we're moving to a Click and Collect trial with Transport for London in London.

The bank transition remains on track and we opened our 1,500th ATM during the quarter.

We remain confident we'll deliver the 750,000 square feet we outlined for the year ahead, with those 27 new convenience stores, and we're continuing our refurbishment programme, 12 convenience stores and three supermarkets refurbished in the quarter.

As we look forward, we expect consumer spending to remain cautious, and we will of course continue to invest to keep our offers competitive, and that is of course helping the pressures on household budgets. But we remain confident with our clear and longstanding strategy, our real differentiation versus our grocery competitors, that we will continue to outperform our supermarket peers in the quarters ahead.

With that I hand over to questions.

<u>Question and Answer session</u>

<u>Question 1</u>

Edouard Aubin – Morgan Stanley

Good morning. Just two questions from me. One of your competitors recently talked about the grocery market turning deflationary in recent weeks. Is that something you've seen as well?

And my second question is about again your competitors having announced in recent months their intention to reduce the promotional intensity and move towards more of an EDLP model. Have you seen any material change in terms of the promotional intensity in the market in recent weeks and months? And are the changes you just implemented at *Brand Match* related in any way to the market moving more towards an EDLP model, potentially?

Justin King

Mike should pick up the *Brand Match* and promotional intensity questions.

As to deflation, I think in the past we've talked about the fact that we don't see Kantar, on occasion, reflecting the reality of pricing in the market. As it happens, I think in the last number of Kantar reports they're calling inflation - because there is still inflation - about right, they're showing it at about 1.2%, I think, in their latest data. They were probably, in the run up to Christmas, reporting it still somewhere around 3% or 4%, and this time last year, probably 5% or 6%. So, we think that Kantar are pretty close to what's happening and that reflects our own experience, and as I've said on earlier calls today, we see our price position as strong, as we exit the quarter, as it's been in a very long time and we're seeing inflation at levels very similar to those that Kantar are calling the market at.

Mike Coupe

I think if you look at the headline rhetoric from our competitors, you would expect that the promotional intensity would have reduced, and certainly in the case of our sales and Asda that's the case. What's interesting is the way that it is measured would imply that some of our competitors have actually increased the level of promotional intensity and not reduced it, despite some of the rhetoric in the headlines. So I think it's very early days to know exactly what's going on in the marketplace. As we've often commented on, it's at a level of flux that we haven't seen for a number of years and we'll see how it plays out over the next period of time.

As far as the *Brand Match* change is concerned, it's based on the feedback from our customers. In the end, it's easier for customers to understand how they qualify for *Brand Match* by counting the number of products that they have rather than having to add up in their heads how much they've spent. So it is a customer-driven change and it's not driven by any of the market dynamics, it just makes it easier to understand how you qualify for the coupon.

Edouard Aubin

So, Justin, to come back on the deflationary comments, I guess the comments from your competitor were more related to recent weeks as opposed to the quarters. Have you seen any change throughout the quarter in terms of how the inflation evolved?

Mike Coupe

It's Mike speaking. Well, I think we've commented on the fact that inflation is at a sort of a 1% to 1.5% level and that is falling. And as I've said already on the press call, we've seen a reduction in commodity prices, particularly in areas like fresh produce, as a result of a better winter, a less inclement winter, leading to better crops. So who knows how it will pan out over the last period of time, but we certainly wouldn't recognise deflation in our business.

Justin King

I think there's been a good deal of misreporting, Edouard, as well. I think, of course, lower inflation than in the previous quarter is a relevant metric to comparing what your performance was in the previous quarter to now. But to suggest that a like-for-like figure versus a year ago is contributed to by deflation is simply not borne out by any data source that I've seen, with the exception of course of fuel, there's real deflation in fuel and you see that in our headline numbers, it's about 5p a litre cheaper than it was a year ago.

John Rogers

And Edouard, just to build on what's already been said, our internal data would suggest that our pricing position versus our competitors has strengthened as we've exited the quarter over the last couple of weeks.

Question 2

James Tracey – Redburn Partners

Good morning guys. Two questions from me. The first one is on the pricing situation in the market. Do you still see the price war as being phoney, or is it a little bit more real now given the inflation?

And the second question is on the difference between the industry sales growth being the worst that it's been in a decade and consumer confidence being the highest that it's been since 2005. So why do you think the consumer confidence is not flowing through into positive volumes for the industry? Thank you.

Justin King

Well, James, I mean I've said it's a price skirmish, and it is, and Mike said on the earlier wires' call that it remains within the cut and thrust of the market that we've seen in the past. It's more dramatic than in recent quarters and years, but we've had periods of this kind of skirmish before and we'll see how it evolves, of course.

To the extent that it's phoney, the point that I was making in the past is that the headlines that others grab with headline numbers, where you take one week's worth of pricing activity, multiply it by 52, and assume it's going to change, it's just that, it's a headline grabbing number, but it doesn't reflect real money that you've put back in customers' pockets. And the real price position today is that price rises are still there, up slightly on a year ago. And therefore price pressure, whilst relieving versus a quarter or so ago, it's still heavy on consumers, and I think that comes to the answer to your second question.

Whilst it may be the case that consumers are more confident than at any point since 2007, they're still net negative; they are less downbeat, they're not actually resolutely positive, yet. And I would expect that to remain the case, not least of which because we all have the uncertainty of a General Election and a Referendum in Scotland racing towards us in the coming quarters to maintain a good deal of customer uncertainty. But they're spending cautiously because they've learnt new behaviours which they're enjoying. We've said many, many times before that the changes that customers have made in this economic downturn are not changes that are going to revert back as customers get a little bit more money in their pocket. They're shopping around more, and through doing that they're saving a bit of money, but they're also buying the quality in the right place for them, at the right time, they're cooking a bit more as families, they're using their leftovers.

We've been helping them with that with the recent launch of our app that we've done with Google. You should give it a go, it's brilliant. It allows customers to put what they've got left over in their fridge into the app and it will suggest recipes and a shopping list for them. So these are behaviours that will stick, so we never thought that a shift in customer sentiment would immediately lead to them reverting to old shopping behaviours.

Mike Coupe

And I think the other point to make is that in the end the key driver of our industry historically has been an increase in net disposable income and the reality is that if you're a customer you're still feeling squeezed overall; and unless and until that changes, I suspect the dynamics of the industry will remain the same. And of course the prospect of interest rates rising, perhaps more pressure on mortgage payments, leads people to be incredibly cautious.

James Tracey

Thanks for that guys. And just with our guidance, you're guiding to slightly positive like-for-likes for the full year, I suppose comps get a little bit easier over the next three quarters, particularly in the second half, and what's the driver for your expectation in improvement throughout the rest of the year?

Justin King

I think in a way you've answered your own question, James. The range of outcomes in 2013/14 was, I think in one quarter better than 2%, and in one quarter worse than -3%, and that added up to slightly positive. And this quarter that we've just delivered against a reasonably strong quarter a year ago is entirely consistent with our guidance.

<u>Question 3</u>

Andrew Gwynn – Exane

Good morning all. Firstly Justin, I'm going to miss you, obviously when you're giving your eminent quotable comments, so the best of luck and we'll be intrigued to see where you turn up. I'm sure you've got a little book you could leave Mike, perhaps, I don't know!

Justin King

He's never to use a phrase that I use ever again I'm sure!

Andrew Gwynn

They're all going to be taken with you, I'm sure, copyright Justin King!

My question follows a little bit on James's question. Clearly there's a lot of talk and so forth, and how do you think consumers' perceptions are changing of the big four? Do you think all this talk around pricing is really cutting through to the consumer? Do they just sort of ignore it, it's just more of the noise?

And second to that, how do you think their desire, whatever you want to call it, for quality, all that kind of stuff, is changing?

Justin King

Well, I think if you were to add up the balance of coverage of our industry over the last couple of years, it's hardly surprising that we're seeing incredibly strong growth in the discount channel, incredibly strong growth in the convenience channel, because that's very much been the tone of coverage of our industry. And that's inevitably unhelpful for all of us with a large part of our business in what remains the core. One of the charts we showed at the prelims reminded us that the main event is still the core grocery market and will remain so in any version of the future that we can see.

But I think that what's important is that what consumers take from that is not that it's a big four issue. But the issues are one retailer at a time, and that's why we focus so much on our point of difference versus our other mainstream grocery retailers, because we are materially different and if you like we shouldn't and can't justifiably be tarred with the same brush on some of the sweeping statements that are made about the problems of major grocers. So for example, the conversation about large stores is essentially an issue for others not us. Our centre of gravity is in stores that remain strongly performing and supported by consumers. We've never opened a shop with a greater amount of space dedicated to non-food than food. We never have, and we've been consistent for the ten years that we didn't believe that that was right format for Sainsbury's as a for instance of that.

In terms of the focus in the future, Mike should comment, but I would just go back to 2007/08. A lot of the conversation that we're hearing today is very similar to the conversation back in 2007/08, an assumption that a consumer downturn would expose Sainsbury's offer in a unique way because of our quality and values' credential. And yes, it's turned out that during that consumer downturn consumers have become more not less concerned about these issues, and our differentiation on so many dimensions has actually widened. As others had focused on frankly removing quality and differentiation from their offer, we've invested in it and the gap's opened wider, and that's led to our sustained outperformance over many years.

Mike Coupe

Again it's just worth reflecting on the point about pricing, it gets very heavily emphasised. But if you go back to the key drivers, by far and away the biggest coping mechanism that customers have used during the last five years, is to shop more frequently, buy less when they shop, throw less away, use shopping lists, take money out of cash point machines to control their expenditure. So the big dynamic in the market is the move towards little and often shopping and shopping more locally and more conveniently, and that by far and away is the biggest consumer trend.

To a point Justin's already made, in the end we can put colour on it, we know when our competitors emphasise their supposedly price credentials, our customers will actually come across the road to us for that very reason because they want a quality shopping experience, they don't want things to be taken out of the value, and value's part of the mix. We will continue to emphasise our points of differentiation, the quality of the products that we sell, the values that underpin them, the standards that we maintain in our shops. And again we won the Grocer 33 – which we've talked about a number of times – for service and availability, last night, all of these things are important to the proposition going forward, and there's no evidence to suggest that customers don't want that.

Andrew Gwynn

That's all very useful. Just a very quick question for John actually lurking in the background, I suspect.

Justin King

He's not lurking, we let him actually sit at the table!

Mike Coupe

We'll bring him out of the cupboard!

Andrew Gwynn

On the consensus, you've said it's clearly obviously profit down for the year, and actually minus positive like-for-like it's not too bad, and if the market carries on in this sort of skirmish mode with inflation, what do you think the chances are that you'll come in with a number substantially ahead of where consensus is at the moment?

John Rogers

Andrew, as you'd expect me to say, this is a trading statement so we're not going to comment on profit during a trading statement, and I'm not expecting to see consensus change at all post this call. We're three periods into the financial year, there's still a lot to play for, and the guidance that we gave at the prelims holds true today.

<u>Question 4</u>

David McCarthy – HSBC

Good morning. A couple of questions. You talk about your price position being the best it's been for some time. Can you give us a bit more colour on that and say relative to what? I mean, is that relative to Tesco? How is that compared to the discounters on comparable baskets to what they say, how it compares to Asda? Because within that one big picture there might be some very interesting sub-trends that we would like to hear about.

Then secondly, if we just stand back for the moment and look at the industry, it went through a long period of having positive like-for-likes of 3% or 4%, and then about three or four years ago it took a step down to being low single digits, sort of 0% to 2%. I can remember having discussions at the time, originally that was described as a blip, but then it's become accepted, and I remember asking the question and Justin you saying, "Yeah, we can't describe this as a blip anymore". Do you think we have now entered a period where flat to negative like-for-likes are going to be the norm for the industry over the next several years?

Justin King

Well, I'll have a go at both and Mike should chip in too. I think that we've been clear on the price position. A bit of colour that we could add is that of course *Brand Match* checks, our price basket against Tesco and Asda, I don't think there's any dispute that the sharpest prices amongst the grocers and the grocer that is looking most carefully at its relative price position versus the discounters, is Asda. *Brand Match* compares our pricing versus Asda on brands and we continue to win 50%. So I think we're confident that we've stayed locked on there.

If you move into the own label part of the basket, of course you then very quickly get into debate about relative quality. The only point that we've made before, and I'll make it again, which is if it were purely about grams per penny, the cheapest place to do your shopping today would be to come to Sainsbury's and buy Sainsbury's *Basics*, which of course has vested in it all of Sainsbury values, and our competitors can't say that about their entry price point ranges. So we're confident that in grams per penny terms we're where we need to be on *Basics'* pricing, but of course one can get into a big debate about where quality is actually comparative. Of course we're having exactly that debate with the ASA and Tesco over their price matching, which will come before a judge later this year.

In terms of the longer picture, I think I was always clear that I felt that at some point in time the market would return to volume growth because our population is growing, and I think pretty much all economic forecasts point towards that being the continuing state of affairs. There's no doubt at all that the longevity of the changes of behaviour that Mike talked to in the answer to the previous question, has been much greater than any of us expected and persists today. But I think you phrased your question as stand back and look to the long-term. I think if you stand back and look to the longer-term population will grow, the grocery market in total will return to small underlying volume growth reflecting that population growth, the grocery market will continue to accrete share in those categories that its share is very low, most notably of course clothing and non-food; and that longer-term there will be food inflation because those pressures are worldwide and very macro in their behaviour. That's my view if one steps back and takes the very long-term view.

Mike Coupe

We've already answered the price question. I guess one other piece of colour to put upon it, if you look at the core commodities: butter; bread; milk; eggs, in effect the price gaps that existed with the discounters have been more or less closed, so one could argue that if you look relative to the discounters, the price position, not just for us but for all of the major grocers, has improved pretty significantly on those core commodities.

To the point that Justin's made, if you take a 25 year view of the industry, it has grown broadly speaking in-line with the economy, and that's a combination of population growth plus inflation, so underlying growth of 3%, something of that order. The reality of where we are today, I don't think any of us, I don't think you would have predicted six months ago some of the dynamics that are going on in the industry, so it is clearly volatile in terms of the changes in behaviour and what that's doing to the overall channels. My own view, for what it's worth, is that the trends that we're seeing in the industry will continue against the backdrop of probably a return to something like a normal growth level, if you were betting, but there are a whole bunch of possibilities which I'm sure you're just as capable of modelling as we are in the dynamics of that.

I think the last point I would emphasise is, we are not invested in the part of the market which is most under pressure, which is very, very large out of town superstores. They are subject to lots of pressures not least from the internet in non-food product areas. Secondly, we've got optionality around our store estate, so we will continue to invest in convenience stores, online and shops which are more in the sweet spot of where customers will be in the future, and we have the ability to move our investments as the market dynamics change, if they do change.

David McCarthy

So on, say, a three year view, you say a return to more normal levels of growth.

Mike Coupe

Over 25 years I will predict – and you can ask me in 25 years time – that the market will go back to a trend which looks like growth roughly in line with the economy. Because the facts are very straightforward, which is there's only so much economising that customers can do, there's only so much waste that they can save. So you would have to expect that at some point the market will go back to an underlying growth based on population growth, which is broadly speaking the volume growth plus inflation. Whether that happens in three years time, five years time, next year or ten years time, I think that is pretty unpredictable as we stand today.

David McCarthy

All right. Just a couple of things on that because we hear those stories said quite a lot by various people. Global population growth has peaked, it's slowing in absolute terms and in relative terms, and yields continue to increase, so they're just some other parts of the equation which you've not mentioned there. I come back to on a three year view, do you think we will be having across the industry flat to negative like-for-likes? The 25 year view we can have the debate on another occasion, but nought to three years what do you think industry like-for-likes will be?

Mike Coupe

I think I've said all I'm going to say. I'm not sure it is predictable. We would expect at some point over the next period of time we would see the market go back to some kind of growth rate in line with the economy. As I say, whether that happens in a year, two years, three years, five years, I think is really difficult to predict. On the global macro economic trends, that's another conversation for another time as well.

<u>Question 5</u>

Mike Dennis – Cantor Fitzgerald

Good morning. I've got two questions. One is around your new extensions, they seem to be working again from the point-of-view of the 0.2%. I was wondering if you could comment on whether that is a trend that you're now going to see continuing through this year in terms of extensions and non-food? Also, I just want to get an appreciation of the positive around your younger stores, is that what is driving this better performance in the industry, or is it your bias towards the south-east in your view? So does this justify your new space growth strategy?

Justin King

Let me have a go at picking up the second, John should talk about the contribution from extensions. I think the younger stores' point is, if I understand the question right, because of the amount of investment that we have made over the last five years or so, we believe that our store estate today is better invested than any of our major grocery competitors. The average length of time since a store last received an investment is shorter in Sainsbury's than any of our grocery competitors.

What that means is, is that the in-store experience for our customers is better because of the environment, whether it be a car park minus potholes or the store just looking spick and span; but also closer to our current proposition, because one of the things that's allowed us to do as we've developed our offer, our understanding of how our counters should look, the footprint mix between food and non-food, all of those things have been developed as part of that process.

But we did signal a couple of years ago a shift away from extensions, not away from extensions, but a higher proportion of our extension money spent actually on refurbishment, so not stores where there was an opportunity to do more than grab a small amount of space, but where we could still make a significant difference to the customer by bringing it up to date.

We largely don't recognise the observations made about the benefits of being in the south; actually if you look at most of the figures they don't point towards a dramatic difference in performance by geography. It's often been said that we're less exposed to the discounters, we're not actually if you look at the data, our geographic exposure to the discounters is proportionally identical to Tesco's, so we don't recognise some of those observations. And of course the south has been the hotbed of new store activity as far as convenience is concerned; all of our competitors are very focused on convenience as a route into the south.

Our new store development activity is biased away from the south, it's not exclusively north and west, reflecting where we have particularly low market share.

John Rogers

Mike hi, it's John. Just to come on to your question about extensions, obviously the contribution to like-for-likes from extensions in the first quarter was 0.2, and actually we guided if you remember at the prelims for the full year to a contribution from extensions similar to the previous year which happened to be 0.2. So we're not necessarily expecting that number to step up as we go through the rest of the year. But it's fair to say obviously that about 80% of our extension space is for non-food and we've seen tremendous growth in non-food in the first quarter, so double digit growth across the board. We note in particular of course the growth of our clothing offer in the quarter, again being double digit. So non-food for us as a category is growing very strongly and I think it reflects the relevancy of our offer. As we said, we've got a great home offer, very much aligned to the core grocery business and we're seeing good growth across the board.

<u>Question 6</u>

Bruno Monteyne – Sanford Bernstein

Good morning. My question is about the price investment you were referring to at the beginning of your press release in the conference call. Can you just give some colour to what extent those price investments are still mainly the staples - the milk, the cucumbers, the carrots, or to what extent has that started to extend into the branded goods in the market?

Mike Coupe

Hi, it's Mike speaking. Yes, I mean I think we made the point at our prelims and it's still the case that the substantive price investments are in the core commodities, to your point, bread, milk, eggs, butter, and to some extent in some of the produce and primary agricultural areas, but that's at least in part driven by a reduction in commodity prices, in input prices. So that one is a little bit more difficult to disaggregate and to call.

As far as the rest of the basket is concerned I think we've made the observation before that it's very much in the cut and thrust of a sort of normal pricing world that we've lived in for, well all my time in the industry, and in the case of some of our competitors they're just re-establishing a position that they've lost over the last two or three years. So very much the core commodities are where the real money's being spent undoubtedly and we've played our part in that, we've matched it toe to toe, but in the rest of the marketplace we're seeing as you might expect lots of volatility, lots of up and down movements.

<u>Question 7</u>

Niamh McSherry – Deutsche Bank

Morning all. Just one question from me. Going back to consensus for '14, '15, the consensus that you're happy with implies margin decline of about 30 or 35 basis points compared to last year when your retail margin actually improved, despite the fact that your like-for-likes, your guidings were broadly similar. Is it fair then to assume that that reflects price investment as you kind of discussed in the past quarter?

Justin King

We're all looking at each other. Which one wants to answer that one? We're going to give it to John.

John Rogers

Well, we're not going to update, as I said before on the call, we're not going to update on guidance in relation to profit on trading statement, as you say as a function of the maths the consensus as it stands today reflects that sort of 30 to 40 bp investment but if you look at the range, it's a very broad range of consensus rating from the high 500s to I believe north of 800 reflecting the uncertainty that clearly exists in the market today. That situation hasn't changed since the prelims so we're not updating any further today.

Concluding comments: Justin King

Well, I think that was our last question. Thanks for all coming on the line, if you're still on the line. My thanks to you for all your support, I think that's what it's been over the last ten years, I've enjoyed it, I hope you have too, and I hope you'll give Mike and the team at Sainsbury's continued support.

This is a truly fabulous business, one that's done great things for customers over the last ten years and I hope will continue to do so for many years to come, and therefore deserves your support. So thank you once again, I hope to see some of you in the coming weeks before I formally step down on 9th July. Thank you.