J Sainsbury – Second Quarter Trading Statement 2015
8.30 am
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Mike Coupe
Chief Executive
Good morning ladies and gentlemen, this is Mike Coupe speaking. I am also joined by John Rogers who is on the line this morning. And as has already been said, this is our Second Quarter Trading Statement for the 16 weeks finishing on 26th September which was last Saturday.

So overall we are reporting that our total retail sales for the second quarter are up 0.3%, excluding fuel. That means that our like-for-like retail sales for the second quarter were down by 1.1%. And that is driven by both volume and transaction growth as a result of our pricing strategy, particularly the move to lower regular prices. We are also announcing today that we would expect the underlying profit before tax to be moderately ahead of the published consensus.

So with that I will open up to questions. So over to you.

Q&A Session

Question 1

John Kershaw, Exane BNP
Good morning guys. And I suppose congratulations for the first retailer in the UK for a long time to upgrade profit expectations. It is a rare thing.

Mike Coupe
Why are you laughing?

John Kershaw
Well it has been a long time. You know as well as I, it has been a long miserable journey for food retail for a while, so well done for doing that. But I suppose therein lies the question. Are you signalling a sort of distinct change, so consumption improves of growth in the discounters, slows such that you can rebound profit? Or are you just signalling slightly less competition and a lower rate of decline? So that is the main question.

And then more broadly, linked to that, how do you think about going forward, your cost saving potential, given the living wage and the like?

Answer: Mike Coupe
Well I will answer the first part and maybe John can talk a little bit more about the second part. Just to give me a rest of my voice. I guess the way we would look at it is it is that we have done a little bit better on a number of fronts right across the business. So you could argue that the market is probably a little bit more helpful than we thought it was going to be when we set out plan. There is no doubt there has been some volume growth returning to the market. The deflationary pressures

however have persisted. However within that context, our overall pricing strategy seems to be working from the point of view of driving both volumes and transactions and you have seen that in the published market data. Broadly speaking we have held share over both the quarter and the half. And we have continued to drive the things that make Sainsbury's different, our service levels in our shops we would argue have never been better. Our availability is better, as a result of our pricing approach we are seeing less volatility of demand which means things like waste, have actually come through more strongly as in lower than we were expecting. And we continue to invest in the growth areas of the marketplace. So we are very well positioned in online, we are very well positioned in convenience stores and of course we have got a non food business with our clothing business growing at 13% which is on balance helpful, and we acquired the Bank and that is also making a contribution to the overall profitability. So we will talk more about this at the Interims, because clearly this is a Trading Statement and normally we would not talk about profitability. But to pick out any single factor I think would be wrong. What we are saying today is broadly speaking across a number of fronts we have done a little bit better than we expected. And the cumulative effect of that is we are able to say there is a slight uptick, a moderate, I think I have to use the word, a moderate uptick in our profit expectations against the consensus.

And of course the other thing we would argue is perhaps the market was taking a view of us in the context of our competitors which we haven't always thought was fair and I think this is reflective of the fact that Sainsbury's is a business, albeit challenged by the market conditions, nevertheless, which is in fundamentally better shape than some of our listed peers.

John do you want to comment on cost savings and indeed anything else?

Further answer: John Rogers
Sure, yes just on the cost savings John. At the Prelims we said we would deliver £200 million of cost savings this year and £500 million over a 3 year timeline. Clearly what we are updating on today is we expect to come ahead of that £200 million guidance. Now in terms of visibility of cost savings going forward, obviously we have full visibility of the cost savings for this financial year. And in fact we have got pretty good visibility of those cost savings that we think we can deliver for the next financial year and we are in the process of if you like filling the bucket for the third financial year. As to whether or not we will be ahead of the final £500 million we guided to, we will provide a further update on that at the Interims in six weeks time or so. But what we are certainly saying today is that we are ahead of expectations in relation to the £200 million for this year, which is a very positive sign. And clearly we have given some line of sight as to what that comprises in the Statement itself. So as a result of our lower regular prices and in particularly we have been able to improve our demand forecasting. That is actually helping availability in our business and also significantly reducing the expected levels of waste. So there is one example, is cost savings have come in ahead of expectation.

Further answer:
John, I am sure I will get asked the question, you mentioned briefly the living wage. I might as well give a direct response to that because I am sure other people will be asking the same thing. I mean we set out a couple of years ago to move down the track which in effect has been signalled by the Chancellor in the Budget. So we gave 3% last year, we gave 4% this year. And we had a plan over the next 3 years to get as well on the way on that journey. We don't have line of sight on years 4 and 5 it is fair to say, but we know where we would like to get to by year 3 and it is not inconsistent with the kind of levels the Chancellor has been signalling. So it is kind of

contained within our own business plan as we stand today. There is work to do on what years 4 and 5 look like and there is work to do on talking to our colleagues about how we reward them in the future and how we simplify some of the things that are to some extent accidents of a very long history in this organisation. But nevertheless, we think in the round actually it is a good thing from a motivation of colleagues point of view and from a retention point of view and I think that is reflected in the service levels we offer in our stores. So in the round it is broadly speaking we are where we are expecting to get to over the next 3 years. There is work to do on what years 4 and 5 look like, but to be honest that is so far in the future at this moment in time, that is something we can reflect on over the next 6 to 12 months.

Further question
Thanks for that. If I can draw you on my question, I think you would still be looking to the guts of 10% plus decline in EBIT even on the ups expectation on the retail EBIT, So we are still talking about a moderation of decline or are you trying to signal something more positive?

Answer:
No I think that is absolutely right. It remains a challenging market and you know as well as I do, these businesses are quite highly geared and I guess the million dollar question, I don't think any of us are in a position to answer, is when we might see some kind of across the market return to underlying like-for-like sales growth. So our best estimate which again we have said before in the last Quarterly Trading Statement, we would expect as deflationary pressures start to abate during the course of this Quarter and into the early part of the next calendar year, but equally we have not seen the full impact of the harvest this year of exchange rate volatilities. So there are many other factors that might come into play which may change that view of the world. It does not feel there are massive inflationary pressures on commodity prices as of today. So the million dollar question in terms of the underlying de-gearing of the industry is the extent to which we will see any return to inflation any time soon. And I am genuinely not in a position to speculate much beyond what we have said previously.

John Kershaw
Okay, thank you.

Question 2

Bruno Monteyne, Sanford Bernstein
Morning. It is three questions please. I noticed that your online sales are accelerating again from having a weaker period. Is that because you see the market getting more rationale on the cost of deliveries, the rational delivery pricing or have you started equally discounting some of your delivery charges on some online?

The second one is, you quite clearly said you landed a lot of price decreases at the end of the last financial year and you thought that would be enough for now, so am I right to assume therefore you did not need to lower any more prices than the ones at the financial year end last year?

And the third question is, I think I picked up you talked about positive volumes. Am I right in assuming you have about 1% positive volume growth on a like-for-like basis, so excluding your space? Thank you.

Answer: Mike Coupe

Shall I comment on the first and last and leave John to comment on the second two just to keep it balanced.

Actually we are really pleased with our online business because we in effect made a decision during the summer last year that we weren't going to play the game of vouchering extensively to drive volume because it is a mugs game. It is a zero sum gain. What is important to us is we offer online as part of an overall service to our customers, to Sainsbury's customers, we don't just buy volume for the sake of buying volume. And as a result of effectively a year's worth of improvements in the service, whether it is product availability or on time deliveries, pick accuracy, whether it is improvements on the website. I mean if you go onto our website, it has now got a much more modern feel, much more easy to access. So there are any number of small incremental changes which means actually that growth has actually come without vouchering. It is genuine underlying growth. It is genuine appreciation of our customers of the service we offer. Roll out of click and collect is another example of something that is gradually improving the service. We will have a hundred stores by Christmas. So I am really pleased with our online business. As you said, it has done better in the quarter and it has done better without having to resort to any form of volume spiking. It is true underlying performance and that is something that is a credit to the team involved in it.

Further answer: John Rogers
And Bruno just to come onto the point about price investment. If you can say what price investment will be required going forward, and of course what we can say today is that we have never been more competitive on price than we are today and we intend to maintain that position. If you look at internal metrics of the price and also some of the external benchmarking surveys the data will support the fact that our price position is as good as it has ever been, and indeed that is also reflected in our customer price satisfaction scores. So we are very pleased with where we are today, but clearly the market is competitive and will remain competitive. I think it will be very foolish to say that there will not be any further price competitiveness in this market. All I can say is we will continue to compete on price in this market going forwards and we have the fire power to do so.

I think in relation to your question on volume, you are absolutely right, we have certainly seen positive volume uplift at the total level which is very pleasing. I think at the like-for-like level it would be too early to call the turn just yet. I think we would say we were essentially flat on volumes, but the trajectory there is a good one. So let's see what happens going forward.

Bruno Monteyne
Thank you.

<u>Question 3</u>

Niamh McSherry, Deutsche Bank
Morning all. Most of my questions have actually been asked, but maybe just for clarification on the deflation, your deflation in the quarter versus Q1?

Mike Coupe
I will let John answer.

Answer: John Rogers

Yeah I was just going to say, we are saying deflation for this quarter is around 1.5% to 2%. So last quarter we said it was 2 to 2.5% exiting the Quarter 1 and around 2%. This Quarter we are saying it is between 1.5 and 2%.

Further question
So is that the level you are expecting in H2?

Answer: John Rogers
I think what we said before, we would expect the underlying commodity deflation piece to start to unwind in Q2 given the movements in October and December of last year. Clearly there may be some further price investment on top of that, only time will tell. As Mike has already said on the call, it is quite difficult to predict as and when deflation will fully unwind. But we are certainly expecting the commodity component of deflation to unwind towards the end of this calendar year.

Answer:
Niamh just to add to that. I think it is fair to say, you can see this standing back. I don't think we have ever seen a period of such commodity price and exchange rate volatility. So to predict the future in terms of the effect that will have in terms of input prices is really, really difficult. And probably more difficult that it has ever been. So it would be naive to make any predictions about what we might think will happen to input prices and therefore what would happen to retail prices at this stage. All you can say is that if you look at what happened last year, certainly the deflationary pressures we saw came through towards the back end of the calendar year and into the early part of the next calendar year. So that is what you are lapping up against. But that is one part of the equation. The other part of the equation is that we just have no idea, genuinely no idea what will happen to commodity and exchange rates over the next period of time.

Niamh McSherry
Okay, thanks.

<u>Question 4</u>

Mike Dennis, Cantor
Morning. I have got two questions. One is on promotional activity. You say obviously you have been doing the simplicity strategy now for a year or so, two years. I was wondering, the less promotions going through the industry, is that something you are seeing now industry wide, they are all following the same process you are? And that in itself is creating some underlying inflation in the industry which is currently being masked by all this staples deflation? Is that the sort of shape and picture we are seeing and hence your prediction that coming to Q1 next year we should be seeing some relatively small industry inflation? That is the first thing I want to clarify.

And the second thing is a bit of a thing, but I noticed on 5 October, obviously you have all got to go bag less in the industry. Are you expecting everybody to take on board the 40-50p online charge that you are going to be putting through to do online orders, is that what your expectations are? Are you just going to pass that on to the consumer or are you thinking of going into paper bagging or something? Can you explain what you are going to do with that?

Answer: Mike Coupe
I think I will probably answer both these. I will answer the second one first. Yes we offer a bag less option. So well over a quarter of our deliveries last week were bag less. So we have already introduced that. Some customers however are still happy

to pay the 40p. And of course it is impacting England, but it is already implemented in Wales, Scotland and Northern Ireland. So the industry and we already have experience of what carrier bag charging looks like and means. We actually charge for effectively a bag for life which we will replace when it runs out. So this is about reducing carrier bag consumption. There is a danger it starts to become something about raising money for charity which we are slightly wary of. And if you take Wales as an example, we saw carrier bags, reusable carrier bag, sorry disposable carrier bag consumption reduce by 90% when we implemented it. So it is a significant change. We introduced bag less online about three months ago and are rolling it out as part of the change.

As far as promotional activity is concerned, I guess you would have to ask our competitors about their approach. I think if you look at the market stats, it is fair to say that the amount of promotional activity in the marketplace has reduced. Ours has reduced proportionately higher. I think we were placed, our promotional participation is around the low 30s at the moment. And where we make changes to our promotional strategy. So for example, we have taken multibuys off a number of areas in our business. We reflect that in lower retail prices. So I don't agree with your underlying assertion. What we found or what we do is when we take off multiple buys we put the value back into the product so that is part of our underlying pricing strategy and that has worked pretty well for us. Because what we see as a result of that is we actually see more customers buying into a category and ultimately more volume.

And to your point, actually we have been doing this for three years now. So we have got pretty good experience about what works and doesn't work. And perhaps the other reflection we would make is the best performing categories in our business has tended to be the categories where we have been doing this the longest. So not only do you get a volume uplift in the short term, by sticking to your guns, breathing hard annualising, you actually see a continuation of growth over a long period of time which gives us confidence to some extent that we will see that sort of volume growth as we rollout in more categories sustained.

Further question
Is the bag less thing, on the flipside, is it a cost saving, if people do take it up and bring their own bags and that sort of stuff, is it quite a big cost saving?

Answer: Mike Coupe
Well no, we make a charitable contribution on the bags that we sell so there are upsides and downsides.

Mike Dennis
Okay, thanks.

<u>Question 5</u>

Nick Coulter, Citi
Morning. Just two or three from me. Just following up on Niamh's question, roughly what do you think the commodity and FX component of deflation was in Q2? The part that you think is visible to some extent going forward?

And then, secondly, backing out deflation of 1.5 to 2%, I think you said around 1% volume growth, it looks like you have got a positive mix effect. Could you talk to what is driving that? And also could you give a broad indication of transaction growth, where that lies relative to volume growth?

And then just a couple on non food and convenience. Are you able to size or give the growth rates for those two areas? Thank you.

Answer: Mike Coupe
I'll have a go at the first couple and maybe John can come back on transaction volume and the non food convenience mix. To be quite honest, I could not give you a breakdown of commodity and foreign exchange rates. I am not sure anybody could. You can read through from the numbers that you see published, whether it is wheat prices which is probably the single biggest, wheat and soya are probably the single biggest two drivers of the industry, followed by oil. But you know what has happened to Euro exchange rates and given roughly a third of the food that is sold in the UK, comes from the European Union, you can probably make your own assumptions about the knock-on impact of deflation and FX. We don't look at it in that way. So I am not sure I could even begin to disaggregate the effect it has.

In terms of the volume growth, yes you are right, we are saying 1% volume growth which implies as John has already said, broadly speaking a flat like-for-like inflation. Actually the mix effect has been helpful in one sense. We have talked about clothing, that is obviously helpful to the mix, we have talked about 13% growth rate. Actually on the other side, the areas we tend to over perform in as a business like fresh foods, produce, meat, have been the categories that have been most affected by deflation. So that is broadly speaking unhelpful to the mix. So probably in the round it plays a draw by the time you have worked all the numbers through. But actually one of the things that we could argue is a sort of good performance from our point of view is actually the categories we do best in, produce, meat, bakery tend to be the categories that have been most deflationary, and therefore you would have expected our sales to have suffered more perhaps than they have. So again we see that as a positive thing rather than negative thing. But as far as the mix effect is concerned, it will be in the round of things.

John do you want to talk about transaction volume and the other points?

Further answer: John Rogers
Yes I think you have probably covered the volume piece. But I think on transactions we have seen overall transaction growth 3% which is very pleasing with customers coming into our stores reflecting our very competitive price position and improvements in quality.

In relation to convenience and online, the contribution to like-for-like in those two together is about 0.4% so we are seeing a positive contribution from those sides of our business, given they are growing. And of course a positive contribution from non food as well which has grown about 8% or so, sorry 6% or so during the period. So again this reflects our overall offer. We have good components of growth across our business, whether it is our online business, non food business or indeed whether it is our convenience businesses, all part of our overall offer to our customers and we are seeing good growth in those areas.

Nick Coulter
Thank you.

<u>Question 6</u>

Rob Joyce, Goldman Sachs

Good morning. Three from me. The first one, I think you have kind of answered it John, but if you could just give us the total online growth in the period, that would be great.

Second one is, are you able to give us any idea of how much the potential tail wind has been from the lower oil price, have you been able to retain some of that?

And the third one is just on the timing of the improvement. The kind of need to upgrade numbers come as quite a surprise? I was thinking was that more driven by recent trading? I was thinking in terms of the preference shares that were issued a few months back and whether there would have been better rates on those if they had come now? I am not sure how that impact them, how the timing of that improvement has come? Thanks a lot.

Answer: Mike Coupe
I will ask John to comment on the total online and preference shares point. I guess on the tail wind point, we should argue that the reducing levels of commodity pricing is ultimately reflected in retail prices and that is writ large if you take fuel prices as an example. Should have the effect of putting more money back into customers pockets and there is no doubt that the consumer environment. If you are a customer you are somewhere between £18 to £20 a week better off in terms of disposable income than you were last year. If you look at the consumer industry more generally, that money seems to be spent on better holidays so you see Easy Jet and Ryanair have had very good quarters. Car sales are very buoyant. House prices are continuing to rise. So although we have seen some volume growth in the grocery industry in the half and certainly a reversal of the long-term trends we saw over the last 4 or 5 years, it is fair to say that we haven't seen perhaps the full effect from the consumer disposable income point of view, apart from perhaps in our clothing business, where undoubtedly that has done pretty well and certainly outperformed the market.

Further question
My question was more, are you able to make more pence at the pump this year by retaining a little bit of the fuel price reduction?

Answer: Mike Coupe
No broadly speaking, the market is pretty straightforward. The retail prices track the input prices very accurately so it is very much in the rounding of the overall business and that is true right across the business. The one thing you would say about the grocery industry is it is incredibly affective at passing on lower commodity prices as we see week in, week out.

In terms of the improvements, actually it has been pretty much steady across the half. You never would be committed to a particular number too early in any trading year, but as we have gone through the year, as we have gone through the first half, it goes without saying, our confidence in our ability to deliver the numbers that we are implying today, has got stronger and then as you know you have a choice about when you need to say something about that and we thought it was appropriate we should say something in advance of the Interims. Normally we would talk about our profitability at the Interims, it is actually quite rare for us to make any statement about profit at our Quarter Two Trading Statement. We thought it was the right thing to do. We thought we had an obligation to guide the market in the way that we have.

John do you want to talk about the other two things?

Answer: John Rogers

Yes sure, online Rob, we have seen total orders increase in the quarter of 15% and we have seen total sales increase over 8% in the quarter in answer to your question there.

In relation, I think you made a comment on preference shares. I think you were probably referring to the hybrid bonds that we issues a few months back. Yes I think that was a very sensible funding at the time. I don't think the pricing of that transaction would have materially changed had we done it then versus had we done it now. In fact we have got a very good blended rate across the funds on that transaction of 4.69 across both the Hybrid bond and Convertible bond, so we felt it was a very competitive and very sensible piece of funding to do at the time. I don't think we would have particularly got better terms if we were doing that transaction today to be honest.

Rob Joyce
Okay, thank you.

<u>Question 7</u>

Clive Black, Shore Capital
Morning. Can I just ask a question more broadly about your expectations from the national living wage in two respects. Firstly, do you think that this will provide a tailwind for you in further injecting cash into particularly lower income households that you are particularly well placed to capture?

And secondly in that respect, do you think it will be inflationary?

Answer: Mike Coupe
I think I have already answered the second question. Over the 5 year period we haven't quite got to where we can answer the question directly, but certainly over the 3 year period, we had line of sight and in effect factored in a sort of step well onto the journey that is implied by what the Chancellor has said. And by definition that implies that we didn't expect that to have a knock-on inflationary impact. We believe it is containable within our plans, within our cost saving initiatives and all the other things that we are doing across the business. So for us no. Whether or not it does for other people you would have to ask them. And I suspect if you looked at the grocery industry generally and if you looked at retail around the piece, you might argue that there are some organisations, some competitors who are more challenged in that area. But in the end there is, in the grocery industry, there is a very large competitive dynamic. I suspect the opportunity of passing price increases on is virtually non existent. So by implication, those that are more challenged in terms of the challenge that has been laid down by the Chancellor will see perhaps an impact on their profitability or will have to do other things in order to make up the gap.

As far as the impact on consumer income, I think we have said it before, the primary driver of our industry is disposable income and that, if you look at the underlying trends of the industry throughout history, that is the thing that drives volume growth and ultimately the growth of the industry. We have seen an improvement in disposable income of the order of £20 a year. I has reflected a little bit on underlying grocery volumes, but if you look at what happens historically, I don't know whether it is an indicator of the future, but you usually see a knock-on impact about 12 top 18 months after, customers have got over the sort of buying a better holiday, buying a new car, buying a new tele and all the other things they are choosing currently to do with that income. And I guess the answer to your question is it should probably have a benefit, but it is largely down to what happens to the other parts of the household expenditure equation. And so you would have to say if disposable income continues to grow at £20 a week over the next couple of years, that has to have an impact on the way that customers spend money. They will spend more money over all one way or another. It is then just a debate about where. History would say at some point will have an impact on the grocery industry, but we have not seen that other than an underlying slight increase in volumes over the last 6 months or so.

Further question
I really much appreciate that. My thinking there or our thinking was given it is going to particularly boost the lowest income households who spend all that they earn at the moment, whether you guys would be particularly well placed to capture that and indeed it might encourage some trading up from those people who found out that Aldi existed 20 years ago and not 3 years ago?

Answer: Mike Coupe
Yeah I have answered the question in a slightly different way to the way you framed it, but in effect it is the same outcome. There is no doubt for the last 5 years customers have chosen to shop around and one of the primary drivers of that is the economic benefit of shopping little and often and in effect wasting less and that is why we have seen a big rise in convenience shopping, or at least one of the reasons we have seen a big rise in convenience shopping and to some extent the discounters represent some form of convenience shopping, albeit there are other benefits that they might bring as well.

You could argue that as customers have more money in their pockets, they may choose to trade the other way round which is in the end, they will trade money for time. So the savings that they might have garnered through their behaviour, and particularly the reduction in household waste you might argue, and I think it would be perfectly reasonable to argue, that you might see a movement in the opposite direction. And one of the things we picked out from our Statement, which perhaps w haven't highlighted too much as we have talked today is we have seen a stabilisation of our supermarket business. That is a very important point because for the last 5 years that has not been the case. We have seen underlying volumes decline and it is not quite zero, but it is pretty much flat volumes. As you could argue as deflationary cycle works its way through the system we can have an argument about when that might be. There seems to be some stabilisation in the supermarket business in our business, I can't reflect on the market more generally and we would see that as some evidence to support your underlying hypothesis.

Clive Black
Okay, thanks very much for that Mike.

<u>Question 8</u>

Edouard Aubin, Morgan Stanley
Good morning guys. Just one question on gross margin maybe coming in slightly ahead of expectations for the year. So to what extent is it driven by lower expected cuts of the brand match programme or less vouchering in general?

And regarding the brand match products specifically, have you see a noticeable change in the percentage of baskets where you are cheaper than Asda over the past 12 months?

Answer: Mike Coupe

I will let John answer that, I have done too much of the talking, so John to you want to have a go at that one?

Answer: John Rogers
Yes Edouard we haven't made any specific comments on our gross margin position and we never would provide too much detail on that as you know. I think other than say our price position is as good as it has ever been and certainly that is reflected as I said before in all the internal and external surveys and also in what our customers are telling us.

In terms of our vouchering position, we have seen no material movement year-on-year in our vouchering position and our brand match survey tells us that our pricing position versus Asda is as good as it has ever been, so again a really positive reflection on the investment we have made for the year both in headline prices, but also in simplifying our pricing position versus our competition.

Edouard Aubin Okay, thank you.

<u>Question 9</u>

James Tracey, Redburn
Morning Mike and John. First question is what sort of like-for-like sales growth would you need for the PBT to be moderately ahead of consensus as you have spoken to today?

The second question is on the convenience business, what was the value, total value growth of convenience?

And then the third question is where are you expecting the bank EBIT to be? You were previously guiding to single digit growth there, has that changed?

And a final follow-up question would be, what was the impact on the finance charges, issuing that subordinated debt? Are some of the finance charge dropping below PBT as a result? Thank you.

Answer: Mike Coupe
Shall I have a go at the first two and John can talk about the last two. So the like-for-like I guess we have seen as we described, an improving trend through the quarter. But I guess I would answer the question the same way as I answered the general observation about inflation/deflation. In the end the big unknown factor as we go through the balance of the year is what if any changes we are seeing to commodity prices. All other things being equal you would expect the deflationary cycle we have seen, moderates during the course of the rest of our financial year which effectively will take us to the end of March. And all other things being equal if we continue to see the volume trends we have seen in our business, you can draw your own conclusion. But at some point you would expect that the line will go through zero. But there is a big caveat to that in that we are in the most volatile commodity price and exchange rate regime I think we have ever seen. So I would probably be a currency or commodity price speculator if I could predict what is going to be happening in the future.

But in terms of the total convenience business, I mean we don't break it out directly, but we have seen convenience growth of just over 10% and that would imply slightly above zero like-for-likes. The convenience business in particular is quite affected by weather, particularly in the big towns and as I have already observed, it was probably not the most helpful summer for the grocery industry, but that would be particularly the case for the convenience stores. So we did see a slowdown in our convenience business, but still a great engine for growth. And as I said a growth of 10%.

John can reflect on the other two things, but I would also say this is a Trading Statement and not an Interim full presentation. So he may not want to be completely expanding on some of the points you made, but John maybe you can give any colour that you can.

Further answer: John Rogers
James hi. Just on the Bank, no change in our guidelines on the bank, single digit year on year growth in underlying operating profit, so no change on that guidance today.

And in relation to the finance charge, I mean you are right from a technical perspective. The coupon on the hybrid bond is effectively treated as a dividend as opposed to an interest payment, so there will be some charges that go below the line. But rest assured when we report on this at both the Interims and Prelims in due course, we will reflect the charges on that, assuming the hybrid is both accounted for as debt, but also accounted for as equity, but we will break that out very clearly and transparent. And the underlying if you like finance charges including the coupon on that bond, that there is no change in our guidance.

Further question
So to what extent, so the coupon is about 250 million times the interest rate, so is the guidance, the underlying PBT reclassifying that coupon as a finance charge and deducting it or is there an upgrade implicit to shifting the finance charge down?

Answer: John Rogers
As I say we will break this down more at the Interims. But for the purposes of our guidance, we are not changing our guidance today and assume within that guidance when we talk about finance charges that we are talking about finance charges on the straight set as well as the coupon on the hybrid. So effectively we will show that broken below and above the line, but will assume for the purposes of our, if you like management accounts, how we report, that is in effect an interest payment, although technically treated as a dividend just so it is very clear what those charges are. As I said, we are not changing our guidance on this as to what the underlying finance charges will be for the full year, including of course the coupon on the hybrid bond.

James Tracey
Okay, that's great, thanks a lot.

<u>Question 10</u>

Xavier Le Mené, Bank of America, Merrill Lynch
Good morning gentlemen. Two questions if I may. The first one, how do you compare your execution right now versus your competitors because you are saying your execution is doing a bit better, almost everywhere. So your KPI is improving. But would you say that your relative improved finance is also due to your competitors executing not as well as they should do or not as well as in the past? That is the first question.

The second one, where are you in terms of the price investments or you were going to do the £150 million? So are you done with that? Does that mean you are not planning to do more going forwards? So can you elaborate a bit on that too?

Answer: Mike Coupe
I will do the first one and John can do the second one. Yeah we obviously as I am sure you do, visit our competitor stores all the time. We also get a lot of reads literally week by week as to how we think we are doing relative to our competitors. You can draw your own judgements as to what you think they are doing and how well they are doing. What we can say with some confidence is that our stores are as good if not better than they have ever been. You know, on any of the scores, whether it is availability, cleanliness, tidiness, customer service, quality of execution more generally, we would measure ourselves as never having done a better job. And we think that is part of our overall success story and part that perhaps gets missed. In the end there are a number of parameters that customers judge us on. The market is certainly obsessive about price over the last couple of years, for perhaps understandable reasons, but there are other factors that customers choose their supermarkets on the basis of and service and quality are certainly pretty significant in that and we certainly would believe our execution would compare very favourably with any of our competitors. And I would mean that across a broad front. So certainly our internal measures would say we have never done a better job and the external measures would also reflect that and that would be also relative to our competition without being too specific.

John do you want to talk about price investment?

Further answer: John Rogers
Yes on the price investment we talked about £150 million gross investment and £110 million net investment in 15/16. That is now largely done, that is already in the numbers. Of course we can't say going forward we are not going to make further price investments. Clearly what we can say is we intend to compete aggressively on price in the market. If the market invests more price over the coming weeks and months then we will match that. So I think at this stage it is impossible to say what further price investments may or may not take place in the market, but it is absolutely our intention to compete on price and we have got the fire power to do so.

Xavier Le Mené
Thank you.

<u>Question 11</u>

Stewart McGuire, Credit Suisse
Morning. Just a couple of questions on new space. Obviously very heavily skewed to convenience over supermarket. I am just wondering, is that a timing issue or should we expect the same kind of relative split going forward?

And on pricing, the same kind of line. Any comments on how your pricing has changed between the two formats as you invested in price?

Answer: Mike Coupe
Shall I talk about the second and John can talk about the first. The pricing for our convenience shops is set broadly speaking, relative to the supermarket chain. But we also look across our competitive set as well to make sure we are competitive. So we would have invested proportionately in our conveniences in the same say. Of course it does actually have a mix effect. So where the price investments have been made, it tends to be in the higher volume and particularly the fresh food product areas. So you could argue it is disproportionately affected our convenience business. Not because the price position has changed materially but because of the mix of the products that

we sell. But in the round, we link our convenience pricing file to our supermarket price file.

John do you want to talk about the space point?

Further answer: John Rogers
Sure. No changes to our guidance on the space side. So in relation to convenience, we are still projecting to open one to two convenience stores per week and with the numbers we are reporting today we are on track to meet that expectation.

And in relation to new supermarkets, again we are going to be opening 3 to 5 or so new supermarkets per year. So the trends that you are seeing in the numbers today you can expect to see going forwards over the next few years or so.

Stewart McGuire
Great, thanks very much.

<u>Question 12</u>

Sreedhar Mahamkali - MacQuarie
Morning all. Three questions from me as well. Apologies but just following up on Edouard's question, I couldn't hear the answer fully, but just in terms of the better profit you are talking to today, you highlighted cost savings and better shrink. But was a contributory factor also slighter better gross margin rate ahead of where you thought it might be? That is the first one.

Secondly, just in terms of non food like-for-like, if you can give an idea of what it was?

And finally, curious to hear if you have any thoughts on potential new competition in the shape of Amazon? Those are the three, thank you.

Answer: Mike Coupe
I will ask John to talk about the profit, I am desperately trying to find a non food like for like number, I don't know if we can break it out.

John Rogers
About 5%

Mike Coupe
About 5%, John has the number in his head. Yeah the new competition, it is always interesting to have new competition. I guess you can welcome new competition. I would not underestimate the challenge of entering a market where you have got effectively I would argue, 6 of the best operators in food grocery online service, very fiercely competitive. So we will see how it is made out over time. They will certainly create both Aldi and Amazon, an interesting dynamic in the marketplace, but equally I would not underestimate the challenge of taking on what are 6 very well established incumbents. And of course the key battle ground is London where they are in very entrenched positions. So we would welcome the competition, I am sure it will create some interesting dynamics, but it is very small beer in the scheme of the overall market at this stage. So I would not underestimate the challenge they face particularly in delivering quality volatile fresh foods. It is very, very different.

As far as the profits are concerned, John do you want to reflect on that for a second?

Further answer: John Rogers
Sure. I just want to be very clear on this point, because there is no point, if we commented on our gross margin position. So I want to make it absolutely clear that we are not saying that the upgrade today is based on an uptick in gross margin. As you know we have never commented on our gross margin position and we won't start today on this call. What I will say is that and in the face of the Trading Statement, is that the key drivers of the profit upgrade are a combination of a beat on expectations on our sales line and a beat on expectations against our cost savings line. And it is those two factors combined that are driving the need for an upgrade today. I am not going to be drawn or comment on the gross margin position, but you can infer from that what you will in relation to the key drivers of the upgrade being a sales uptick and a cost saving beat against expectation.

Mike Coupe
Can I make a comment. We are running out of time. The last two quarters this conference call has lasted about 15 minutes so this is about the most active one we have had for a while, maybe for understandable reasons. We can just take one more question and then I am afraid we are going to have to close it down. I apologise for that but you clearly can talk to Duncan in the Investor Relations Team about any clarity you need and of course John and I are available whenever. So one more question and then we will have to close it down.

<u>Question 13</u>

Borja Olcese, JP Morgan
Morning. Just wondering if you could share with us the nature of the cost savings that is leading to the shrinkage or waste and if you could be more specific on the breakdown between the different moving parts leading to the £200 million plus number which is a sizeable number?

And secondly, if you are not planning to see any supermarket space closures from here onwards? Thank you.

Answer: Mike Coupe
Well I will have a go at the first and John can comment on the second. We will comment more fully on the performance more generally at our Interims, so we are not going to get drawn on the specifics and indeed we would be reasonably circumspect about where we made the savings even at our Interims. What we would point out is that if there is an area where we have done better than we were expecting, it is particularly the waste line and that is a result of reducing the volatility of demand as a result of the pricing strategy we have adopted. So we have seen a bigger benefit than perhaps we were expecting from that particular aspect, but we are not going to go at this stage any further in terms of breaking out the cost savings.

And John do you want to reflect on the general issue of supermarket space and supermarket closures?

Further answer: John Rogers
Yes sure Mike. Just to be clear, we are not at this stage anticipating any major supermarket closures in terms of space. Never say never, but at this stage we are not forecasting any supermarket closures.

Closing remarks

Mike Coupe
Okay, I think we are going to have to call it a day there. As I say, one of the longer calls we have had at our quarterly Trading Statements and thank you for everyone's indulgence and I apologise for closing it down before we have answered all the questions, but you can come back to Duncan and the team if there is anything specific you need clarifying.

Thank you very much and I am sure I will see you all in the not too distant future, 6 weeks time indeed.

End