Sainsbury's

Third Quarter Trading Statement 2014-2015

Wednesday 7th January 2015

Mike Coupe – Chief Executive

Good morning, it's Mike here. I'm also joined by John Rogers, our CFO. John will just headline our trading statement and then we'll open up to questions.

John Rogers – Chief Financial Officer

Morning everyone. Happy New Year. I'll just take you through three key points. I'll assume that you've obviously read the statement in full but first and foremost the like-for-like performance over the third quarter down 1.7%.

Secondly, we had a fantastic week in the run up to Christmas with over 29.5 million customer transactions. That was up year-on-year, so a really strong Christmas week performance.

And the third point, just to highlight that in the Outlook Statement we think the market does remain challenging. And reflecting food price deflation and the price reductions of course that we announced yesterday we do expect our fourth quarter like-for-like to be similar to that of our first half, which was of course at around minus 2%.

So, overall we think a strong performance, a bid to expectations, but we remain cautious about the outlook in the market in the fourth quarter.

And with that I will hand over to Q&A.

<u>Question 1</u>

Bruno Monteyne – Sanford Bernstein

Good results. Just a few questions from me. One is I'm trying to back sort for the Christmas like-for-like, because obviously you have a full quarter of results. And it looks to me that your Christmas of the last four, six weeks would have been even better than what your quarter three suggests. Would that sound right that you were close to flat or even positive like-for-like for Christmas?

My second question would be: your space growth contribution is a bit below what you guided to before; is there anything that we need to understand better on that? Is there any more colour on that?

And my last question is: Netto stores, anything particular to say how they traded through their first Christmas? Thank you.

Mike Coupe

Well, as you know we don't break out any of the individual weeks over Christmas so you'll have to take it as the trading statement reads: the 14 weeks.

We do however bring out the customer numbers in the week before Christmas. We served 29.5 million customers, and that was certainly up year-on-year. So, you can draw your own conclusions from that. And of course you'll have to wait to see the market data, such as it is, to see our overall and relative performance to the market place. Of course the reality is that we don't know at this moment in time, and we won't know until the Kantar data is published next week.

So, we don't break out the numbers; we never do. But as you can see it's relatively in line with the guidance we gave at the half year.

Perhaps John can comment on the space growth, and I'll come back on Netto.

John Rogers

Before I comment on the space growth just to reinforce Mike's points on the like-for-like: I don't know where you're doing your calculations from Bruno, but if you're using the Kantar to make an inference that we outperformed over the Christmas week then I would push back on that analysis on the basis that we said quite consistently that the Kantar data is under-reading our performance. And I think that's reflected in the overall minus 1.7% number when you look at the Kantar data.

And actually, whilst we don't break it out on a period-by-period basis, there's no particular period throughout the quarter where we either outperformed. It was relatively consistent performance throughout the period, throughout the quarter. It wasn't particularly characterised by either a strong or a weak Christmas performance; it was relatively flat over the whole quarter.

In relation to the space growth, you're right to highlight that the contribution from space has been a slight downturn compared to the 2% guidance; but we're maintaining that 2% guidance. So, the reason it's slightly lower this quarter is just simply due to the timing of openings of stores. And if you look at this quarter we actually opened stores relatively late in the quarter compared to the same period last year where we opened the stores at the very beginning of the quarter. So, the contribution has taken a small step back year-on-year. But this was absolutely in line with our expectations and we're not in any way, shape or form changing our guidance for the full year.

Mike Coupe

And on Netto: we're not saying anything about Netto other than the fact that we opened the five stores before Christmas very early. To say, they've only been trading for five or six weeks in the period before Christmas; and when we've got something to say we'll say it.

<u>Question 2</u>

Edouard Aubin – Morgan Stanley

Good morning Mike and John, just two questions from me. For Q4, so you're guiding for like-for-like sales evolution slightly below current consensus. But is your forecast for the next quarter in line with what you had initially in your budget at the beginning of the second half?

My second question is: could you just give us by how much online sales impacted your like-for-like sales in Q3? And what was the figure in Q2, if possible?

Mike Coupe

I'll ask John to answer both of those, partly because I don't know what the second number is.

John Rogers

In terms of our expectations for Q4: they are actually bang in line with where we guided at the trading statement in October. We said at that time that we expected like-for-likes in the second half to be similar to the first, so minus 2% overall. Obviously the number that we announced today at minus 1.7% is a little bit better than that. We're now guiding for Q4 to be minus 2%. So, we're not really changing our guidance back from October. We said around minus 2% for the second half in October, and we're broadly reiterating that today. So, absolutely bang in line with where we expected to be.

In terms of the contribution from online in the quarter: for Q3 it was around the 0.1% level. And historically it's been a little bit higher of course because we've had higher growth; so in the past it's been around the 0.3% level. But in this particular quarter, at Q3, at 0.1% contribution towards the minus 1.7%.

<u>Question 3</u>

John Kershaw – Exane

Just a couple of me; obviously some of the key ones already boxed off. As far as you can can you comment on just initial reactions to what you've seen from Asda? Clearly we will hear some words from Tesco tomorrow and perhaps some more actions; but anything of surprise from Asda's seemingly accelerated price cuts?

We've seen on the news wires that you say you will follow and match any price cuts. How far do you take that? I see Asda has gone to 89p on four pints of milk; no one else has yet responded. At what point do you stop following?

And then just a couple of specifics: Like-for-like and Convenience if you could give us some colour on that? I think you were talking to 0.5% deflation in food, but about 0.5% inflation overall at a company level; so why have we got 5% to 10% inflation in non-food please?

Mike Coupe

I'll start with the price position and then I'll ask John to pick up the other two points.

The first point I'd make is that our price position has never been stronger. We are very happy with our price position, and certainly we feel that we're very competitive at the moment.

If you wanted a reaction to the Asda detail, the reality is it would appear that they've certainly dressed up some promotional activity as a series of price cuts. Our price cuts are focused very much on mainstream food commodities and they are, as far as these things are, permanent prices on ongoing week in, week out prices. And we will match prices toe to toe as we have done. We can get into specific details about individual skus; but the underlying point is that we will lower prices which are relevant to our customers, where we think it will have the most impact on their individual baskets, on their individual pockets. And we will do whatever we need to do to maintain our price competitiveness in the marketplace. We've done a pretty good job over the last year, and we would anticipate that we'll do a pretty good job in the future.

John Rogers

Like-for-like on Convenience just over 3%. And in relation to your point on inflation/ deflation: you're right to say that we've seen food price deflation between say minus 0.5% and minus 1%; probably exiting the quarter at around minus 1% - which is of course a great message to customers, reflecting in part obviously price investments in the market overall.

In relation to your comments on therefore the inference about what that is seeing on inflation in non-food: that's purely driven by a mix effect, very sensitive to what items you're selling and movements of course from electricals into other categories. So, that's why you're seeing the mathematics of that in the way that you've described. But it doesn't reflect a like-for-like increase in prices on the non-food side.

John Kershaw

But you recognise those numbers basically?

John Rogers

Yes, I think we recognise the numbers. So, just to be absolutely clear to everyone, the food price deflation at between minus 0.5% through to minus 1%, overall for the, if you like, the overall basket, slightly positive; so about the 0.2%, 0.3% level. But again that's driven by the mix effect in non-food.

The key message there of course to take away from all of this is the food price deflation point. Indeed in certain categories, particularly in things like obviously fresh and produce, we've seen significantly more deflation than the 1% that we just made reference to. So, a great thing for customers, and clearly reflects the tough market that we're operating in; but a positive news for customers.

<u>Question 4</u>

Niamh McSherry – Deutsche Bank

I had three questions. The first one was just on online: I think I saw a number for 6%, and you referred to the fact that it has slowed down. So, maybe you could give us your view as to why online sales have slowed in this quarter?

The second one was just following up on price investment in the market, so following on John's question. Can I just confirm then that the price investment you've seen from Asda isn't anything more than you were expecting, so that you don't at this point feel the need for more than the £150m that you outlined in November as part of a three-year plan for price investment?

And then the third question was actually about the lower fuel price. Given the Nectar card data is there any way for you to see in savings from lower fuel prices whether customers are actually spending that in groceries or not? Thank you.

Mike Coupe

Our online growth was 6%. The reality is that there was a huge amount of vouchering activity in the marketplace over Christmas. We said at our November update, and will continue to reiterate, we're not going to chase unprofitable sales; what's important for us is that we serve our customers, Sainsbury's customers, on a week in, week out basis in our online business. And we did a pretty good job of that over Christmas: we shipped 110,000 orders in the three days before Christmas; and our operational statistics, our operational performance was the best we've ever seen over the Christmas period. So, we're pretty comfortable with that position.

Price investment: what we said in terms of the £150m was that would be a relative price investment; so that's sort of above and beyond the normal day to day cut and thrust of the marketplace. When other people make price investments, when other people change their prices we will match them toe to toe, we've also said that, and we will continue to do that.

Our price position, if we look over the year, and certainly most recently, has never been stronger; so we've certainly been doing that. And certainly some of our competitors have tended to dress up some promotional activity as ongoing price investment. Our price investments are on everyday food staples and our ongoing price investments.

Fuel savings: I think it's roughly 15p a litre year-on-year. The average household buys about 30 litres a week so, you can do the arithmetic, but it works out on average customers are probably, if you take food and fuel together, somewhere around £8 to £10 a week better off. But at the moment we remain very cautious because there's no evidence so far that that's reflected in an improvement in the grocery market, whether that's an improvement in grocery volumes or an improvement in the way that customers are shopping in the sense that they are trading up overall.

Certainly if you look historically disposable income is a key driver of our industry; but we haven't seen that reflected yet. Certainly if you look at some of the other published data around other markets, for instance we saw car sales, automotive sales, this morning up year-on-year, it appears that customers are starting to purchase things that perhaps they've deferred for a few years. So, that's perhaps where that additional money is going at the moment.

So, no evidence so far in any of the data we're looking at that that increase in disposable income is finding its way into grocery volume.

Question 5

Mike Dennis – Cantor Fitzgerald

I have three questions. Firstly, on the Waitrose figures – rather than looking at the other end on Asda – their performance seemingly over the same 14-week period, their total sales were up 5.1%. They didn't give a like-for-like but I'm assuming it's a sort of 1.5%, 2% like-for-like within that. Is that an indication that higher net worth customers are leaking out of Nectar and into myWaitrose or into the Waitrose business? Or the trading up factor at Christmas is greater now than it has been before? Is there any data from your end, from Nectar that suggests that? Because that performance seems to be significantly better than the rest of the competitors.

And inflation, I was intrigued by the -0.75% deflation in your food business. I was under the understanding that doing less promotions and changing base pricing was actually inflationary in categories, or is that being covered up the initial investment in price, and will it become inflationary in categories in the second half of this year? That's the second question.

And in terms of overall Asda, are you gauging how effective your £75m investment is? Because there seems to be an awful lot of people talking about very big figures, but an awful lot of industry like-for-likes and negative, and given we haven't got a relative figure for you against the rest of the market, because you're not saying that Kantar data is relevant enough, I'm wondering how effective you're seeing your £75m investment in your eyes?

Mike Coupe

I'm still trying to understand the second question but I'll come back to that in a second.

In terms of the first question, I think it's a reflection of the continuing trends that we've talked about before and the reality is that customers in all income brackets and all socio-demographics are shopping around more, they're shopping little and often, and that tends to play into the hands of chains that have smaller shops and shops which are more conveniently located. And of course perhaps the other factor in the Waitrose numbers is the fact that they've got a relatively immature online business and they've clearly seen significant growth out of that.

There's absolutely no doubt in the run up to Christmas that we saw a trading-up in the way that you've described, and that's similar to the trading up that we'd have seen in previous years, and that's the trading up through the mainstream grocers that I'm pretty sure that we'll see our market share stepping up over the Christmas period when we see the numbers published. And also within our overall mix we've seen that customers do trade-up, we've seen a growth year-on-year yet again in our Taste the Difference sales, up 5%, so in the overall mix it is a reflection of the fact that customers will trade-up over the Christmas period.

As far as the second question is concerned, I'm trying to think of a way of expressing it, but the reality is that we bring prices down to at least the average ongoing retail price we'd have seen when you included promotions, if that makes sense, but also we're seeing significant deflation in commodity prices, which is reflecting itself in deflation in retail prices as well, and that's particularly the case in some of the fresh food areas like produce. So trying to unpick it in the way that you've tried to unpick it I suspect is almost impossible and you probably need a degree in maths. But our ambition as far as our simpler pricing is concerned is to reflect a similar average retail selling price with or without promotions, if that makes sense, but the main deflationary factor in the marketplace is undoubtedly the fact that we're seeing commodity prices falling and that's reflected in a very efficient market and passing those prices on to customers.

The last question on Asda, I mean lots of companies dress us the numbers in lots of different ways and we would reflect on the fact that what Asda seem to be describing is rollback, which is, in effect, a series of promotions and that's the way they've expressed their promotional investment. What we've said all the way along is our £150m is aimed at improving our relative price position and we believe that we've done that and that we see a volume response when we do that in the individual categories, but it's a long-term gain and it takes a long time for price investments to reflect themselves in volume growth and volume changes.

So I think it's, even at this stage, too early to tell the overall impacts on our business in the medium to long-term, whether that's reflected in customer numbers or, indeed, overall volume growth. I don't know if John wants to reflect?

John Rogers

I just wanted to reinforce what Mike's saying and hopefully provide clarity as well, that the £150m that we talk about is not reflected in the current deflation number that we are seeing.

That deflation number, as Mike has highlighted, is being driven by input cost price deflation flowing through into retail price deflation. We are not, in the way that we calculate our price investment, and counting that as price investment.

Now I can't say that's true of all of our peers, but we think it's more intellectually honest that that just reflects input prices coming down and that, therefore, follows through into retail prices. The £150m that we talk about is entirely separate to that, just to be absolutely clear.

Mike Dennis

Okay. So just one other thing then. On the question about price simplicity or value simplicity, what's your promotional participation doing in your business? I'm assuming the whole industry is now becoming slightly less promotional, so what's yours doing?

John Rogers

I think if you looked at the Kantar data, overall promotional participation, as it always does, does step-up slightly a little bit over the Christmas period. However, as a consequence of what we talked about eight/nine/ten weeks ago, where we talked about moving from a high/low pricing strategy to a medium/low pricing strategy, as a consequence of that we are starting to see, all else being equal, a reduction in the volume of product that's bought on promotion, so in other words a reduction in the promotional participation, all else being equal. That's slightly masked over the Christmas period because you tend to see a little bit of a tick up, but we are starting to see the tide turning slightly. But as Mike's already highlighted, this is a very long game, this takes time, it involves working very, very closely with your suppliers, it involves having that relationship of trust with your suppliers that we believe that we have in order to bring our promotional participation down slightly over time.

Mike Coupe

And of course it's a journey we've been on over the last two or three years, so it's important to reiterate that this is not something that we've done overnight. We continue to have the ambition of simplifying our overall price and promotional proposition to our customers, to make it more transparent, to make it easier to read through the price comparisons at the shelf edge. The consequence of that over time should be to reduce the level of promotional participation, but of course it also means that the ongoing retail prices will be lower to also reflect the overall mix. So that's the ambition, that's the direction of travel, but there's also a high level of jeopardy and risk if you get it wrong, so we're making sure that we do it systematically, thoughtfully, and in a way that our customers understand over time, and that should, ultimately, reflect in increased customer footfall and also increased volumes.

<u>Question 6</u>

James Grzinic – Jefferies International

Morning and happy New Year. I have two quick ones. The first one is can you perhaps help us understand what you think that minus 0.5% to minus 1% does in terms of food deflation into your guide for Q4 LFLs, how that contributes to that?

And secondly, since you've been quite careful not to put your performance in context around Christmas, but clearly IGD gives you a fairly good take as to how you've done relative to the industry, can you perhaps shed some light on that? Thank you.

Mike Coupe

I'll ask John to answer the first but I'll reiterate what I've already said on the second point! We don't break out the numbers, we give you a 14 week read and I think it would be wrong to break out the individual numbers, but you can surmise that given the fact that our customer numbers were £29.5m, that was a significant increase year-on-year, that broadly speaking we were pretty satisfied with the Christmas trading period.

As John's already said, however, if you looked at the profile of the quarter, it's broadly speaking the same sort of level of performance over the entire quarter, and we'll see the relative market performance when we see the published market data. Clearly the IGD doesn't include all of the players so it's important that we look at the performance in the round.

John Rogers

And James, I think in relation to your question on food price deflation going into Q4, I don't want to get drawn on specifics other than to say that we are projecting further food price deflation in Q4 and that's clearly wrapped up in the overall guidance of the minus 2% like-for-like that we've given, and at this stage I wouldn't want to be more specific than that. There's clearly a lot of pricing activity going on in the market, least not, of course, by ourselves, but it's wrapped up on the minus 2% guidance that we've given and we certainly expect food price deflation to continue.

Question 7

Rob Joyce – Goldman Sachs

I think you answered them on the inflation one I'm going to ask you but just in terms of the potential price mix in that minus 2% in the fourth quarter, can you broadly say how much you expect to come from your own price investments and how much from actual cost deflation?

And then the second one: just in terms of the fourth quarter guidance again, comp last year minus 3% versus broadly flat in the third quarter, implying that it's slightly tougher in the fourth quarter. What is it that's tougher sequentially quarter-on-quarter now that you see?

John Rogers

I think in terms of what's price investment and what's cost deflation I don't think I'd want to be drawn on that for Q4 at this point. We've given very clear indications on the price investment of £150m; we've given very clear indications of the expected like-for-like performance in Q4. We'll perhaps throw a little bit more light on your question come the trading statement in Q4 and prelims; but I wouldn't want to be drawn on that now.

In relation to the comp point on Q4, first and foremost the market is very uncertain; the market is challenging. There's clearly price investment going on in the market at the moment, so we're taking a sensibly prudent view of where we see Q4 out-turning. I think that's eminently sensible in what is traditionally a tough quarter for customers, who typically tighten their belts at this time of year.

But the other thing to highlight – and again hopefully I won't get drawn on talking about three-year wraps too often on these calls – but actually if you took the analysis back and looked at the three-year wrap quarter on quarter, and indeed four-year wrap quarter on quarter, actually you would see that the projections for Q4 for this year seem much more sensible in that context. Of course you mentioned the two-year wrap; but actually if you look at the three and the four-year wrap it looks much more sensible. And that, dare I say it, harks back to the bumper that we saw in '12/'13 as a result of the horsemeat scandal where we saw a significant upturn in our performance that meant that last year's Q4 number looked relatively weak versus the previous year's horsemeat outperformance. And therefore this year's number, if you look at comp, minus 2% is a sensible place to be. If that makes any sense to you at all?

Rob Joyce

Just about yes. Thanks very much.

Mike Coupe

Go back to horsemeat is the answer!

Rob Joyce

I'll try not to. Thanks

<u>Question 8</u>

Arnaud Joly – Societe Generale

I have three questions. First one: regarding *Brand Match*, when we had the cost call on Q2 sales you mentioned that more than 50% of your basket was cheaper than Asda. So, which percentage did you have in Q3?

The second question on cost inflation: in Q3 are we seeing that the low end of the range that you traditionally give between 2% and 3%?

And last question regarding the decrease of fuel prices: Is it immediately passed on to customers or can we expect a positive impact on margins?

Mike Coupe

Broadly speaking *Brand Match* 'cheaper than' redemptions are where they have been historically. It's actually a good proxy for our overall price position. So, that's why we can be confident that our prices have remained sharp in the marketplace, and indeed have never been sharper. So, you can take it from that that the *Brand Match* 'cheaper than' versus Asda remain over 50%.

Yes, fuel prices are pretty much as near as you'll get to a pure market. Our cost price reductions are passed straight through to customers. We do a brilliant job as an industry competing with each other as far as fuel prices are concerned, so there's a direct read through. Of course it does get distorted slightly because actually the underlying cost of the base fuel is only 25p a litre; the rest is all, broadly speaking, tax. So, sometimes when people talk about the cost per barrel dropping by half the reality is that's only reflected in the underlying cost of the fuel; which is why the headline price doesn't always reflect some of the headline cost per barrel prices. But as I say, it's pretty much a pure market, and the cost prices are fed straight through to retail prices.

John Rogers

I'll just comment on cost inflation in the quarter. Obviously it's a trading statement so I'm not going to get drawn on reporting quarter-by-quarter cost inflation numbers. However, what I would say is that we are not changing the guidance that we gave at the interims in that we expect the full-year out turn on cost inflation to be at the lower end of our 2% to 3% range, certainly around the 2% level. So, that guidance hasn't changed as a result of the Q3 trading.

Closing Remarks - Mike Coupe

Thank you everybody for dialling in. I look forward to seeing you all over the next few weeks and months. And Happy New Year to everybody. Speak to you soon.