J Sainsbury – Interim Results
Wednesday 9th November 2016

David Tyler
Chairman
So good morning everybody, morning. Thank you for being here. This is the Interim Results Presentation for Sainsbury's and you are very welcome. And actually just to say, we anticipate talking for a little longer than normal this morning because we have got quite a lot to cover.

So let me start by saying that during the first half our like-for-like transaction growth numbers were good and we also saw growth in total number of items sold. And as expected, underlying profit and EPS were a little lower than last year. Ed is going to take you through the numbers shortly. But I would like to note that in this challenging marketplace that has been around for a while, our profits have been considerably more resilient than any of our mainstream competitors over this period and we continue to pay a dividend. As you know half of our annual earnings equivalent on an annual basis. So the strategy that we outlined to you two years ago now is showing results and delivering results.

Now I am just going to make three points before I hand over to Mike, while I am on my feet. First of all to say this has been a seminal half year for the business. It is one where we created the business we want for the future with the acquisition of Argos which gives us the scale and strength in consumer products and services across the waterfront now. We have strong positions now in food, in clothing, in general merchandise and in banking. And in all of them we can see many opportunities ahead to enhance our customer proposition further and to cut our costs.

So we are in a strong position with a great platform for growth for the future. And indeed we feel confident enough today to announce a new cost reduction programme which will begin in March 2018 which aims to take a further £500 million of annual costs out of our costs by the end of three years starting in that year, March 2018.

So that is the first point. The second point I wanted to stress was simply our Balance Sheet. Our Balance Sheet is stronger now than it has been for many, many years. With the acquisition of Argos we have added to our assets and we have also added to our earnings capacity for the future. At the same time, despite that acquisition of Argos, we have reduced our net debt to £1.3 billion, significantly lower than at any time in our recent history.

The third point I just wanted to make was to stress that in my view, and indeed in the view of the whole Board, we have the strongest Management Team in the sector led by Mike, the most experienced CEO in the groceries market and by John who is also here at the front today who has had an excellent start running our clothing and merchandise business over the last couple of months or so. And we also announced as you should be aware, two outstanding new hires recently, Kevin O'Byrne, who will join as our CFO in January, who will bring with him a massive financial and Retail experience from the Dixon Store Group, from Kingfisher and from Poundland. And also Simon Roberts who previously headed up Boots in the UK and Ireland will also be joining us next year and he will be running Sainsbury's stores and distribution.

So in summary, what I would say is that the business is now in a formidable place strategically and it has got the best team in the sector to actually execute that plan.

So that is all I wanted to say. I am going to hand it over now to Mike to initiate the detail. Mike.

Mike Coupe
Chief Executive
Morning, it is not so many times in your career you get bumped off LBC by Donald Trump which is what happened to me first thing this morning. So I am going to talk through, by way of introduction, where we were two years ago and what we have done in between times and it is quite monumental that I can reflect on the fact that it is literally two years ago to the day that I got up and talked about our new trading strategy and underpinning our strategy was the reflection on the fact that our customers shopping habits were changing and changing very rapidly. So our view of world is that supermarkets in grocery will still be the place that people will choose to shop in the majority of cases. We also have to accept that the rise of technology, the growth of online and the growth of digitalisation is very rapidly changing the way our customers choose to shop. And they want flexibility, they want convenience, they want speed, they want to be able to order online. They want to be able to order on their mobile phones and they want to have the flexibility of where those products get delivered. And whatever we have seen in the last five years we expect to accelerate over the next period of time and we set out the business that can deal with those changing consumer habits.

That strategy was based on five underlying principles, many of which were continuations of what we are already doing as a business. So whether it is selling great quality products at fair prices and in an increasingly broad range of quality products at fair prices, delivered by then 160,000 colleagues who are motivated to serve our customers and run brilliant shops, underpinned by a core set of values. Those elements of our strategy were very much around the DNA and the history of the organisation. What is different were two aspects, firstly the underlying principle of understanding our customers better than anyone else and we can say that and we can do that because of our Nectar database. That gives us a huge insight into our customers shopping habits and behaviours and allows us to join our proposition together in a unique way.

And at the bottom of the slide, the underlying principle of being there for our customers, in our words 'whenever and wherever they want'. And that is where a lot of the investments we have made, whether it is in convenience stores or our online business. But of course, is a reflection of the ultimate acquisition of the Argos Home Retail Group business which gives us the ability to accelerate that move towards being an online retailer or growing our online business.

If we look at the business two years on, we have delivered our quality investment programme. We have now got through 2,100 products, another 900 to go in the balance in the year. We have done a huge amount of work on simplifying our price and promotions proposition, so we have more or less eliminated multi-buys in our business. We have removed Brand Match from the mix. We have started running same day deliveries in groceries online, so we have that in 30 stores. We are trialling one hour delivery in a couple of shops. We have opened around 130 convenience shops in the last couple of years and we have maintained very high levels of service and availability in our shops. So we do think we run the best shops in the industry and I think that is demonstrated. We see it in our internal measures, but also in the external measures.

As David has already said, we are well on the way to delivering the £500 million of cost savings that we have committed to. And we will have delivered another £65 million in the first half. We have completed now the first stage of the migration of the Bank, which gives us tremendous platform for growth and diversification in that business. And of course we have

acquired the Home Retail Group and we have started to roll out Argos stores in the Sainsbury's supermarkets and we will have 30 of those stores trading before Christmas. So we have done a hell of a lot of stuff in the last couple of years.

And as we look forward, there are now four priorities that we would set for the business, and we will talk in more detail or I will talk in more detail when I come back on these particular issues. The first is to further enhance and differentiate our food proposition. In the end, at the heart of the Sainsbury's brand is selling high quality food at fair prices and that is the prime engine for growth in the business or prime engine in the business and we serve 26 million customers week in, week out with high quality food at fair prices.

Secondly, we have a tremendous opportunity to grow our general merchandise and clothing business to deliver to £160 million of the synergies that we outlined in the case for the acquisition of Argos. So we have a very large non food business, clothing, general merchandise business, but it still only has a relatively small share of the market at 2.5 to 3% depending on how you measure it. So we believe there is a significant upside opportunity in that market.

Thirdly, now we have undertaken the first stage of the re-platforming of the Bank, we do have an opportunity to diversify and grow our Bank into the future.

And fourthly, we have talked about committing to another £500 million of cost savings over the subsequent three years and that we will maintain and improve our Balance Sheet strength over the next period of time as well.

So I will hand over to Ed, who is going to talk through the numbers and then I will come back and give you a little bit more detail on that.

Ed Barker
Interim Chief Financial Officer
Okay, thank you Mike. Good morning everybody. Before I get into the detail of the Presentation, I just want to talk through the HRG transaction effect. We completed on 2 September, so we have consolidated only three weeks of performance into these results. That is just £281 million of sales and a £1 million profit. But we have of course consolidated the whole Balance Sheet. There are a number of quite complex moving parts that we will cover as part of Presentation, they are all summarised in your booklets and we can of course cover more offline with the IR Team afterwards.

So clearly the majority of what we are going to talk about this morning and in the Presentation is the Sainsbury's business. And here we have seen like-for-like transaction growth across all channels, that is supermarkets, convenience and groceries online and total volume growth.

It has been well documented that the market remains competitive and pricing pressure has continued to affect margins, but within this our market share has only declined 6 basis points. Property profits of £113 million realised in the first half, that is mainly as a result of our Nine Elms development and we completed the Pharmacy sale generating another £98 million profit.

From a Balance Sheet perspective, net debt reduced significantly to £1.3 billion, mainly as a result of the transaction but also improvements in retail working capital. And we have concluded the Sainsbury's defined benefit pension scheme triennial valuation. And we will see net cash recovery payments increase by around £6 million to £84 million a year.

Finally, David has already mentioned the Dividend. The Board has approved an Interim Dividend of 3.6 pence per share, that is in line with our policy to pay 30% of the prior year full year dividend. And we remain committed to paying an affordable dividend with full year dividend cover to be two times our underlying earnings.

So coming on now to the Group performance. Group sales up 2.1% mainly as a result of the inclusion of those Argos sales of £281 million. And if you take those out it broadly flat. Given food price deflation and our continued investment in price this year, we have seen our Retail Operating profit decline by 7.2% to £308 million. The Bank's performed in line with the guidance we gave at Prelims, and that is a profit of £29 million and after taking into account finance costs of £65 million, joint venture profits of £5 million, this delivers an underlying profit before tax of £277 million, that is down 10.1%.

The tax rate is lower at the half year than it will be at year end at 21.3% and the lower tax rate helps the EPS which is down 6.7% at 11.2 pence.

I have already mentioned the dividend, but finally down at the bottom there, a very pleasing profit outside of our underlying results of £95 million, we work very hard for these property profits, as part of the mixed use developments that we do and the example this year being Nine Elms. And I will take you through a little bit more detail of those one-off items on a later slide. But that means that profit before tax is actually up 9.7% at £372 million.

Moving now to the Sainsbury's only retail sales, again no new news really on this chart because we gave you all of this information at the Q2 Trading Statement. But overall like-for-likes in the half down 1%. Contribution from new space added 0.9%, delivering total sales decline of 0.1%. As always we have broken out that sales performance for you over on the right, a good performance in our growth channels, but continued pressure on our supermarkets and our food business.

Again we have given you guidance for your models and we highlight that over on the right hand side of the slides and here contribution from new space to be 0.8%. That reflects around 40 convenience stores and 5 supermarkets. That is two new supermarkets, one replacement and we are converting two of our Netto stores. However, we have also lost the Pharmacy sales, so we sold the Pharmacy right at the end of the first half. And the contribution from net new space therefore is expected only to be around 0.3% for the full year and therefore a negative 0.3% in the second half.

Coming now to retail margins, and this is for the whole Group, so it adds in that Argos sales of £281 million and the £1 million profit. So it is actually slightly dilutive in the first half. At the EBITDA level, delivering 7.49%, down 9 basis points. And that reflects the ongoing food price deflation and the investments in price that we have made during the half.

Underlying operating margin down 24 basis points to 2.47% reflecting in part the higher depreciation charge that we guided to at Prelims. And then guidance for the full year so we remain and will remain competitive on price. And our full year underlying profit expectation from the combined Group remains in line with current market consensus which includes Argos. But we expect the Sainsbury's second half underlying profit, i.e, that element excluding Argos to be lower than the first half as a

result of the continued price investment and a step-up in cost inflation in the second half.

Okay, so coming on now to the Home Retail Group acquisition. We completed the acquisition on 2 September and the economics of the deal were uniquely well set for us both in terms of the synergies that we can realise and our ability to finance the acquisition through the Argos loan book. Final consideration just under £1.1 billion paid for in cash and shares. And the fair value of assets acquired was also just under £1.1 billion. So goodwill of just £18 million overall. When you take into account some of those assets that we have acquired such as the customer loan book of £615 million which of course we could choose to run off into cash, we won't but we could, net cash after the capital return of HRG shareholders of £322 million and taking into account the £18 million of goodwill, we have effectively bought this business for £156 million.

When you then take into account the synergies that we are going to create over the next three years of £160 million, we think this is a really good deal.

Full details of the opening balance sheet are included in your Interim Statement which is also in your booklet.

So looking at the Argos acquisition impact on the Group. I am just going to step you through how HRG previously used to analyse the Group and then I will take you through how Sainsbury's are now going to work with the Group.

So HRG previously analysed the Group as Argos, Homebase, Financial Services, Central Activities and then there were some interest income as well. Homebase has obviously now been sold and no longer part of the Group. The transfer of the Financial Services business took place right at the end of the first half to Sainsbury's Bank. So all future results and guidance will part of Sainsbury's Bank. Any interest income will now form part of the Group's finance costs. So that leaves Argos, central activities and of course, let's not forget Habitat which we are now going to call just Argos going forward. And these will be combined into a Sainsbury's retailing segment.

In line with our expectations, Argos should achieve an underlying profit in this full year in the range of £30-50 million, that is before the impact of synergies and any Homebase transitional services agreement impact.

We are giving this as a range due to the highly competitive market that we play in, and of course the key trading period is still in front of us. Again in line with the guidance that HRG Management gave last October, the first half Argos made a loss of £26 million. Please note though that we did not own the business at this time and therefore this element is not consolidated this year. The loss in the first half has been driven by two key factors. Increased costs from annualising Fast Track. Fast Track only launched this time last year, so you have got the full year effect coming through in H1. There is also some higher depreciation from digital spend. And finally there is a bonus cost in the current year and there was no bonus cost in the prior year. Therefore we are guiding to a second half underlying profit contribution in the range of £55 million to £75 million which of course will be consolidated.

Some Argos space guidance for you over on the right. Around 45 Argos stores within Sainsbury's supermarkets by year end, 30 by Christmas, 45 by yearend and that includes the original 10. Around 35 Argos stores in Homebase will close in the second half with the remainder of those Homebase stores closing in Half One 2017/18. 7 Habitats that Mike has already alluded to and 4 pop-up stores that we will talk a little bit more about in the next section.

So on top of this base profit, we need to overlay synergies. We have already announced that these will be £160 million by the third full year post acquisition. And to make it easier for you, because they span different financial years, we have now broken that out for you on the graph. Mike will talk more about the synergies and where they are coming from later.

We continue to have high levels of confidence in these numbers. They are prudent, audited numbers and they won't be impacted by FX rates. And again as we have already announced previously, in order to achieve the synergies we will need to invest £130 million of exceptional integration costs and £140 million of integration capex over that same three year time period.

More complicated guidance for you. Over on the right, which I will just step through slowly. So firstly we expect synergies in the second half of up to £5 million. We have still got the Homebase separation and restructuring ongoing and there are some costs associated with that as well. These have all been previously highlighted. Firstly, in relation to closing those remaining Argos stores in Homebase, secondly trapped costs at the end of the transitional services agreement and together we expect a cumulative profit impact of up to £5 million this year, £10 million next year and £20 million in 2018/19 from those. There will also be a £10 million exceptional cost in relation to the Homebase separation and restructuring, that is part of the previously announced £75 million. And then there will be some exceptional capex and costs, £15 million of exceptional integration costs in this year and £20 million of exceptional capex costs in order to achieve those synergies. Again more detail in your booklets.

So moving on now to the Sainsbury's Bank performance. Total income up 3.6% and underlying profit of £29 million, that is down almost 15% but in line with our expectations, and we guided to this at Prelims. The lower profit as a result of reduced interchange fees and the investment we are making in order to enter the mortgage market next year. All of the key metrics remain steady and as I have already said, the Argos financial services loan book was transferred right at the end of the first half and that took place and required £100 million capital injection into the Bank as part of that.

From a guidance perspective, underlying operating profit expected to be around 10% lower year-on-year and that is due to that investment in the mortgage market and the reduced interchange fees. And a small second half single digit contribution from Argos Financial Services will be offset by the ongoing cost of the increased customer deposits that we raised in order to refinance that loan book. Transferring the loan book to the Bank and funding it through the low interest rates that we pay to

customers is a very effective way of funding, rather than the Group having to go our externally and maybe fund at 4%.

Sainsbury's Bank transition costs to the new banking platform expected to be around £40 million in the full year with capex in relation to that platform of £40 million as well. Capital injections I have touched on, but the Bank are expected to receive about £120 million this year, £100 million of which in relation to the loan book.

Items outside of underlying, £95 million and the split out up on the chart, £113 million from profit on the disposal of properties, again mainly as a result of our Nine Elms Development. £98 million from the profit on the sale of the Pharmacy business to Lloyds Pharmacy. A number of other items on there, most of which you will be aware of already. A small impairment charge of £30 million driven by movements in market values of land and increased lease exit and break costs. And then the other items again down at the bottom are broken out on another chart in the appendix.

From a guidance perspective, we don't expect any further property profits in the second half. The Pharmacy transaction is now complete so again no further profit expected there. And then I have already given you the guidance for the Bank, Argos and Homebase exceptionals on previous slides.

Financing costs. Net finance costs of £65 million, up 4.8%, that is mainly as a result of the full year effect of the hybrid securities and as we said previously, technically from an accounting perspective, you would account for the coupons as dividends, but to be transparent we have treated these within our underlying finance costs. And from a guidance perspective, net finance costs expected to be slightly lower year on year. This is as a result of the improved average net debt as a result of the acquisition and the refinancing of the loan book. And then just at the bottom there, an underlying tax rate of between 23-24% for the full year, that is slightly higher than the Interim rate, and that is purely to do with the timing of recognition of the changes of corporation tax rates on deferred tax balances.

Cost savings. £65 million delivered in the first half and on track for the £120 million in the full year and we remain on track for the £500 million target that we set out by the end of 2017/18 and hence we would expect to deliver £155 million next year. As David has already mentioned, we are also setting ourselves a target, another three year target starting from 2018/19 for a further £500 million.

Cost inflation at the lower end of the 2-3% range we guided to, but importantly with a step up in Half 2 and that is mainly as a result of the pay rise we awarded to colleagues at the end of August.

Cash flow, there is a lot on this slide. I just tried to highlight the key elements, but strong cash generation even after pension scheme of exceptional payments of almost £200 million and the payment of our final Dividend of £151 million.

The refinancing of the loan book has enabled us to repay the cash that we drew down on the RCF as part of the transaction. Net cash acquired of £322 million and an improvement in working capital of £239 million, although there are some timing in there that will reverse before year end.

So from a guidance perspective, we expect a small working capital improvement and as I have already mentioned full year dividend will be covered two times by our underlying earnings.

Core retail capital expenditure, £237 million in the first half, that is one new supermarket, one replacement and 16 convenience stores. And you will see that we also acquired one freehold property in Chiswick and we acquired that freehold because we see an opportunity for another mixed use development similar to the Nine Elms and Fulham Wharf developments that we have done in time.

From a guidance perspective, core retail capital expenditure to be around £600 million for the full year and that now includes all of the business as usual Argos capex. It excludes Sainsbury's Bank capex and the Argos exceptional integration capex.

The specific Sainsbury's depreciation guidance we gave at Prelims still holds. And finally we would expect now over the medium term that our core retail capital expenditure would be around £600 million including that Argos business as usual capex.

Moving onto the Balance Sheet, we have seen a significant reduction in net debt and we have strong levels of liquidity. So net debt down to £1.3 billion, that is down £485 million since year end, the movement mainly as a result of the transaction, the improvement in retail working capital I have talked to and after of course the pension payments of almost £200 million and the dividend of £150 million. Remember the timing in there from the working capital perspective, and therefore we are guiding to net debt at yearend of around £1.5 billion, but that is still down significantly year on year.

Facilities of £4 billion with only £2.8 billion drawn at yearend, so lots of capacity and flexibility to fund the business going forward. The value of our property has stepped down slightly and that is due to a combination of reduced expected future rents and a very small yield, reducing the value down to £10.3 billion. But remember that is still significantly in excess of the net book value.

Stable balance sheet metrics. We have seen fixed charge cover come down slightly as a result of lower EBITDA and lease adjusted net debt to EBITDA is stable even though there is included the capitalised leases of Argos with almost no EBITDA contribution in the period we have consolidated. So you would expect that to come down further by yearend. And of course as we have said before, no financial covenants across any of our borrowing.

Pensions. We have concluded not one, but two triennial pensions valuations in the first half. So I will just start with the Sainsbury's triennial, an actuarial deficit of £740 million. And since March we have now made the two previously announced £125 million exceptional payments into the scheme, so totalling £250 million. And of course it is the actuarial deficit that drives the recovery payments and we have agreed our recovery payments with the Trustee and had sign off from the pensions regulator as well that they will increase by £6 million to £84 million.

In relation to the HRG Argos triennial valuation, this was agreed as part of the transaction. A deficit of £315 million, but again since March 2015, HRG scheme has received two exceptional payments of £50 million. One was in relation to the Homebase transaction and one was in relation to the Sainsbury's transaction. And again we have agreed a recovery plan of £40 million per year.

In terms of the accounting deficit, the IAS19 deficit, these were struck at 24 September 2016 date, so a different date from the actuarial. And like many others, we have seen a significant fall in discount rates since the yearend. So the Sainsbury's deficit is just under £1.1 billion and the Argos deficit £249 million. So a combined £1.3 billion deficit. However there is a lot of volatility as you know within the discount rates and if you had struck these deficits at yesterday's date, the discount rate had actually recovered by 50 basis points from 2.2 to 2.7% and therefore that combined deficit of £1.3 billion would now be under a billion. Just shows the volatility that we see in these numbers.

Combined Group reporting, a little bit more colour on how we intend to report the combined Group going forward. Again there is a more detailed appendix slide on this. So firstly for Q3 and Q4, we are half way through the year so we are not going to change anything, we are going to do it in the same way we did it at Q2. So you will have separate Argos and Sainsbury's sales like for like performance. For the Prelims at 2017/18 onwards we will report a single retail like for like and total sales number, we will no longer be splitting the performance between Sainsbury's and Argos, it is just not how we are going to run the business internally. We will absorb Argos into our current retailing segment, but we will continue to give you all of the additional disclosure that you get now around food, clothing, general merchandise, convenience, groceries online. And where we give future guidance it will be on a Group basis. So there will be no split out as we have done today in terms of Sainsbury's and Argos, other than we will continue to report of course on the synergies and how we are doing against those.

So finally, covered a lot in these slides, it is all summarised as I said in the appendix to your booklets. Any more detailed questions we can always take afterwards and we have the IR Team on hand over the next few days as well. But a quick summary of the guidance that I have already given you. So combined Group underlying profit in the full year in line with current market expectations which includes Argos. We expect Sainsbury's second half underlying profit, excluding the impact of Argos to be lower than that achieved in the first half. And that is as a result of continued price investment and a step up in cost inflation we expect to see in the second half. The consolidation of Argos is expected to deliver an underlying profit contribution to the Group of £55 million to £75 million. Synergies of up to £5 but offset by the Homebase concession closure effect of up to £5 million. Yearend net debt of around £1.5 billion and then the full year dividend cover maintained at that two times.

Alright, that is it for the numbers, I will hand back to Mike for the next section of the operational overview.

Mike Coupe
Group Chief Executive
Thank you Ed, we will be testing you all later. So as I said earlier, we set out with our plan two years ago, we have been executing against that plan and broadly speaking we are ahead of where we expected to be at this point in time. We now have what we believe to be a very strong platform for future growth. And I outline the four priorities. First of all to enhance and differentiate our food offer. Secondly to grow our clothing and general merchandise business and deliver the synergies associated with the Argos transaction. Thirdly to diversify and grow the Bank which we think has a unique platform for growth. And fourthly to continue to deliver the cost savings we have outlined, the £500 million in the subsequent three years and to strengthen our Balance Sheet.

So we start with our food. We said that we would enhance the quality of 3,000 products. We have completed about 2,100 of those and we will complete that programme by the balance of the yearend. We have made improvements in categories like Deliciously FreeFrom which is our allergen free range where we overtrade compared with our competitors. Our Taste the Difference ready meals and I will talk more about our On the Go range which is an opportunity roughly of a £16 billion market where we have significantly improved the quality of the products. And we are not sitting on our hands, we are planning to undertake another 125 range reviews over the next year, which means that we will one way or another touch around 60% of our food sales. So quite a significant programme.

But if I take the On the Go range, this is a good illustration of the kind of work that we are doing. As I say, a £16 billion market. We have introduced quality changes. So new softer bread, on trend ingredients and improved taste and freshness. New forms of packaging, better labelling. We have actually invested £8 million in the underlying pricing and also the quality of the range and we have increased the number of meal occasions covered by the range. So whether that is breakfast or snacks or indeed Sushi products. So it is a great example of the kind of work that we are doing. It is holistic, it is looking at all aspects of not just our supply chains, but also the products we are selling.

We have also made significant strides in the last couple of years in our value proposition and we said two years ago we would simplify our value proposition and we have done that. So we have seen our promotional participation reduced now to 24%, that is a massive step. We have removed Brand Match and we have all but eliminated multi-buys in our business. And of course that has the impact of making it a lot easier to run our supply chains. And so we see that reflected in our store availability, but also things like our waste costs. So a very significant programme of change and we are seeing that reflected in our customers reactions. So our transaction growth, whether it is underlying volume growth in the business and indeed the level of customer satisfaction that we measure in our overall offer. So a massive amount of change, a massive amount of work.

And we believe that we are as competitive as we have ever been. We have said before that we think our price position relative to our big three competitors has never been narrower and indeed our position relative to the discounters has never been as close. And I give an illustration on the left hand side of the Sainsbury's versus Aldi

basket, £36 pays £36.85. That is a typical basket, it is a basket of goods that an average shopper would buy week in week out and it is interesting to reflect that these prices are 13% cheaper than they were last year or 21% cheaper than they were two years ago. And that is a reflection of the fact that we have reinvested the money from multi-buys, from Brand Match, from reducing promotional participation, back into base underlying pricing.

And on the right-hand side there, a Which Toiletry Survey, again an independent survey which will show Sainsbury's the cheapest amongst not just the big four grocers, but indeed other competitors as well, whether that is Boots, Waitrose, Superdrug or Ocado. So we have done a lot of work on simplifying prices. We have done a lot of work on eliminating the complexity of our pricing promotional offer and we are seeing that reflected in the offer that we have to our customers and their behaviours.

In terms of our service, we never lose sight of the fact that in the end our executional standards sit at the heart of our business and we continue to run what we believe to be the best shop in the industry, whether it is in terms of the service standards or the products available as indeed things like cleanliness and tidiness and we are very proud of the fact that we won the Grocer Gold Award now for the fourth year running. I think we are ahead of the league table as well this year for availability and service. And I think, whatever metrics we look at, whatever metrics we see reported on, we consistently run outstanding shops and we must never underestimate our standard of execution as being one of the drivers of our underlying performance.

As Ed has already referred to, we have given a 4% pay increase to our colleagues this year, that keeps us ahead of the national living wage and again we are very proud of the fact that for the third consecutive time, we have actually invested in people Gold Accreditation which again is a tremendous testament to the work that we do in the business. So it is a reflection of the work that is done in our 160,000 colleagues in Sainsbury's of course, but we welcome another 30,000 colleagues from Argos, so in total the Group will have around 190,000 colleagues as we look forward.

And again at the heart of the brand are our values. If you take the Paralympics, we were again the sponsors of the Paralympics Team this year, but we also work that back into our Active Kids programme. This is a programme where we allow schools to collect tokens and that ultimately results in them being able to buy equipment for schools, whether it is sporting equipment or cooking equipment. And we actively engage 2.5 million children in Paralympics sports as a result of the Active Kids programme.

We recognise the sustainable sourcing, so we have the highest possible score for the World Wildlife fund's Palm Oil Buyer's Scorecard. It is one of the key ingredients in a lot of the food and a lot of the products that we sell. We made a big commitment to cutting food waste which is the single biggest issue on the minds of our customers when it comes to corporate social responsibility. So we have committed to investing £10 million in helping our customers reduce food waste, starting with a programme in our Swadlincote store and in the Swadlincote district of £1 million where we are

learning what kind of interventions work and therefore what kind of things can we rollout across the country more widely.

One of the things we have also encouraged is food donations so now we have 1,100 charitable partners. We have the highest proportion of food donations in the UK. And we have seen a reduction in our food waste of almost 10%. So we have started with reporting on our food waste in our business and that has come down 10% year on year.

And again in terms of local charity campaigns, as well as supporting Comic Relief as a corporation, actually every single one of our stores and most of our departments in our central organisation, also support a local charity. We raise many, many millions of pounds as a result of that and we have over 1,200 charities supported by stores in their local communities.

If we look at our channels. As we have said before and I will say again, we believe that we have a structurally advantaged store estate. So if we look at the market going forward, there is nothing that we said two years ago that would change our minds about the way the market will develop over the next period of time. So the slide on the right-hand side is identical to what we put in the slide two years ago. But the first point to make is that means that traditional supermarkets will remain the biggest channel in the industry. And as I say we have an estate which broadly speaking is biased towards the South-East of England and is broadly speaking, smaller than some of our major competitors. And we believe that gives us a structural advantage.

Nevertheless we have continued to invest in other channels for growth and I will come onto that in a minute. But we have also got the opportunity of taking Argos stores and building concessions in our shops and we have said that we will get 30 Argos concessions in Sainsbury's stores by Christmas and of course there is an opportunity to roll that out further over the next period of time. 200 digital collection points, we need to make our traditional supermarkets more convenient for our customers and again we are working on the layout of our stores to allow us to do that as well as putting click and collect collection points in as well as putting the Argos concessions in. We actually have 8 trial stores building on the learning from last year which are now trading and giving us again further learnings in terms of what we can do in the future to make out supermarkets more convenient for our customers.

Looking at Convenience, we have seen 6% growth, so we now have not far off 800 stores trading. We have got 16 locals opened in the first half of the year. The businesses are doing not far off the £2.5 billion sales business. But we have also been very disciplined in our approach to capital allocation. So we will only open sites where we make superior returns and hence the number has come down over the last couple of years because those sites are more difficult to find as the market becomes more mature.

An interesting development, we have actually moved into franchising for the first time, so we have entered into an arrangement with Euro Garages and we will have 6 by the end of this week, we will have 6 stores trading, we have actually got 5 stores trading today. And that gives us access, if it works, to further opportunities in actually

a low risk way because the stores because they are franchised they are capital light. Of course it has the potential to build more points of distribution for us in the future in terms of the overall proposition in the way that we join that together.

Our grocery online business, so £1.3 billion business. Again great sales growth, 8% during the course of the year, order growth at 12% which is a reflection of our focusing on our customers. We said this two years ago, this is about doing a great job for our customers. We are not just going to trade the business for trading the business, we are not just going to buy sales. And actually in terms of our customer satisfaction measures we have seen again progress over the last couple of years. And we have also opened our Dark Store in Bromley by Bow in September, that means that we now have more capacity in London which again gives us the opportunity to serve that capacity and serve the market growth in London in the future. Around 5% of our orders are now through the Grocers online app which was launched during the course of the summer and we are now in same day delivery in 30 of our stores. And subject to that being successful, we will continue to look to roll that out and we have the chop chop app working in a couple of shops in London just to test the appetite of our customers with quicker delivery turnaround which is quite an interesting trial, and again may point towards some of the future activities that we will be looking at.

If we look at our clothing and general merchandise business, starting with the overview of the business overall, Sainsbury's general merchandise Tu clothing, of course the Argos business and Habitat. So by combining those businesses together, depending how we measure it, we are either one of the largest multi-channel retailers in the UK or the largest in the UK. But it gives us significant scale and we must never lose sight of that. But as I have said already, still a relatively small share of a relatively unconsolidated market. So we believe that there is significant growth opportunities across a number of the categories in the non food general merchandise clothing area.

If we look specifically at the Sainsbury's business, the general merchandise business grew by 5% so pretty creditable performance in a challenging market. Actually our clothing business grew by 1% in the half as would have been reflected in others results, it has been a challenging market, it is fair to say, the weather was less than helpful during the early part of the summer which is one of the main selling seasons. But nevertheless, we saw our market share grow. And we are the 6th largest clothing retailer by volume, which again if you consider that business to all intense and purposes, didn't exist 10 years ago, that is a fantastic performance over that period of time. And we have launched Tu Premium, we have launched the Admiral Brand, which is our menswear brand during the course of the half as well, and again they represent tremendous upside opportunities.

Looking at Tu clothing, again we said this in the business case, in the synergy case, in the Argos platform. Argos used to have a reasonably substantial clothing business and again we believe bringing those two businesses together and serving Tu clothing through the Argos platform gives us an opportunity for growth in the future.

If we talk more specifically about the Argos business, we now have a new management team in place which some members are in the room, led by John, who

I am sure you will get the chance to speak to later on. Made up roughly I think 5 Sainsbury's people and 7 Argos people so a team that brings together the best of both businesses. So we have absolutely set out to build on the strength of the teams within the organisation because we think there are lots of great things that that business has been doing. And we have combined the best as I say of the two organisations. We believe that before we walked through the door that there was a high level of cultural alignment, we worked very well in the trial stores during the course of the last year and that has proved to be the case, so there is a high level of joining up going on within the organisations and we are working well, albeit very early. We have only whatever it is, 9 weeks into owning the business, we are working well together on how we combine the business and we are getting on with executing what we said we would do.

If we talk specifically about where Argos's strengths are. Number one in toys, number two in electrical, so it has significant scale advantages over most, if not all players in the marketplace. It is the second most visited retail website in the UK and that is a tremendous asset to build on with over a billion website visits per year. Around 50% of the volume is online, 75% is fulfilled through stores which of course means that about 50% of the stuff bought online is actually click and collected. And again by opening up the channels of distribution, more shops, more sites, again that gives us an opportunity to grow that business as we look forward. We would claim to be the first UK multi channel retailer that has achieved a billion pounds worth of sales through mobile devices. Again that would have been unthinkable five years ago and it reflects the changing shopping habits of our customers. The Argos digital stores represent about 20% of the estate and of course as we go through the rollout programme that will increase as a proportion of the stores and there is a partnership with eBay which was started roughly a year ago and we have shipped our ten millionth parcel which again brings footfall into the Argos stores, but in future has the potential to bring footfall into Sainsbury's stores as well.

So Sainsbury's has unique multi channel capabilities infrastructure, online, mobile, home delivery, click and collect. If we take the fast track proposition specifically, 20,000 products, same day delivery, 4 hour time slots 7 days a week, £3.95 within four hours. So I would encourage all of you to go on your mobile phones after this presentation and order all of your Christmas gifts through Argos and get it delivered to your local store within four hours. Store collection within 60 seconds. So these are really significant sources of competitive advantage as we look forward, especially as we can bring it to more customers over the next few years. It is facilitated by unique hub and spoke systems and real time supply chain data at an individual item level. So that single item supply chain is something again which we think is unique and a platform on which we can build.

And one of the hidden gems which we haven't really talked about at all is their two man delivery service. So if you take categories like furniture, again a relatively unconsolidated market, and Argos is in a pretty strong position to be able to enhance its furniture offer over time and take advantage of that two man delivery service. So again a platform on which we can build as we look forward.

I am going to show some Christmas ads I hope.

[**Christmas adverts – Argos]**

And John Rogers was the one in the green suit for those of you who were watching carefully! So as we say, we deliver 160 million of synergies, we have more confidence than ever that we will deliver those 160 million of synergies. We will put 250 Argos digital stores in Sainsbury's stores so not quite about half of the estate, Sainsbury's has about 650 supermarkets. But nevertheless a significant physical presence over the next three years. There are significant cross selling opportunities as I have already said, across the portfolio. For instance Tu clothing within the Argos business platform. We will have an Argos point of presence in every single or more or less every single Sainsbury's store. So where we don't have an Argos digital store, we will have click and collect points across our estate.

We have got £70 million of central savings, cost synergies, removing duplication from central and store functions and we are getting on with delivering that. But also there are product purchasing benefits across the goods line represents an opportunity. And for retail, again there are many things that we don't sell that we buy and across the Group, things like electricity, fixturisation and things that we can seek to reduce our costs. And again we have got good line of sight on delivering those synergies. And as I said, already other revenue synergies for instance putting Sainsbury's clothing through the Argos network.

In terms of the infill stores, we will have 28 open by Christmas, these are where we don't have an Argos presence in the catchment area so these are white spaces in terms of filling in the opportunity. And of course they leverage Sainsbury's footfall of space and our customer base. And we have annualised the first ten trial stores. So they are performing well, very strong sales densities. Like for like growth, I mean it is early days in terms of annualisation, but in the order of 20-30%, so strong like for like growth.

A halo effect in terms of the supermarkets. So we talked about this in the synergy case, that we see an uplift of 1-2% on supermarket sales. A very positive customer response, customers get this. They absolutely get why this is going to work for them. And of course the range of the products are actually complementary. So Argos strong in toys, strong in electicals, strong in white goods. Sainsbury's strong in clothing, in housewares, in home textiles. And roughly 60% of the volume is online click and collect and around 40% is walk in. So again it shows customers are choosing to shop online and click and collect which is consistent with what we modelled when we looked at the business.

The other two stores that we will open by Christmas are actually relocations and this is of course part of the business case where we have made some assumptions, but now we are starting to validate those assumptions. We have done one so far which is Oldham, where we have closed the store and relocated it in Sainsbury's. We get cost synergies, again this is one of the drivers of the business case. We reduced the occupancy cost, we reduced some of the management costs and of course we bring the Argos offer to Sainsbury's customers. One of the assumptions we made was that we would retain some levels of sales and it is very early days, we are literally talking about a couple of weeks, but actually if we look at Oldham and post the relocation

will actually take in more money than the catchment area overall than we were previously. So again, very early signs, have to caveat it very strongly, but so far so good and that leads us again to have more confidence that we can absolutely deliver £160 million worth of synergies.

Talk a little bit more about the Bank, it is fair to say the last couple of years have been dominated by our replatforming work. We have now replatformed our savings platform and we have replatformed our ATMs. So that is a pretty significant for us, step in the right direction over the last period of time. So that has landed brilliantly well and we expect to have a loan platform transitioned by the end of 2017. With the acquisition of the Argos Financial Services business, of course they have a card platform, and we are now looking at how we bring the two card platforms together. And we think again that represents an opportunity for the future and it wasn't, and we made no assumptions about synergies in the underlying business case for the acquisition of Argos.

As Ed has already said we have transferred the Financial Services loan book to the Bank which is affected in our balance sheet. We now actually have 220 travel money bureaus working, around 1700 ATMs, around 9% of the cash withdrawn through the Link network is actually withdrawn from a Sainsbury's ATM. And we have record credit card sales in the half.

As we look forward, we do have an opportunity in our Bank. So whilst in the short term we have to go through an investment phase in the mortgage business, it does give us an opportunity effectively for an annuity and endowment business as we look forward and it gives us a diversification of our loan book. So we are launching our mortgages in the course of next year. In home and car insurance we are relaunching that in the early part of the new year to give us a much broader coverage with a pool of insurers across both home and car. As everybody said, the addition of Argos Financial Services gives us an opportunity to leverage that loan book over time. We have 1.5 or 1.6 million active card holders purchasing Argos products and of course we have the opportunity of putting Sainsbury's ATMs in Argos locations to extend the reach. And again in terms of the one plus one equals more than two, we talked about this before, if a Sainsbury's customer owns some kind of financial services product, they will spend more money in our supermarket chain. And that is particularly the case with the credit card.

So we delivered £65 million of cost savings in the half, we are well on the way to delivering the £500 million that we committed to over the three years of the plan. Some examples of where we do that. Replenishment of the most efficient plans of the day. So we have changed night shift in many of our shops with better use of our warehouse capacity across our network. The deliveries, the way that we organise our deliveries, the way we pack our deliveries, again is an area that we have made progress on. How we organise our logistics management. And of course we have many third party contracts which again we are constantly reviewing and looking at how we can make better over time. And as we have already said, we have committed to a further £500 million in 2018/19 and beyond, roughly savings across the three years.

As we have said our balance sheet strengths remains a priority. Our balance sheet is stronger than it has been for a long while and you have seen that reflected in the numbers Ed talked about before. But if we look specifically at Argos, as we look forward, now we have acquired the business, we can look at the average lease lengths and again in terms of delivering synergies, the average lease length is around 3.3 years which means that the programme we are talking about is more than deliverable without any onerous costs coming in our direction. And less we forget, we have maintained our dividend and we pay two times cover and that means we will cover a dividend of 3.6 pence this year.

So bring that all together, we think we are in a fantastic position. We think there are significant opportunities if we look at the Group overall. So 90,000 products, 26 million customers walking through Sainsbury's doors each week. A fantastic amount of customer knowledge which we can use to sell the goods and services that we now provide. We have fantastic delivery networks, whether it is in our groceries business or whether it is through the Argos network. We now employ 195,000 motivated colleagues who are focusing on delivering customer service. We have a portfolio of stores which broadly speaking are the right size, in the right locations, biased towards the South-East of England and on the smaller side of supermarkets. And overall, we will end up with around or we have around 2,000 points of distribution where we can bring that brand presence to there. And as I say, I think we are uniquely positioned as we look forward in terms of our opportunities for growth.

And then to talk through Nine Elms. We are going to show you a video as well. But let me talk through what we have done with Nine Elms. So if you get a chance, if you haven't already been there, it is not that far from here, it is only about a 15 minute cab ride and it kind of shows you how we are bringing all the elements that I talked about together, and it is a really live showcase of how our propositions work in a physical sense on the ground. So the food offer, again we have worked hard on making it more convenient for our customers, brought things like On the Go together, we have introduced the Sushi Bar, if you look at the run of counters, again we set that on, we have introduced things like Patisserie range. So we have worked really hard on the food footprint to get that in a great place as far as our customers are concerned. We have reworked the non food space, the physical presence of our non food, our clothing and general merchandise and again although we are not pretending to be a department store, it certainly looks and feels more like the high street than ever. We have put up Habitat concessions in, again that is an interesting opportunity, it is something again we have not built into our synergy space. So as we have already said, we will have 7 Habitat stores running in Sainsbury's stores by the end of our financial year. We have got an Argos concession in, we have the Lloyds Pharmacy in the store, so again where we transferred our pharmacy business to Lloyds. And we even have a Starbucks downstairs. So as I say, if you haven't done it already, I would encourage you to actually go and have a look because of course it brings all of the elements of the brand together.

So I am going to show you a video and I will just wrap up.

[Video of Nine Elms Store]

So in summary, we set out our plan two years ago. We are ahead of that plan. Secondly the market will remain competitive, there is absolutely no doubt about that, but of course it has been competitive for many years. HRG and the acquisition of Argos and Habitat gives us the ability to accelerate that strategy. We have a differentiated position in food, our customers tell us that all the time. And we believe we have a strong platform for growth.

So with that, I will sit down and take questions. Thank you.

Question and Answer Session

Question 1

James Tracey, Redburn
Morning Mike and Ed, James Tracey from Redburn. First question from me is on Argos and can you comment on what you expect the impact from the devaluation of the pound to be on profits for next year when the hedges roll off? It is sort of preliminary views if you can.

Second question is on the customer service and availability. As you say, Sainsbury's is probably doing better than ever in terms of customer service and store standards. Yet when you look at the like for like sales growth data, you can see that relative to Tesco and Morrison it is slipping a bit and sort of worse than it has been for the past few years. So what is your view on like for likes going forward? Do you expect to return to positive like for likes and also better like for likes than your competition? Thank you.

Answer: Mike Coupe [1:07:30] track record over 5 years we have maintained our market share and there have always been when we have done a little bit better and some quarters when we have done a little bit worse. We are not unique, we are not immune to some of the forces going on in the industry but nevertheless we are confident about our ability to maintain and grow the business across the portfolio of products and services that I have talked about. So from that perspective I remain confident about market positioning.

Predicting the future, I think it is quite an unpredictable world that we are living in at the moment, not least, some of the things that have happened in the last four hours. So I am not going to make myself a hostage to fortune in terms of predicting what happens next. What I would say is I think, as I said in the Presentation, we have a unique platform to build this business over the next 3-5 years.

Further Answer: Ed Barker
Thanks James. Hedging 80-90% hedge year, so at the time of Brexit that would have been the hedging position in terms of the timing. From a value perspective, about 1.2 billion dollars from an Argos perspective, obviously some in the Sainsbury's non food as well as part of that. I think the effect of what is actually going to happen still remains unclear. We are obviously 7-8 months away from that unwind. It is an industry wide issue, it is not just an Argos issue. People seem to think that this is just an Argos issue, it is going to affect everybody within the industry. And we are going to work with our suppliers to mitigate as much as we can for our customers as part of that.

Further answer: Mike Coupe
I expect this question will be asked at least 17 times during the course of this conversation, the same is true across our food business. In the end we will set out to mitigate with our suppliers. Any cross price pressures, we will look to our own business in terms of self help

and we will do whatever we can to limit any impact as far as our customers are concerned. I think the other point I would make about Argos is we are going to deliver £160 million of synergies in a market which is relatively unconsolidated and in a business that has a very strong position in many of the categories that are subject to the kind of forces you are talking about. And these are not forces which are unique to Argos, these are forces which are across the entire industry and if you take the synergies as an example, these types of benefits are just not available to our competitive set. So I will go back to what we said all the way along which is these are relatively unconsolidated markets. We are now one of the largest non food retailers in general merchandising retailers in the UK and therefore our ability to mitigate costs combined with the synergies is in our view, puts us in a unique position to deal with whatever happens over the next period of time. But to Ed's point, it is uncertain. In the end I think to any of us to predict what is going to happen next is going to be really, really difficult.

James Tracey
Thanks Mike, thanks Ed.

Question 2

Bruno Monteyne, **Bernstein**
Pre the Argos acquisition, you guided to a medium margin development of going back to 3-3.5% in this financial year, was going to be like the low point and then going back up. Are you still down on the old retail business this first half further going down in the second half? Are you pushing forward at medium term guidance of this being the low point and then back up?

Answer: Mike Coupe
Again to the point I made earlier, there are some unpredictable forces in the marketplace, but we won't shy away from what we said previously, which is in the end we believe a 3-3.5% is a reasonable place to get to over the next let's say 3-5 years. If you look at the unwind on this half compared with the first half of next year, there are some things that start to come through like synergy benefits and the cost saving initiatives that we talked about. So perhaps Ed if you just reflect a little bit more on that?

Further answer: Ed Barker
Yes, you have seen we are £120 million in cost savings this year, that steps back up to £160 million. So I think you need to take that into account and the synergy profile is, not much of that synergy comes through this year, a lot of it steps back up next year in terms of that. So I think you need to weigh up everything in terms of where we are going to flatten out as part of that. And I think we stand by what we have said previously that over the longer term, medium to longer term, 3-3.5% we think is a reasonable return of where we will get to from a margin perspective. What we don't want to do is set a time limit to that. We want to do what is right by the customer as well with our differentiated offer.

Question 3

Stewart McGuire, Credit Suisse
Good morning, Stewart McGuire from Credit Suisse. A couple of questions from me. Just clarification, that is gross, not net cost savings you are talking about? And if it is gross, can you give us an idea of what you expect cost deflation might be?

Second question on Argos relocations. Can you give us an idea of the number of stores that might be close to existing supermarkets, total number of stores that might end up being relocated? And on page 42 you mentioned the size of the Argos store. Does size of the

Argos store matter? Can you just move that into a Sainsbury's? Does it matter how big the Sainsbury concession is? Thank you.

Answer: Mike Coupe
Shall I do the last two and ask Ed to comment on the cost savings. I think we have already covered the point. We have not broken out the relocation versus white spaces and we won't. Clearly it impacts on individuals so we have to be quite careful about what we say, but we have given you a headline number of the 250.

In terms of the size, yes it does matter. In terms of the offer, basically it matters about how much of the Argos offer you can get that can be instantly picked up. So one of the things that we will be learning through the next 30 or through the 10 that we have already opened and the subsequent ones we will open before Christmas is what the optimum size and also what is the optimum location. And we have got some variables that we understand, but it is fair to say that if you have got a 900 square foot concession you are clearly not going to be able to get as much of the product actually in that location. Of course it doesn't get away from the fact that with the fast track offer, you do have, we do have available to us the 20,000 products within four hours wherever we trade.

Further question
So a quick follow-up on that. If the space at front of store versus warehouse, does that make a difference then, the amount of space you allocate within a supermarket versus the storage space in the back where you get the product?

Answer: Mike Coupe
Yes the most important factor, if you think about the percentage of sales for Argos in a given location, that is determined by the size of the warehouse at the back of the Argos concession if that makes sense. We have opened stores which range from 900 square feet up to 5,000 square feet. And I am sure you can ask John at the end of the Presentation or end of the conversation about what percentage of Argos sales get into that kind of space. But I would also emphasise the point that the four hour deliver service gives you access to a significant percentage of Argos turnover in four hours.

Answer: Ed Barker
And remember the slide we put up that 60% of those store pickups are already generated online which enables 60% of those sales anyway to be there ready and waiting for you. It is only the 40% of sales that are walk in that you would expect those products to be there and Argos instore in Sainsbury's will probably hold 2-3,000 of the products rather than our hub and spoke model where the hub is obviously holding the full 20,000.

Answer: John Rogers [1:15:40] to clarify, if you look at Nine Elms which would hold about 6,000 SKUs which is about 3-4,000 square foot unit. If you look at something like Crayford that would hold about almost 15,000 SKUs, so slightly larger footprint that can hold 15,000. But 15,000 to 20,000 available through fast track. And as Mike says, we are trialling different formats, different SKUs counts to find the optimum size and position in the store.

Further answer: Mike Coupe
Re-emphasise the headlines, there is nothing that we have seen so far that would undermine any of our confidence in delivering the synergies and all of the things so far would give us encouragement on the plan of the rollout of what we said we would roll out. So we are pretty sure that we can get to that 160 million

Further question
And in terms of the cost savings?

Answer: Ed Barker
The £500 million is the bottom line number,that is what we will drop to the bottom line number, so it is a net number. If we have to spend money to get there then so be it, but that will be the bottom line effect.

Question 4

Edouard Aubin, Morgan Stanley
Edouard Aubin, Morgan Stanley. Just one question from me on the impact of cost inflation on your food retail margin. So you reported a roughly 20 basis point decline in your food retail margin in H1 and I think you are guiding for roughly 40 basis points implicitly in H2. So I think I remember in May you told us you expected cost inflation to be at a lower range of the 2-3% kind of guidance and potentially below 2%. So what has changed versus what you are expecting then in terms of the cost inflation?

Answer: Ed Barker
So the key movement is the 4% pay rise for colleagues that we announced from August as part of that we stepped up where we thought that would be. And therefore I think where you see your cost inflation it was probably a bit lower than the 2% in the first half and it is going to be a little bit higher than the 2% in the second half because of that.

Question 5

Andrew Gwynn, Exane
I will go for two and I will go for a gross margin question. On the food business, as things stand at the moment, are things better or worse from a gross margin point of view, think about your intro in debt Mike, is it getting smaller in terms of issue? But in terms of the issues in terms of price investment and with a wave of cost pressure that could come through in the food business, how would you characterise the UK food retail market now? That is the first question. You can swear and talk about gross margin if you want.

On the second bit, about Argos, we talk about synergies, but we haven't talked about the use of synergies. It was obviously a question that was deferred through the process of Argos, but how much of the £160 million would you expect to reinvest and how much may be delivered to the bottom line?

Answer: Mike Coupe
In terms of the characterisation of the market, I was asked a question about 17 times on the call this morning, it is very uncertain. There are clearly FX pressures coming through, but equally our job is to be agents of our customers, to push back on our suppliers, to work out if there are things that we can do to source alternatives, to look at our own business in terms of how we reduce our costs to make sure we do everything we possibly can to limit any impact on our customers. Of course the events last night may also have some bearing on what happens next. So there are so many uncertainties which make it really difficult to predict. If you look at some obvious impacts, if you take the price of petrol, it has gone up by 5p a litre. We still remain extremely competitive on fuel, but it was 110 on 22 June and it is now about 115 on an average at least and so there are some cost pressures coming through. But it is really difficult to predict how it will play out over the next period of time. And Ed has already made the point, there are many contracts that we strike on an annualised basis and where in effect cost prices are hedged. And so again it is not until you come to renegotiate those contracts that you are actually dealing with whatever is happening in the here and now. And that will be related to commodity prices also be related to currency. As far as the synergies are concerned, in effect £160 million is what we would anticipate

dropping through to the bottom line at a net level. We made a commitment that we would expect it would add earnings accretion and we stick to that inherent position.

Further question:
Can I follow-up very quickly. Again coming back to gross margin outlook. You mentioned obviously your guidance, not guidance, but ambition for the 3-3.5% margin. Getting back to that from where you are at the moment, how much is going to be driven by cost savings and how much do you think can be driven by a recovery in your gross margin?

Answer: Mike Coupe
I don't think we would break it out in that way. I guess if you look at the building blocks we talked about, we talked about £500 million cost savings, we have also talked about £160 million worth of synergies. You can make some assumptions about what you think would happen in the Phase 2 of the business, but also we have got some opportunities in the Bank and as we look forward, although we will go through a period of investment in product as opposed to an investment in systems, you do start to build a newer theme come endowment income from things like mortgages over time and so without going all the way looking into what that might look like, there is a potential upside within the Bank and of course the Argos Financial Services book has the potential to add to that. So those elements come together over 3-5 year period.

<u>Question 6</u>

Rob Joyce, Goldman Sachs
A couple of ones from me. Firstly just one the core business and the guidance there, can you confirm I think the maths there, what you are guiding to a sort of 40 basis points decline in the second half of the core business margins?

And when we look forward, we accept the step up in savings you are making there, is there any reason to think that those cost pressures disappear in outer years?

Answer: Mike Coupe
Which cost pressures?

Further question
The cost pressures which are driving the margin decline in the second half? Maybe Ed if you can talk to that?

Answer: Ed Barker
Yes I think, you know without going through all of the detail, we have given you all of the building blocks that you need to be able to get to the second half. We have confirmed that consensus was what we were happy with. You have got the H1 number, you have got the Argos contribution, you have got finance cost guidance there and that should enable you through your models to be able to work out what that element of decline will be in the second half.

Answer: Mike Coupe
And again we will make the point next year there is £155 million of savings built in plus the first stage of the synergy programme that we were talking about for Argos mainly as well. So there are some things on the upside which I think you should be able to unpick over the next period of time to work out how that would play out.

Further question
But there is no unique cost savings, sorry cost pressures in the second half that would disappear?

Answer:
I am now trying to think out loud, not that I can think of right here, right now.

Further question
And the second one is just on Argos. The gross margin there and sort of not given guidance any more, but if you look at it, despite the fragmented nature of the industry, gross margins down give or take 500 basis points last sort of 5-10 years, is there any reason that pressure abates from here if we exclude the impact of FX?

Answer: Mike Coupe
Well I think there are a couple of points you can make. First of all it is a larger business so if you take Argos business, we are combining two businesses together and we have a very strong position in the marketplace as we do in things like electricals, part of the opportunity for the combined Group is in Sainsbury's products being sold through the Argos platform which generally speaking are own label products that have higher margins and therefore you can imagine over time as we work through the categories, there is an opportunity to enhance the mix. And I have already talked about two man deliveries in a category like furniture is very high margin category, you look at the results of some of the competitors in that area and again we think there is an opportunity of bringing Sainsbury's and Argos's magic to that particular category and potentially grow our share. So we can see ways of enhancing margin, mainly through mix, because of that uniqueness of bringing the two product brands together.

Question 7

Nick Coulter, Citi Research
Nick Coulter, Citi. A couple from me please. Could I ask firstly on transactions, volumes and basket size and whether the elimination of multi-buys has meant that you perhaps are not building your customers baskets in some of the more discretionary categories and whether you think the elimination has reached its final point and there is more to gain in terms of your promotional shape?

And then secondly just on Argos, for the first time I think you called three cost pressures that have led to the increased loss. Can I just get clarity that it is phase 3 cost pressures that led to the increased loss and there is nothing else in the mix? Thank you.

Answer: Mike Coupe
I will ask Ed to pick that apart. First of all you are right, strong transaction growth, actually that is a leading indicator of the success of a retail business. In effect it makes choice more democratic for want of a better term, so people will buy what they want to buy when they want to buy it. That is reflected in volume growth overall for the business. But you are right, it takes a while in some categories for customers to change their behaviour and generally speaking the more "impulsive" the category is, the longer it takes for customers to change their behaviour. So in some categories you see almost an instant response to removing promotions or taking out multi-buys and in other categories it takes a longer time. But of course we have been doing this now for three years so we have kind of worked our way through a lot of that change and we have done it in a very thoughtful and targeted and data driven way. And so we have gone a long way down that spectrum. And I make the other point which is, it does allow us to run a simpler business that works better for our customers and we think that is a strong platform for the future.

Further question:
When will that annualise out as that is a volume in basket size for you?

Answer: Mike Coupe
Well the final phase in multi-buys is the early part of this financial year so we are talking about April/May, that is when we made the big move and then I think we finally got to the end point in August, so there is still an annualisation effect. But if you take it on the category by category basis, they broadly speaking behave in the same kind of way. The only question is where is the point of the trough and how long does it take to get back to underlying growth.

Further question:
But are you seeing a marked impact in some of the discretionary categories where you are not encouraging people to build baskets? Do you think that behaviour will change over the course of time?

Answer: Mike Coupe
Yes, we have confidence in the way we have done it and we have seen this time and time again when we have done it that shows an initial reaction from customers and of course the point, if you are not encouraging multi-buys you might see a volume reduction in the short term, but over time customers get used to and then feel good about actually, I am not loading my cupboards with a load of stuff I am never going to eat. And ultimately they see that as a good outcome which is why we are really pleased to see our customer satisfaction rising. And as I say, over the next period of time, the last move we made which effectively was April to August will annualise to your point.

Further answer: Ed Barker
And those are the key three, so the fast track annualisation which launched last year, digital spend that has been going on over the last three years, therefore increased depreciation and bonus cost that was not there last year, but is there this year. Of course there is general inflationary pressures within the business and that would include the national minimum wage, but they have been offset by cost savings that are also taking place within that business. So those are the three call outs.

Further question
So you would not call out gross margin within that mix then?

Answer: Ed Barker
Overall, no.

Further question
So in terms of what Argos disclose is 100 basis points of gross margin pressure in Q1, then that would have reversed effectively in Q2 or not something you would want to call out?

Answer:
We have also seen the increased sales that have come through, so from a cash perspective probably broadly offsetting.

<u>**Question 8**</u>

Clive Black, Shore Capital
Clive Black here. In terms of inflation that may be coming down the line, does it worry you or what is your view on how the consumer may behave if inflation in CPI goes much higher than wages?

And in that respect, what are the lessons that you have learnt from prior years in terms of food in particular that would prevent people from going back to discounters? And in that

respect where do you see your private label offer relative to brands in terms of consumer behaviour?

Answer: Mike Coupe

Yeah first point I would make is a point I have already made which is our job is to mitigate any cost price pressures through our supply chain either with our suppliers or looking at our own business as to how we can do things differently. If you start with the premise that there is some food price inflation which I am not necessarily agreeing with, but let's assume that we look at history and say, what happens next? Generally speaking, if customers start seeing their income being squeezed, they start cutting back on the more discretionary things in their lives, holidays, eating out would be a good example, and you could argue that is one of the things that is weighed against the grocery sector is we have seen the opposite effect in the last couple of years. And remember that household incomes are still growing, so there is still money out there to be spent. And in those scenarios, in the scenario where that happens, customers see their income squeezed, they start eating in rather than eating out, and if you look at previous cycles, that is usually helpful to grocery retailers. So the last time we saw this which was 2008, where we saw a very significant inflationary spike and I think at that point in time, we would have said that the grocery retailers were doing pretty well as we saw that change in behaviour. What is different, as you have highlighted is that the discounters in 2008 probably were 4% of the market, now that they are 10% of the market that clearly is a different dynamic. But nevertheless, the headline I suspect would still be the case. On balance it is probably mutual if not slightly helpful. Of course there is a subsequent phase we saw through 2010 and beyond where incomes are squeezed to the point where people start dialling out volume and start dialling down in terms of where they choose to shop. At that point in the cycle I think we saw two years where incomes dropped what was it by 7%. So even the most extreme sectors at this moment in time would not lead you to that point of view as we stand here today, but who knows. We live in turbulent times.

Further question

Just in that respect then, on the first question, given a lot of international priority brand manufacturers in particular have got dollar and euro denominated earnings, do you see them trying to as we have seen with some high profile movements recently, put through price rises that leads you to strategically change your emphasis on private label to stop people going to discounters?

Answer: Mike Coupe

How shall I answer that question? We won't talk specifically about individual branded manufacturers and we would point out to any large branded manufacturer and say allow their cost prices and by proxy their retail prices to get too far out of line with where the own label market is whether it is our business or the market more generally, they will suffer volume losses therefore suffer a consequence from that. So we would point out that fact loud and clearly. Our job across our entire portfolio whether it is brand or own label is to do everything we can to mitigate those costs. Of course in Sainsbury's particular position, we have a very strong British sourcing policy and in many categories, if not all categories, we have gone as high as we can possibly go in terms of British sourcing over a lot of the products that we sell. In some senses we have mitigated the impact of own label, but of course a proportion of our business own label is higher than most of our competitors as well as most of our direct competitors. But I would highlight the very point you have made, the manufacturing companies, if they allow that gap to get too wide, generally speaking they will suffer as a result. And so if you look at the relative profitability of some of the large CPDs compared with people like us, there are clearly questions that we would be asking.

Further question

Sorry just to finish, given you have got the same price basket as Aldi apparently now, is your expectation of the discounters market share gains which I think was accompanying estimate on your slides, overstating things on their behalf?

Mike Coupe
Sorry, say that again?

Question:

Is the discounters market share gains in future, which I think was an estimate on your slides, overegging their potential growth?

Further answer: Mike Coupe
Well we said we think they will get to the 15% level in the marketplace and as we stand today, that is largely going to be driven by new space growth. So you can read the numbers we read in terms of their current performance and you have seen their sales growth slow down significantly. And as far as we could tell, the majority if not all of their sales growth is now coming through new space. And of course new space programmes have very long life to them as we know ourselves. So you can model it in the same way that we would model it, if you look at 3 years or 5 years, you continue at compound rates we are talking about, you would get to those kind of numbers. So I think the million dollar question is, what happens next, whether or not the pressures in the marketplace would reduce capital investment and we are seeing in effect a return to a for want of a better word, a more normalised state than we have seen in perhaps the last 2-5 years.

<u>Question 9</u>

Niamh McSherry, Deutsche Bank
Niamh McSherry, Deutsche Bank. I just had a question about the grocery business deflation outlook. Given that you talk about renewed price investment. Could you just confirm whether you are talking about a similar level of deflation and as you go on H1 because you intend to invest more in the market or perhaps maybe a little less in line with the market, but continue investment?

Answer: Mike Coupe
Well in Half 1 it was minus 1%, again if you look at the two year picture, prices are 4% lower for everything that we sell compared with a couple of years ago. But it is really difficult to predict so I will go back to what I said earlier, it is very difficult with all the moving parts that we are talking about and again the events of the last 24 hours is part of the overall mix, that to predict exactly what is going to happen in terms of inflation or deflation as we look forward. There is clearly a currency element, a commodity element and of course a competitive element as well. So all of those things I would not want to make myself a hostage to fortune on predicting what is going to happen next.

Mike Coupe
Closing Remarks

No more hands. Well thank you very much everybody. I am sure we will get a chance to talk to you and look forward to welcoming you some if not all of you to Nine Elms at some point. Thank you.

End