J Sainsbury plc
Conference Call - Cash and share offer for Home Retail Group plc
09.00am - 21 March 2016

Transcript

John Rogers
Chief Financial Officer

Morning everyone, welcome to the call this morning to discuss our offer for Home Retail Group. I am afraid you have got me this morning. Mike as you would expect is busy running our business. As you know on Friday last week we announced the 2.7 in relation to the transaction and I would actually like to start today's call by walking you through an investor slide deck, that should be available on the Investor Relations Section of our website. I think many of you have been sent the deck as well, so hopefully you will have a copy.

So just turning through the deck and I will move through this at a pace as there are some slides here we have taken you through before, but just turning first to comment on slide 3. Firstly the overall terms of the transaction haven't actually changed at all since our offer that we made in February. So the 55 pence cash per share and 0.321 new Sainsbury's shares. Now as of the end of play Thursday, that equated to 173.2 pence value obviously is subject to the movement in our share price and that of course includes the capital return relating to Homebase and the 2.8 pence in lieu of a final dividend. As we said to you before, HRG shareholders were only 12% of the combined Group and of course our offer document talks about a mix and match facility which allows shareholders to take either cash or equity subject to there being an equal and opposite request from another shareholder.

We talked a little bit in the past about the funding of the deal so the £447 million cash element will be initially funded through existing resources and then of course in the end that will be entirely refinanced through the transfer of HRG's Financial Services business to Sainsbury's Bank. And of course as a consequence of that refinancing, the overall leverage – the lease adjusted net debt to EBITDA – of the Group actually improves.

Turning now to slide 4, accelerating our strategy for growth, I think Mike has taken you through the slide a number of times, but just to pick up the key highlights. It is all about creating a multi-product, multi-channel strategy, creating a retailer fit for the future. Very much about optimising use of the combined space of both retail operations and creating significant value for our shareholders. A key update on this slide of course is £160 million of synergies whereas previously we talked about total synergies of £120 million.

Again, turning over to slide 5, the key basis as to why we think this transaction is particularly compelling: creates a leading food and non food retailer of choice to customers; offers customers a winning combination of location, range, speed and flexibility – so we would have over 2,000 points of presence across the UK as a result of this transaction; optimises the use of combined retail space; combines delivery networks that are fast flexible and reliable delivery, very much meeting the changing needs that customers are expecting today; greater financial services proposition with consumer centric services by combining financial services proposition of HRG with that of Sainsbury's Bank; and of course as we will come on to talk about in a little bit more detail, delivers revenue and cost synergies for both sets of shareholders.

Coming on now to slide 6, again we reiterate that this transaction creates significant value for our shareholders. Low mid-teens return on invested capital. Double digit earnings accretion by year 3. And as I have already highlighted, reduced leverage at the overall Group level.

Now in terms of the update on synergies, we are now delivering £160 million of synergies compared to the £120 million previously. So when that is broken down by the three buckets that you see on that slide, we previously had £60 million of synergies for concessions, that has now increased by £15 million to £75 million of total synergies. We previously had £40 million of cost synergies from central and support and that has now increased to £70 million, so an additional £30 million on synergies and we previously had £20 million of other revenue synergies. We have actually taken a slightly more prudent view on a number of assumptions that underpin that and therefore we have revised that number down slightly by £5 million to total other revenue synergies of £15 million, again giving £160 million in total.

Again in relation to the transaction costs, previously we cited £280 million, a combination of one-off exceptional costs and incremental capital. We have now, having had line of sight on some of the dilapidation costs for example and the lease exit costs, we have now been able to revise the one-off exceptional cost number down slightly to £130 million and the capex of £140 million remains as is.

Moving on now to slide 7, we consider this to be a Class Two transaction, therefore it does not require JS Sainsbury's Shareholder approval. And as it sits today, the deal is structured as an offer, albeit as you will note from the offer document itself, we retained the option of moving this to a scheme subject to target consents and Panel consents.

We expect completion in Calendar Q3 of 2016. Of course that would be post a CMA process and highlighted in the bottom box, key conditions precedent for this transaction are of course sufficient acceptances from HRG shareholders, CMA approval and then FCA approval and Guernsey Financial Services Commission approval which relates to some captive vehicles within the business that requires again the authority's approval.

Moving on now to a little bit more detail on the breakdown of the synergies. Now a lot of it is data I would have shared with you verbally when we had our Fireside Chat a few weeks back, so you will understand some of the basis on which we have derived these synergy numbers, but now just to take you through some of that detail again just to remind you of how we have gone about the process.

Of course, the key headline is that the synergy number overall has increased to £160 million of EBITDA synergies by year 3, compared to the £120 million discussed previously and of course you will see on the right hand chart the phasing of those synergies over time. So £23 million in the first year post completion, £102 million in the second year post completion and £160 million in the third year post completion and again you can see the breakdown into the individual buckets as to how those phase over time.

Secondly, in relation to the costs and the capex costs again, you can see the £130 million of one-off exceptional costs and £140 million of incremental capex. And again you will see the rollout of those costs over the three year cycle. So of course in the first year, as you would expect, you would see a high concentration of the one-off exceptional costs, principally driven of course by the restructuring costs, the lease breaks and dilapidations. And again when you look at the phasing of £140 million of incremental capex, very much based on the rollout of the relocation concessions and infill concessions as we roll those out incurring the capital costs associated with those.

Turning now to page 10, just a brief overview of how through the business process we have been able to report higher synergies than previously announced and as you can expect in any process there are some overs and some unders. We have broken that down for you on this slide. This does not cover all the areas in detail, but it covers the principle areas. So going through the list we have actually highlighted additional concession opportunities to that that we have seen previously, obviously mainly driven by the infill opportunity, the idea of bringing the Argos plan to further additional parts of the UK. We see increased savings also from moving, relocating Argos concessions into our Sainsbury's stores principally driven by higher than expected occupancy costs in the standalone Argos stores. We have seen increased product purchasing synergies so we have been able to do a very detailed overlap of the buying books category by category, margin by margin, we have identified areas of overlap where we can move so to speak to lowest common denominator or indeed areas where by bringing the two buying books together we deliver additional scale, which in and of itself would deliver better buying conditions.

We have also seen increased central cost savings, having access to the detailed data. Principally looking at things like marketing costs, plc costs and some of the other central costs savings we have identified. We have obviously had access to very detailed information now which has allowed us to firm up those cost savings.

And last but not least on the upside, goods not for resale, this was something we had not included in our previous synergy analysis, but of course given the overlap of purchasing on goods not for resale, things like IT, things like logistics, things like store consumables, there are considerable opportunities to make savings in those areas by combining those two buying books together.

And then in the interest of balance, a couple of areas of where through the decisions process we have identified areas which were not as synergy creative as we first thought and the first one of which relates to the rollout of the instore concessions and the infills and relocations. What we have allowed for here is a little bit of balancing, rebalancing food versus non food sales, given we are going to take up some space in our stores through these concessions. We have therefore just had to take a quick look at the balancing of the non food and food sales within those stores, and we have taken a small adjustment to our synergies as a consequence of that.

And then secondly, we have been just taking another bit of prudency to the assumptions surrounding our ability to rollout our clothing, homeware and seasonal products onto the Argos platform, both in terms of the sales, number of small haircuts to the sales and also the margin we can drive from those sales. It is not a massive reduction, but again we have just taken a little bit more prudency on those two. But net/net as we said, this creates an additional £40 million of synergies, £160 million in total.

Coming on now to slide 11, just to break down synergies in a bit more detail. You will see there the £75m, £70m and £15m buckets and the synergies from concessions principally driven of course as we already described, by the relocation of some existing Argos stores into concessions within nearby Sainsbury Stores, revenue gains from infill concessions within Sainsbury's Supermarket and that is where we have stepped up the opportunity. Obviously there is then cross-selling opportunities, so Sainsbury's food and grocery halo sales and Argos sales to Sainsbury's customers, as well of course of the opportunity to roll out click and collect across the entire Sainsbury's estate and indeed that is what we believe creates a very unique business post this transaction, with the opportunities through these multiple points of distribution to meet the ever growing needs of our customer base. And then again you see the other two boxes, the cost synergies from central support driven by cost synergies, COGS synergies, GNFR synergies and removal of duplication. And the other synergies are the revenue synergies relating to sales of clothing, homeware and seasonal that I have already mentioned.

So again moving onto to slide 12, so the relocation concessions. So remember the concessions comprise two different types of concession, one of which is relocating an existing Argos into an existing Sainsbury's and second of which is actually identifying new parts of the UK which don't currently have an Argos presence where we can provide that presence in our stores in a much more cost effective way. Those that we describe as infill concessions. The relocation concessions actually account for roughly 55% by number of the total concessions rollout. The assumptions that we have used here in terms of the impact on sales in closing those Argos standalone stores and moving those to Sainsbury's depends on the nature of the Argos standalone store. If the Argos standalone store is actually moving less than a mile and is actually of a similar type of retail location so it is on a retail park for example, we would assume when we close those relocations and relocate those into a Sainsbury store that we assume no sales transfer loss.

For the remaining 50% of stores which are either moving a further distance or in fact are a different type of retail location, so for example it might be a high street location moving to a Sainsbury retail park location, then in those cases we have assumed a loss on those sales. Of course all of the concessions that we open will benefit from Sainsbury's customer shopping in Argos, so we see that positive benefit in terms of halo and of course the key driver of value here, very much so, is the lower operating costs. So as you would expect obviously we are able to eliminate the rent and rates of the standalone units without incurring any additional costs within our own stores and also the costs of utilities and facilities management, again we can eliminate without incurring any additional costs within our estate. So very much the key driver of these particular synergies driven by those cost savings.

If we then move onto slide 13, I think that in essence captures what I have just described so on the sales side, we do see a little bit of a tick back in total non food sales, as I described in the past, in part offset by JS customers also buying into the Argos brand, so in the end sales broadly neutral. But we do see significant reductions in the other costs associated with the operating model, so store labour, occupancy costs, utilities and other costs, leading to significant savings in an operating model where we are able to leverage off existing infrastructure and our existing store estate and save significant costs from the Argos estate.

So turning now onto slide 14, again this is information from the public domain that just makes reference to the lease expiry profile for the Argos estate and shows, this is at October 2015, and the estate was relevant as of 14/15 year end , so you would have expected it to perhaps move on a year since the data was first presented, but at that time the average remaining length on the lease was 4.9 years, you can draw your own conclusions as to where that may have got to one year later. And again you can see the profile of those leases expiring on the chart on the right. And again this gives us the opportunity to capitalise on a much more efficient operating model, operating some Argos's as concessions from our main supermarket estate.

Coming on now to Slide 15 which is the infill concession. It is currently set for approximately 45% of total concessions by number, as I have already described, they relate to areas in the UK where there currently isn't an Argos presence and no store within 3 miles, underserved catchments by market spend and again areas where we think we can offer the Argos brand in a very cost efficient way to customers which would lead to additional sales and additional value for our shareholders. Of course these also represent significant opportunities to increase employment, create new retail roles to operate these infill concessions.

Coming on now to Slide 16, cost and other revenue synergies, again already highlighted the fact, we have been able to have access to much more detailed information as to the cost structures used for example at the plc level. So information on the buying books, looking at some of the central areas where we believe there may be overlap and the opportunity to restructure. And of course on the GNFR as well. So again from that area we have been able to identify significant additional synergies.

And then on the other revenue synergy side again we have taken a small haircut to that number principally driven by less optimistic assumptions surrounding our ability to sell clothing and homeware and seasonal across the Argos network.

And then the last slide again just talks about the costs to deliver and the phasing of those costs over the three years. Again we have been able to update these numbers slightly, as I said at the beginning of the call, principally now we have had access to detailed estate information, store by store analysis, which has enabled us to get a very accurate view of the dilapidations, the lease break costs and so forth which enabled us to update our numbers and reduce that cost by £10 million and again you will see the saving of the capital cost principally driven by the phasing of the concession rollouts across our store estate.

So pretty quickly through that. As I said, a lot of the subject matter will be familiar to you, you will have seen some of the slides before and indeed I know I talked through some content with you before. So hopefully that was a useful scene setter for now Q&A. And I can actually say, Mike has just arrived actually, decided to come in and be available to answer any of your questions as we go through the process.

So handing it over to your now for Q&A.

Q&A Session

<u>Question 1</u>

John Kershaw, Exane BNP
Good morning guys. Just a couple from me. First one, just help us understand, I don't think this has been formally agreed yet obviously by the Home Retail Shareholders. Do you anticipate this being your final bid in terms of price? Clearly the synergies have been raised a little bit? So perhaps some comments on that. And within that, why still no financial services synergy assumed?

A second one is just help us understand, you are going to have an Argos pretty much in every store, so how is the hub and spoke system going to work? How are you going to have good delivery standards across the network when in a lot of stores there is only going to be a very thin stockholding, I assume?

And finally why don't you lose control of your food business when the competition is improving, as you get distracted by doing this deal?

Answer: John Rogers
Maybe I will pick up some of those and Mike can join in. Obviously we are not going to comment at this stage, John, on whether we would increase our bid or not. But what we have clearly said and what HRG shareholders have clearly said is that both parties are moving towards a recommendation. So you can read into that what you will, but obviously I am not going to be drawn into the detail of that at this stage.

In terms of your question on financial services, again I think we have said all along that we do consider there to be the opportunity for financial service synergies from this deal, however I think what we would recognise is that we are going through a relatively large scale transitional programme within our Sainsbury's Bank, and therefore just being sensible and prudent for us, not to overlay on top of that an assumption around future financial service synergies, given that the Bank already has a significant amount of work to do to stand up its new banking platform. So I think again, we are just being I think sensibly cautious about our ability to deliver synergies.

I think in relation to your last question which was about the food business, look I mean we have said all along, we have got a I think a fantastic management team across this business and as is evidenced I hope by the Q4 Trading Statement, a very, very positive performance for the business, we have remained confident we are executing our strategy as Mike and I outlined in November 2014. We are making very good progress, we have a very strong operating Board, a very strong Team. And we are confident that we can execute this transaction in a way that is not a distraction to our food business. We have said many times that what is required to unlock the synergies of this deal are very much at the heart of what management has got experience at. So very much property driven synergies for example. Very much buying book synergies, again things that Management are very familiar with and have got very significant experience at. So we are confident we can execute this transaction and maintain the considerable momentum we have already achieved in relation to our food business.

Answer: Mike Coupe
I would just reinforce that point John. We stand by our track record. I think we have over time grown our market share for the last 5 or 6 years and consistently outperformed the market. We have done in the last year as well in what has remained extremely challenging market as you yourselves would acknowledge. And every time writes to us, they have written numerous times, somebody is going to steal our crown or whatever. I think we have demonstrated consistently that we have been able to deal with whatever is coming in our direction. I stand by our track record.

And your last question about hub and spoke, we have pretty good experience now about what works and what does not work. Typically in a sort of smallish concession you can get something like 60% of the sales turnover, so you know it is a pretty impressive model. And the bits that you can't get within the actual concession itself are delivered within four hours. And of course you have a network which capacity wise is set up to deliver a lot of volume over a relatively short period of time over the holiday season. And so it is relatively straightforward to get your head around how you can potentially grow through the existing capacity sales throughout the rest of the year and indeed put more SKUs through that existing network. So we are pretty confident in terms of our ability to deliver within our existing hub and spoke network

John Kershaw
Okay, thank you very much guys.

<u>Question 2</u>

James Tracey, Redburn
Morning guys, two questions from me. Could you give us a vision of the business in three years? How many of the existing Argos stores will remain? How many concessions there will be? Just so we can model that out.

And then second question is more on the Argos business, it has negative like-for-likes for the past couple of quarters, how will you be planning to retail that business differently? Thank you.

Answer: Mike Coupe
If we start off with the first point. We said consistently we would anticipate that there will be some form of Argos presence in all of our shops, bar a very few of the smallest shops. We haven't been drawn specifically on the number, I think there is still a level of detail to go into as far as that is concerned. But you can kind of see the lease length John has talked about earlier in the Presentation and you can draw your own conclusions, but you can imagine there is a reasonably substantial number of stores that can be relocated. We would expect more points of presence as a sort of non click and collect style offer as you would also anticipate.

On your second point, if you look at the markets in which Argos operate, yes there are undoubtedly some challenges, but equally you could argue there are substantial opportunities to grow our market share. And when I look at the charts these look like in most cases relatively unconsolidated markets and therefore we think there is an opportunity to grow the revenues of the business and we think that by bringing that offer to the best part of 1,300 points of presence and 26 million customers a week you would just increase the mind share and you increase the propensity for customers to want to shop the offer. And of course that is notwithstanding the fact that there is a significant opportunity as we have already talked about to put Sainsbury's products through the Argos network. So we think overall the outcome is pretty compelling and again we have talked before about creating what would be the UK's, we believe, largest non food business when the two businesses come together. I don't know if there is anything you would add to that John?

Answer: John Rogers
Well just to bring a bit more colour to what the business might look like. At the moment you have got for the Argos business about 50% of sales originate online so it is very much an online business, but of course actually roughly 80% of those sales are picked up today in physical stores. So 50% of the orders originate online, 80% of the sales picked up physically in stores. And of course with the points of presence that Mike has made reference to, over 2,000 across the estate of this business, we think that presents a significant opportunity to grow those sales, given that particular market dynamic.

Further question
Okay, and when you mentioned that most stores will have an Argos presence, does that include all the convenience stores as well?

Answer: Mike Coupe
Yes we have already trialled click and collect in our convenience shops and we are surprised and again enthused by the opportunity that presents. The underlying proposition will be go on your mobile phone and have delivered within four hours a range of products which is pretty significant to one, as John has already mentioned, 2,000 points of presence or indeed have it delivered to your home, or in the case of somewhere between 60-70% of the range being able to go and pick it up in a store in a normal way. So we think this provides quite a compelling customer proposition.

James Tracey
Okay, very interesting, thank you.

Question 3

Clive Black, Shore Capital
Well done. A couple of questions if I may. Firstly the CMA, could you give us some colour as to your cautious expectations to how this organisation may behave, because it can be highly unpredictable?

And secondly, depreciation, you have kindly given us a breakdown, John, of capex, can you give us some colour just of the nature of that capex? Is it likely to be short of longer term write-off assets?

Answer: John Rogers
I will probably pick off both of those. Obviously on the CMA process, we have taken, as you would expect us to, considerable legal advice. Clearly, unfortunately I can't go into the detail of that on the call, but we would expect this transaction to complete probably sometime in Q3 calendar of 2016, having gone through a CMA process. So you can read into that what you will vis a vis the nature of that process. But we have taken legal advice, we are comfortable with that legal advice and we are reasonably confident we will be able to complete the transaction in Q3 of this calendar year.

Further question
Just on that then, are we reasonable that we should assume a phase two investigation?

Answer: John Rogers
Well no. If you look at the timings of what is required obviously there is the pre-notification phase which we will have to go through a period of anywhere between 4-8 weeks or so. And then there is the 40 days required through the Phase One process. If you carried all that forward plus allowing a little bit here and there that gets you to a Q3 completion deadline. So again as I said I can't go into too much detail on what our advice on the CMA piece, but we feel reasonably confident we can complete this transaction in Q3 of this calendar, 2016.

Further question
Does the experience of your pharmacy business and maybe even light of Poundland and 99p, not make that sound potentially optimistic time scale?

Answer: John Rogers

We don't think, based on the legal advice we have received, we don't think so. Look clearly in any competition process there is an element of risk, in any competition process it is almost impossible to read the minds of the CMA, but as I have said, we have taken the legal advice you would expect us to take in a transaction of this nature and we remain confident of our ability to complete in Q3 calendar 2016.

Clive Black
Okay thank you.

John Rogers
And in relation to your question on depreciation, again we have not given any specific guidance on depreciation, but we are talking about £140 million of capex which is principally driven of course through the rollout of the concessions across our estate. You would typically be looking at a 7-10 year depreciation on those assets, something of that nature to give you a little bit of a heads up.

Clive Black
Thank you very much John.

<u>Question 4</u>

Bruno Monteyne, Sanford Bernstein
Good morning gentlemen. I noticed some of the leases obviously expired on your page 14 in the last 12 months, what has happened to those that have been expiring at Argos for the last 12 months? Have you been able to put them on hold for renegotiation until you have clarified this?

Second question, how do you plan to report the Argos business and your existing non food business? Are you planning to have Argos separately or combine Argos and your non food together into a new non food reporting segment? Thank you.

Answer: John Rogers
In relation to your question on leases, obviously I won't get too drawn on the detail, but as you know once the lease expires you can hold over the lease for a period of time so you are not required to renew the lease and I would anticipate that Argos would be holding over a significant number of these leases, they are still in occupation, still paying rent, but in effect holding over the lease. So again you will have to draw your own conclusions on the detail of that.

And in relation to how we intend to report this business going forward, first and foremost I would say we would report it on a very transparent basis, we will be very clear. We have not yet defined exactly the parameters against which we will report, but obviously it is our intention to combine together the non food operations in Sainsbury with the non food operations of Argos, so we would most likely report that business in total in terms of non food sales across the entire group.

Bruno Monteyne
Okay, thank you.

<u>Question 5</u>

James Anstead, Barclays
Good morning, just one question from me please. I am just interested to discuss the assumption you are making there will be no sales loss for the Argos relocations when you are moving less than a mile and to a similar type of retail location. I can

absolutely see why in the case of Welwyn, when the two stores seem to be almost across the road from each other, why that would be the case. But I wonder whether that would be so true when the stores might be you know closer to a mile apart and customers are used to a particular location that Argos presumably thought was quite well suited for its business. Can you talk in a little bit more detail why you are so confident on that point?

Answer: John Rogers
I think James we have done the research in terms of looking at how customers behave and how they shop. We have obviously got access to the Nectar data. We have got our location planning teams doing the detail, understanding the different nature of these locations. And as you can imagine, a lot of these are very much almost identical retail type locations, often very, very close to one and other. And in our view we think on balance it is a safe assumption to make that we won't see sales losses through those transitions. Now you may perhaps say that is a little bit optimistic. I think whenever you look at synergies in the round you have got some areas where you take maybe a slightly optimistic view and other areas where you have taken perhaps a bit more of a haircut. And I would suggest that when you look at those locations that are more than a mile away and in different retail locations we have taken quite a material haircut to those sales. When you look in the round, what gives me comfort is when you look at the total non food sales or Argos total sales, through relocating those stores into Sainsbury's stores, the overall sales numbers goes down and I think that is a reasonably sensible and prudent assumption to make in these circumstances.

James Anstead
Okay, that's helpful, thank you.

<u>Question 6</u>

David McCarthy, HSBC
Good morning gents. Just three very quick questions. One is on page 14 where you have got all the leases and decline in the number of leases, do we take it that if you own this business you will definitely close all of those and allow the leases to expire? Or would you be prepared to renegotiate the leases and keep some of those stores open if you are able to get improved conditions on the lease?

Second question, on the staffing. Will the staff be completely separate, you know separate uniforms, separate departments so that you will or will not be able to move staff from a Sainsbury's main store into the Argos concession? Will they have the right training? And are there any issues around the pay of the staff, the terms and conditions, pension, pension deficit etc?

And then finally, on the range overlap as exists currently, and assuming that there must be some price differences, so will we be looking at price harmonisation with Sainsbury's prices being brought down to Argos prices in the short term and that then being rolled out across the entire Sainsbury's range? Or might you end up with different price books for different Sainsbury's stores?

Answer: Mike Coupe
I will have a go at a few of those Dave and leave John to comment on some of the other detailed aspects. It is fair to say we are not going to answer all of your questions simply because I think we are going into too much detail. But if you take staff as an example, indeed the way that we would intend to run the business, it would be as a standalone operation at least in the short to medium term. Clearly we

would argue that it does provide or the two businesses together do provide career opportunities for colleagues in both businesses. We think that is one of the benefits, one of the softer benefits for our colleagues, but we won't comment specifically on pay benefits or indeed harmonisation of terms in more detail. But you can see that there is an opportunity for colleagues, but we would anticipate running the businesses separately.

On the lease point, no you can't make that assumption, you can imagine that over time we would look to optimise the estate and therefore there are a number of stores where you would look to renew leases, not least the hubs where that clearly is part of the overall business model, but it goes without saying as we have already identified in the Presentation, more generally that there is an opportunity to consolidate the estate and indeed put more stores into our existing stores.

And as far as prices are concerned, I think we are getting into a level of detail that goes too far. There are actually not that many categories where things overlap and actually there are not that many places where I think it would be a specific issue. But clearly once we get into the buying book we will make some policy decisions about how we would go about harmonising prices and the ranges between the two businesses, but I think at this point that is just too early to make a comment.

Further question
If there aren't that many ranges that overlap, where are you going to get your buying synergies from?

Answer: Mike Coupe
Well you can take it as read that we have gone through a lot of detail on this Dave and therefore we have got a pretty good idea where we can get the buying synergies from. We would not have made the commitments we have made unless that is the case and indeed as you know with these situations it has to be independently audited and verified so we are pretty clear on where the benefits and where the synergies come from.

Answer: John Rogers
I think you asked a question around pay and terms, again not going to get drawn into any particular detail on those issues, but nothing identified of concern as of yet. And you asked a very specific question around the pension of course and we have had to make a slight change to the cash contributions to the HRG pension scheme which is effectively as reported in the offer document which is an additional £50 million one-off in cash, increase in the annual contributions to £40 million. I think some of you this morning reported it increase of £40 million. Just to be absolutely clear, it is not an increase of £40 million, it is just increasing the cash contributions to £40 million from a previous number and then also providing a little bit more security. But overall we are comfortable that we have come to a sensible agreement with the HRG trustees of the pension scheme.

David McCarthy
Okay.

<u>Question 7</u>

Rob Joyce, Goldman Sachs
Morning guys. Thanks for that on the pension John. Just to follow-up on that. Can you confirm firstly just how long that £40 million top-up is expected to go on for, how

long have you agreed to pay that for? And whether the £50 million you have to pay one-off is included in that £140 million of cash out-going?

And then the second area is just in terms of the underlying Argos business, can you tell us if any of your numbers are net of expected gross margin pressure from, say, US dollar strengthening against the pound and the ongoing price pressure in the market from Amazon? And whether there is anything in there for the increased operating costs which I assume keep increasing as they introduce this kind of four hour collection time slot, because that is still to be rolled out as my understanding is, across the whole network? Thanks very much.

Answer: John Rogers
Thanks Rob, just to come to your question on pensions. As you will know from any pensions process, you go through a triennial valuation negotiation, so anything that gets agreed in effect comes up for renegotiation at a point in time in the future. The Argos scheme runs on a 2015 cycle so in other words we would be expecting in 2018 to renegotiate these terms as you would under any defined benefit pension scheme. So it is valued for the three years.

And then in relation to your question on the £50 million, is actually additional to the £140 million of capex and so it is on top of that. But all of that is of course assumed in our overall numbers and EPS accretion etc, but the £50 million is additional.

In relation to the Argos business, we are not going to get drawn on the detail underlying performance of that business. We are well aware of the structural pressures on the business and the dynamics in place particularly you make reference to a couple in terms of dollar purchasing etc. We believe we have taken a very sensible and a very prudent view in relation to the underlying performance of the Argos business in our base case. And that is the case on which we reflect and present all of our numbers, including the synergies, the impacts on EPS and the return on invested capital. We believe we have taken a very sensible view as to the underlying performance of that business. Of course in part guided by management who have indicated the extent to which there are overheads that can't be recovered and also the impact of course of closing the Argos concessions in the Homebase estate. So we have reflected all of those numbers into our underlying performance and that is of course all reflected in the overall financial position of the deal.

Answer: Mike Coupe
I will just reflect again on the point we made earlier, if you look at many of the markets that Argos and indeed we operate in, they are relatively unconsolidated, nowhere near as consolidated as the grocery business. So lots to talk about taking on Amazon and all the rest of it. To win you have to win against other players, not necessarily just against Amazon. So I would refer you to market share charts, go and have a look at the relative unconsolidated nature of the market which Argos operates. And I would suggest that from that you might summarise that with 25 million customers, 65% of the UK population walking through the door of a Sainsbury's in any given area, there is a significant opportunity to increase the points of presence, increase the mindshare and ultimately sell more stuff to those customers.

Rob Joyce
Okay, thank you.

<u>Question 8</u>

Rickin Thakrar, Haitong Securities
Morning. Just a couple of questions. First do you still expect the deal to be EPS accretive from day one?

The second question is related to your double digit EPS accretion, is that a mid-teens figure or, it sounds like based on the synergies you are targeting it will be higher than that? Those are my two questions, thanks.

And sorry going back, the third question is, are you able to comment on consensus for PBT?

Answer: John Rogers
Okay, Mike is smiling at me across the table at me, I think I will probably pick up all of those. So do we expect the deal to be accretive EPS wise from day one? No. We have relooked at the phasing of the costs and synergies and we don't expect the deal to be accretive on day one. But we do expect it to be accretive of course by year three as we have indicated. I am afraid I can't really give you any more guidance than we have given on the double digit EPS accretion in terms of where that fits, but obviously you can work your own numbers and see from the level of synergies that we believe this deal creates, the opportunity for EPS accretion through this transaction.

And in relation to consensus of course, I am not going to say anything that we have not said already on the Q4 Trading call. So we are where we are. We are obviously well aware of our obligations and if we felt the need to have to say anything then we would. We don't so we won't.

Rickin Thakrar
Okay, thanks.

<u>Question 9</u>

Dusan Milosavljevic Credit Suisse
Good morning gentlemen. What do you think will be the income statement affect from the transfer of the Argos payment book? I think that question was asked before, but I don't know if you have answered it.

And the follow-up question, how would you assess the quality of the Argos payment book, given the business profile of Argos? Thank you.

Answer: John Rogers
I think in terms of the quality of the loan book is I think you are referring to. Again we have done all the necessary diligence you would expect on that loan book. We are very comfortable with the risk profile that that presents to the business overall. We are very comfortable with the level of provisioning in that. What we have said very clearly of course is that as a consequence of our ability to use that loan book, to transfer that loan book into the bank, we can actually at a Group level deleverage, given our ability to fund the transaction through the sale of the loan book, to the bank, which we feel is a very positive aspect of the overall transaction.

Further Question
Thanks and in the first question, you haven't guided on what would be the income statement effect from the movement?

Answer: John Rogers
I think to be determined. A lot of that clearly depends on the transfer value of the book into the Bank, a decision to be taken between the Bank Board and between Sainsbury's PLC. So we will update on that in due course and it depends on that detail yet to be determined.

Dusan Milosavljevic
Thank you very much.

Question 10

Estelle Weingrod, JP Morgan
Morning. Just one quick question from me. Actually just for the Sainsbury's stores you will relocate an Argos store, how can you ensure you have enough availability and freshness for your food offering while the majority of an Argos store is stocked from the States?

Answer: John Rogers
I think we have done, what we have been able to do Estelle through this process is a very, very detailed, almost store by store exercise, identifying where we see the opportunity to close an existing Argos store and move it into one of our existing supermarkets. And indeed where we see there are opportunities to put in these so called 'infill' concessions and provide the Argos offer to a broader UK population. As part of that detailed store by store analysis, we have understood how much space is required for the Argos concession, we have understood the impact that it has on the overall blueprint of the store in terms of the square footage. We understand the impact it has on our food, non food offer and the sales. We have done a very, very detailed piece of analysis which gives us frankly a lot of confidence to believe that we can operate these concessions in a way in our stores that actually enhances the store, enhances the customer offer. Obviously we will continue to maintain the very strong operational standards we see evidenced in our food business today. We are very confident that the addition of these Argos concessions will act as footfall drivers. We know that from the ten store concessions we already have in our estate. We are confident that the offer is very complementary alongside our existing non food and of course our food offer. So we are pretty confident we can deliver the synergies and create the business we have talked about.

Answer: Mike Coupe
Can I just reiterate the point that John has just made. In the end, we start from end of spectrum that this is a food first business, particularly fresh foods, that is what we build our reputation on. These businesses will effectively run completely separate supply chains. We are not anticipating in any shape or form any time soon bringing together for instance the fresh food supply chain, that is one of our crown jewels. And indeed one of the benefits you can argue is if we are selling more stuff because of the relative synergies, the opportunities to sell more food to non food customers and vice versa, generally speaking, that has the effect of improving the offer rather than detracting from the offer. So where you have got more volume coming into the stores, generally speaking, it makes them easier to operate, it makes it easier to maintain shelf standards, availability and freshness. So I would not anticipate, in fact if anything, I would argue the opposite that there would be a detraction or detriment to our food business.

Estelle
Okay, thank you.

Closing remarks

John Rogers

Okay, I think we are done on questions now. So thank you very much for taking the time out this morning to listen to this call and no doubt, I think, I am sure we will be speaking to some of you over the next few days or so, but more formally at our Prelim Statement in May. Thank you very much.

End