J Sainsbury plc – Preliminary Results - Transcript
Analysts Presentation – 09.30am
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David Tyler
Chairman
Good morning and welcome to this Presentation of Sainsbury's Preliminary Results. This is for the 12 months to 12th March 2016 as you all know. And it has been a year of great significance for the business, particularly because of the strategic progress that we have made.

I would just like to introduce the presentation by speaking very briefly about three issues. Our results, the acquisition of Argos and our Management Team.

So first on results, as you will have seen our underlying profit before tax is down 14% and underlying EPS down 8% in the year. In the context of a grocery market under significant pressure and in the light of market expectations this time last year, I think it was a credible achievement to achieve earnings before tax, underlying profits before tax of £587 million. And it was achieved by a tenacious and skilled execution of what is a clear corporate plan. Our business has been transformed by that execution, by major cost reductions, by quality improvements, by price reductions and in particular by our value simplicity programme.

We have also been making good progress on our capital expenditure, it is our retail capital in the year was actually down by £400 million.

And talking about transformations, we believe that the acquisition of Argos will add great value to our company, differentiating our offer even more clearly than ever for our consumers. The combined business, as you know, will be a multi-product one, multi-channel with fast delivery networks which we think will be very attractive to customers. We are really looking forward to the date when the process of the acquisition is completed and we can begin to implement our plans. We are raring to go.

Finally, I can't emphasise enough the quality of our Management Team, lead by Mike and John. It is all of our colleagues who have driven this business forward over the last 12 months and I would just like to thank them very much indeed for their commitment and for their skill. And with that, let me just pass over to John who will talk about the financials. John.

John Rogers
Chief Financial Officer
Thank you David. Morning everyone. Right just before I get into the detail, obviously today we will set out to you the guidance for the year ahead. All of that guidance is though going to be pre an Argos overlay. So none of the guidance today takes account of the potential Argos transaction. Assuming we complete that transaction in August/September of this year, we will then provide you with much more detail of course at our Interims in November in relation to guidance going forward, but also how we plan on reporting the acquisition itself.

And with that I will move onto the financial highlights for the year. So we have maintained our market share with good growth in Convenience, Online and Non-Food. Operational cost savings we stepped up to £225 million in 2015/16 and that is

a significant set up from the previous year when we delivered £140 million of savings. So a good step up year-on-year and we are on track to deliver our £500 million of savings over the three year period we outlined as part of our strategic review.

In terms of deficit, it has reduced significantly to £389 million as a result of the slight increase in the discount rates, but also a large contribution from the company into the scheme. Pharmacy sale proceeds of £125 million have already been received in the last financial year and we expect to complete that transaction in the first half of the new financial year.

Property profits of £101 million realised in the year and that is as we have outlined before largely driven by our Fulham Wharf development.

Liquidity position has been strengthened through the issuance of the perpetual security, we have got £4.1 billion of facilities across the Group of which £2.9 billion is drawn down, so plenty of capacity to fund the business going forwards. And of course our net debt is down to just over £1.8 billion if you count for all the perpetuals as equity.

So coming on now to the Group performance overview. Group sales down 1.1%, retail sales overall up 0.4%, these are numbers that we reported at our Q4 Trading Statement. Given food price deflation and our price investment in the year, we have seen our profit decline by 11.8% to £635 million. A good performance from the Bank, small step up, just under 5% improvement of the underlying profitability of the Bank. Finance costs of £121 million in line with where we guided, all of which delivers a profits before tax of £587 million, as David said, just down around 14%. The tax rate 20.8% lower than that we guided to. So we have seen a big movement in deferred tax balances as a result of the reduction in the future Corporation tax rate that we guided which has obviously helped our EPS. So 24.2 pence down 8.3% on the year. And of course the dividend of 12.1p again down 8.3% reflecting of course our dividend policy of having two times cover.

Results outside of underlying. A loss of £39 million, I will take you through the detail of that in a slide later on, delivering a profit before tax of £548 million.

So coming on now to the sales line, Retail Sales, again these numbers on the left are now new numbers, these were given at our Q4 Trading Statement. But overall like-for-like sales for the year down 0.9%. Contribution from new space of 1.3% delivering total sales growth of 0.4%. And of course again when you break that out across channel and across products you see some of the challenges and opportunities facing the sector going forward and the business going forward to continue pressure on of course on our supermarkets and on the food business, reflected in the food price deflation that we have seen coming through, the great opportunities to grow our Convenience business, our Clothing Business, General Merchandise and of course Online. So some good growth coming through in those channels.

Guidance for your models for 2016/17, we expect to see the contribution from net new space to be around 1% which is down slightly on the 1.3% we delivered in the last year, again reflecting the slowing down of our property opening programme. And again, if you look at the property, the space that we plan to open in 2016/17, 250,000 square feet so down again year on year. Expect to open about 40-50 Convenience stores and about five new supermarkets and again you will see the 40-50 Convenience stores, that is a slight step down from the number that we delivered this year. So last year in 2015/16, 69 stores in total. In the new financial year we expect to deliver about 40-50. It is becoming tougher to find the really good sites and that is

given that we won't compromise on our capital returns, that is why that number comes down very slightly.

Coming on now to margins and again if you look at the EBITDA margin line, so delivering 7.58 down 10bps and clearly that is a reflection of the ongoing food price deflation, reflection of the investment we have been making in prices over the last year and of course offset in part at least by that step up in cost savings we delivered this year, the £225 million that I made reference to. And again if you look at the underlying operating margin again down 33bps, to 2.74%.

So guidance going forwards, well two stages, we will remain very competitive on price in the market. We said many times already over the last 6-12 months that our pricing position versus our competitors has never been better. That remains the case today and indeed you will have seen last Wednesday, we announced a further ream of price investments, price cuts to products again sharpening our price position in the market and we intend to remain competitive on price going forwards. Food price deflation will certainly continue in the first half and we anticipate that we will continue to see food price deflation going through into the second half as well. Again a familiar theme in the sector over the last year or so.

Coming on now to the Bank, as I said previously, really good performance from the Bank, so total income up just over 5%, underlying operating profit up just under 5% to £65 million, so really good performance from the Bank. And again some good improvements in some of the key underlying metrics. So net interest margin up to 4.1%. The bad debt asset ratio down to 0.4%, that is very low, really good numbers there. And a very healthy Tier 1 capital ratio, 15.8%. We only need to carry about 12.5% or so for regulatory purposes so we probably carrying a little bit of excess capital there. But given that success and given the growth of the Bank, we feel very competent in our ability to launch a new mortgage product in 2017 and we believe that is a product that really completes our existing portfolio product and we look forward to the success that that will drive.

From a guidance perspective for 2016/17, we expect the underlying operating profit to be around 10% lower year-on-year and the key reasons for that is twofold. First we had to invest up front to kick off that mortgage product and investment in the mortgage market. And secondly of course we have seen the impact of reduced interchange fees. So our guidance for 2016/17 is 10% lower profits year-on-year. If you stripped out those two components though, if you stripped out the impact of interchange fees and the investment we are making in launching a mortgage product, you would see a year-on-year increase in profitability. So that should give you some comfort on the underlying opportunity that the Bank represents.

And of course we have said many times that the key priority for the Bank over the year ahead is transitioning onto a new state of the art banking platform. We feel that when we have got that platform up and running, it is going to give us real competitive advantage in the banking market. We are very much focused on enhancing our customer experience through that banking platform.

In terms of our savings customers, we expect to migrate those over to the new platforms and the new platform is now up and running and we are going through a lot of testing at the moment and we expect to migrate our savings customers onto that new platform by late summer of this year.

Cards and loans, we are currently in the process of re-planning the timing of that migration, principally of course because of the potential acquisition of Argos where

we talked in the past about bringing Argos's loan book into the, under the umbrella of the Bank. So we are just looking at how we potentially integrate that side of the business. So we are looking at re-planning the cards and loans migration. Nonetheless total transition costs, we are not changing the guidance here, we expect that to be at the top end of our £340-380 million range. And indeed if you look at the components in this year you will have seen transition costs for this year at £59 million and capital costs of £19 million, that is quite a lot lower than that that we guided to and that is principally driven because we have been able to share some of that capital investment with our third party provider.

Capital injections into the Bank in 2015/16 were £137 million, again not quite as high as we guided, so we guided to £160 million of injections, we have been able to rein that back in a little bit and indeed, I have talked many times before about the attractiveness of the business case in the Bank. If you look at some of the performance of the challenger banks in the market today and you look at the opportunities the Bank presents for us in terms of helping our customers through financial service products and we have always talked in the past about customers that come into our stores and buy financial services product end up spending more on their food, and the synergies that that creates. We still believe this is a very attractive opportunity. But of course the priority for us as a business is to get this new Banking Platform up and running.

So guidance for 2016/17, Sainsbury's Bank transition costs expected to be around £40 million and capital costs again, capital expenditure costs within the Bank for the platform expected to be at another £40 million. Just to, injections like this, this is capital going from the Group into the Bank to support the equity of the Bank. We expect to be circa £20 million in the 2016/17 financial year.

So coming on now to items outside of underlying, this is the £39 million loss that I made reference to earlier on and I will just break it down to constituent components. So great results on profits and disposable properties, £101 million again, as I said, largely through the Fulham Wharf development. Bank transition costs of £59 million which I just made reference to and there are other items outside of underlying, you will see them broken down here, things like the internal restructuring costs, the transaction costs associated with our Argos acquisition. And things like the usual pension service charge, retail finance and fair value movements etc coming through to deliver a loss outside of underlying of £39 million.

So guidance for 2016/17, if you remember we guided to overall £200 million of property profits from mixed use developments over last year and this year. So given that we have done £100 million in 2015/16, then we expect to deliver a further £100 million in 2016/17. And of course I have already mentioned the sale of our Pharmacy business to Lloyds. We expect to complete that in the first half of this year, clearly that is subject to competition approval and that is expected to recognise profit on disposal around £100 million and that of course will go outside of our underlying numbers.

So coming on now to financing costs. Just to be absolutely clear and as we said to your last time, we have included within these financing costs a two prong on the perpetual securities. So technically from an accounting perspective you would account for that as a dividend. We haven't done so, we have made sure that is put into the underlying number so you can really see the underlying performance in the business. Again overall interests costs of £121 million in line with that that we guided to which has had an impact given the reduced profitability of reducing our interest cover and our fixed charge cover slightly. Most of that increase is principally driven

through the reduction in capitalised interest. So £10 million reduction year-on-year and you see that flowing through in the step up in our overall finance costs. And of course the perpetual securities I have just mentioned is within that number.

So guidance for 2016/17, finance costs will be slightly higher year-on-year, a little bit of annualisation of that perpetual coupon coming through that results in the finance costs being slightly higher year-on-year. Capitalised interest expected to be similar so give or take around the £7 million number. And of course just for completion, we expect the underlying tax rate to be between 22 to 23 per cent, so a step-up year on year given that this new financial year we don't benefit from deferred tax movements that we have done in the 2015/16 year.

Cost savings. Again this is a chart we are very proud of as a business. A real step up in our cost savings in the year to £225 million, there has been a huge amount of hard work to deliver those savings. And again if you remember, we upgraded our numbers at the half in terms of what we expected to deliver in cost savings for the year. I am very pleased to say we have hit our target of £225 million.

Guidance going forward, we expect cost inflation at the lower end of the 2-3% range, maybe dip below that 2% for the financial year going forward. Operational cost savings of around £130 million. And we remain on track to deliver as I said our £500 million over the 3 years of our savings programme. And in fact what we have done of course by delivering the £225 million 2015/16 is really pull forward some savings that we had badged for 2016/17, we had pulled those forward into the 2015/16 year. So we had a bit of a running start, hence why you will see the slight step up in 2016/17 for the £120 million. But again if you do the maths you will work out in the 2017/18 financial year we expect that step back up to £150-160 million and again we have plans in place to deliver that. So we are confident we can deliver the £500 million over the three year programme as we stated.

And again, you know it is difficult to say where those savings have come from, because the reality is they come from all parts of our Business. But some of the larger items in the year, you know we have done significant restructuring of our store support centres and our retail management. We have talked in the past about our value simplicity programme and Mike will talk about it later on from a trading perspective, but we also see the benefits of that value simplicity programme in our underlying operating costs. So lower levels of waste, given that we are reducing promotional participation in our sales, we are seeing less volatility come through our supply chain, that allows us to control waste more effectively, it allows us to spend less time managing our inventory. And of course fewer price changes. All of which results in operational costs savings within our Business.

We are also going to try to improve our whole logistics operations. Looking at improving fill in our vehicles and again this programme will extend into the new financial year and will deliver further savings going forward. And again energy savings initiatives is one we have pulled out in the past, but we continue year-on-year to deliver fantastic energy savings through our various initiatives that we are making. In fact as I said in the past that capital investment that we make in those areas is one of the fastest paying back areas of all the capital we spend in the business.

Coming on now to cash flow. Cash flow at a headline level. Retail operating cash flow before changes in the working capital. Really pleased here year-on-year with an increase year-on-year. We have delivered a working capital saving this year of 23. It is not as much as previous year, but again that is consistent with the guidance that we gave at the half. If you remember that number was a large number at the half and

I said that some of that would unwind in the second half. That unwind has taken place, but we are pleased to be able to deliver improvements in our working capital position. And then going down the line, taking account of the Bank, towards tax, interest etc. You see the proceeds from the Pharmacy business coming in there. Investment activities, obviously the impact of the perpetuals and a one-off contribution into the pension scheme, £125 million. We will make another special contribution in the financial year ahead. Dividends, etc. Moves down to an overall net debt position of 1.82, so significant reduction year-on-year. Now of course that is taking account of the perpetuals as equity, even if you put the perpetuals in there as debt you would still see a reduction year-on-year. So we have been able to make significant contributions into our pension scheme and yet still reduce our overall net debt position year-on-year.

Capital expenditure, significant reduction. So £947 million in 2014/15, £542 million in 2015/16, so almost halving our capital expenditure year-on-year. And again that is largely a reflection of the slowing down of our property pipeline. Again you can see the breakdown of that expenditure in this chart here. Again you see less capex on the new stores and extensions than would have been seen historically. A bit of a step up in the IT spend and so forth.

If you look at our guidance for 2016/17 going forward, full year, core retail capex of around £550 million and of course that excludes the Bank capex. And again there is a slightly change in shape here, so you will see a little bit of a step back in the new stores and extension piece compared to 2015/16, a little bit of a step back in Convenience because we are doing 40-50 rather than the 70 odd, 69 that we did in 2015/16 and a step up in refurbishments. And again we said to you last year we were going to look at doing the six trial stores and learn from the format experience in those six trial stores and then we would take those learnings and start to roll those out across our Estate. Hence while we are stepping up our capital spend in our refurbishment programme in 2016/17.

This is a specific point on guidance for 2016/17 on depreciation. We expect depreciation, so if you look at depreciation in the 2015/16 financial year at £550 million for the retail business, put the Bank aside for a second, we expect that £550-51 million to step up to about £570 million year-on-year and this is primarily due to the investment in our digital technology assets, but clearly are depreciated over a shorter time period than would be the case for new stores and extensions.

So on the Balance Sheet, we have seen a reduction in the overall net debt and strong levels of liquidity. The net debt of £1.826 billion. Facilities of £4.1 billion, again plenty of capacity to fund the business going forward. The value of our property has stepped down slightly, a combination of reduced expectation in future rents and also a yield shift and it has reduced the value of our property to £10.6 billion, but still a healthy number. And again we have already commented on the reduction in our pension deficit, quite a significant reduction there as a result of an increase in discount rates and the contribution being made by the company into the scheme. And of course we have said before, but it is worth saying again, we have no financial covenants across any of our borrowings in the business.

Guidance for 2016/17, we expect a year end net debt to reduce year-on-year so a further deleveraging of the business over time.

If we look at our fixed charge cover again, largely as a result of the reduction in profitability, we have seen the fixed charge cover come down slightly and the lease

adjusted net debt to EBITDA go up slightly if you treat the perpetuals as debts, we treat them as equity, it is broadly a flat year-on-year slightly down.

And then coming on to the dividends, you know, of course we are committed to paying affordable dividends. The final dividend for this year will be down 1.2% to 8.1p which means a full year dividend of 12.1p down 8.3% year-on-year. And we maintain our guidance for the future that the dividend cover will be maintained at two times underlying earnings.

So that is me done. Thank you very much. I will hand over to Mike now to give you an overview of the Business.

Mike Coupe
Chief Executive
Morning everybody. A year is a long time in retail and the team were reflecting on the fact that it is almost a year to the day that I returned from a day trip to Cairo. So how times have changed. I think it is fair to say from our perspective, we introduced our new strategy, our revised strategy in November 2014 and I think we think we have done a pretty good job of executing that and if anything we are slightly ahead of where we expected to be at this point in time. And that is reflective of the fact that we have maintained our market share, we have seen transaction and volume growth. We have improved our service and availability. We have delivered well on non-food and our overall multi-channel capability. As John has already talked about, we have actually over delivered against the cost saving challenges we set ourselves and we have had a pretty good performance from the Bank. And of course, I will talk about this in a little bit more detail, we are in the process of acquiring, fingers crossed, the Argos business, which will help us accelerate our strategy overall.

If we just reflect a little bit on where customers are. Actually if you look at the growth of disposable income, we have seen that rise by about 15% over the last couple of years and it continues to rise and have risen during the course of this year. And so customers do have more money in their pockets. And if you look at the historical trends, there is a direct correlation between disposable income and the performance of the grocery market. What is peculiar about the last couple of years is that has not happened and what we are finding is that customers are spending that money elsewhere. You can see that in perhaps the travel industry, particularly the discount airlines or indeed record car sales would be another reflection of the fact that customers are choosing to spend that money elsewhere. So you can look at the blue line, the underlying industry has shown virtually no growth over the last period of time. And even the little tick up in March that we have just seen is a result of the timing of Easter and clearly you can see in the Wilson data this morning, there has been a tick down the other way as that is annualised out as the staggers annualise out. So it continues to be a challenging market, although customers have more money in their pockets that is not necessarily reflected in the way they are spending in our business.

And we can see that in the trends overall we have seen pretty sustainable in growth actually during the course of the year, perhaps reflective again of the historical trends but we have also seen the persistence of price deflation. If you measure it over two years, prices have fallen by about 4%. If you think about an industry which is £160 billion, that is over £6 billion of the sales have disappeared over that period of time. And we would expect that to continue to remain, that the market will continue to remain competitive in the second half of this year and we would expect that price deflation will persist at least through the summer and we will see what happens after that.

And we also have to think about the longer-term trends as far as our customers are concerned. And as we look forward, certainly our customers will expect us to offer a multi-channel offer. They expect us to be there for them whenever and wherever they want, whether that is in a conventional supermarket or increasingly online or indeed when they shop with us online, they want the ability to either click and collect or have it delivered to home or any other variation on the theme and we have to reflect that. It is a reflection also of the rise of technology, the free interaction of data both ways. Certainly data that we can see from our customers, but equally the data that they see from our business week in and week out and the transparency that affords them in terms of where they shop. And of course that leads to the risk in our market of some form of disintermediation. Somebody putting themselves between ourselves and our customers and that is something we have respond to over the next period of time.

And we kind of set that out in November 2014, at the heart of our strategy we still have to do what Sainsbury's is brilliant at which is deliver great quality products, great services, delivered by colleagues motivated to serve our customers week in, week out, underpinned by the values of the business. But also to reflect the fact that we need to understand our customers better than anyone else and that we need to do that on a constantly evolving basis and that we need to be there for our customers whenever and wherever they want. And that was the strategy we outlined in November 2014 that is the strategy we are executing against.

So if you look at the specific details, great products and service at fair prices. We have re-launched and improved the quality of 750 products, the rate of improvement will increase over the next period of time. We have a target of 3,000 and we will get most of the way through those 3,000 by Christmas of this year. And actually we have maintained, if not slightly improved our lead relative to our competition in the quality of the products that we sell.

And we should not underestimate that at least in part our value simplicity programme provides an easier way of our customers working out where the value is and where the quality is in our offering. Indeed if you go into our shops today, you will see that we have changed some of our product tends to reflect the fact that we are putting new and interesting and innovative products on our key promotional space which again is a reflection of the fact that as I say, customers appreciate us highlighting the quality in our overall offer.

It is also reflected in our advertising campaign, our Little Twists Campaign is now very prominent in our marketing and will continue to drive our quality perception through the way that we market in the future.

Just to give an example, our fish range, this is an example of a product range where we have gone back to first principles, we have worked with our suppliers, we have actually changed some of our suppliers to make sure we can deliver the right level of our quality at the right kind of price. We have improved the specification of the products, we have improved the packaging. We have improved and made the designs more consistent. And we have re-launched something like 50 new products. So quite a big overhaul of that range and that is reflected in the sales performance in our shops. So we will continue to take an end-to-end view of the product improvements that we make and we need to do that on a consistent basis going forward.

Another example, the well flagged courgettes and boodles, which are vegetable substitutes for our spaghetti and noodles, get it right. And of course that provides our

customers with what they want which is products which are more orientated towards their needs in the future, not least their health needs. And that is also reflected in our Ready Meal range and our updating of that with updated our Be Good to Yourself range and My Goodness ranges. We have introduced some more sophisticated ingredients, seaweed, grains, improved the packaging design and made sure that the messaging on pack is clearer and simpler.

John has already referred to this. We have made a pretty profound change in the way that we market our pricing to our customers. And if you think about it over the last period of time, we have reduced the number of nectar points we are giving out, we have actually removed Brand Match in the last period of time. We have significantly reduced our promotional participation and we have reinvested that back into what our customers say that they want from us, which is ongoing regular everyday low prices. And that has had the effect of improving our customer satisfaction scores as far as our price perception is concerned, which is pleasing. But also perhaps more interestingly over the last period of time, we have seen volume and transaction growth. So we see a response from our customers, almost instantaneously when we make the right and appropriate level of targeted price investment. So something that we will continue on the road of, it is quite a significant and profound change over the last period of time as I say, and you can see in the charts the level of multi-buy reduction in our business over the last year or so.

And we are making progress on our cost of good reduction programme. We set ourselves a target of reducing our cost of goods by £150 million over a three year period and we will do that in a way which plays to Sainsbury's strength which is understanding our end to end supply chains, working with our supply base to make sure we understand how their business works, how we can remove areas of value leakage and that we can use in the case of the pork example we give, the secondary products in a different way and in a way that allows us to create value throughout the supply chain. So it is a big area of work for us. We continue to do it in the right way and we continue to do it in a way where we think we can get strategic advantage by working with the right suppliers in the medium to long-term.

And again another example is our cereals range, where we have done an ingredient recipe review. We have reduced the cost of packaging, again working with our suppliers, working out where value leakage occurs in the supply chain. And we have broadened our supply base. So we have a more pan European supply base which again gives us the advantage of scale of cost of goods reductions in that particular category.

Great performance on clothing and general merchandise. It has to be said I think we will now claim to be the sixth largest clothing retailer by volume. So every year we tick off another point in the chart. I think we have just overtaken Matalan, so give us another 5-6 years, don't quote me on this, but I think Primark are currently the largest volume retailer but we are very, very pleased with the fact that we have grown that business by 8.5% over the last period of time. So great result there.

Of course, we have launched Clothing Online, during the course of last year. Again interesting reflection on customer trends, around about 70% of the products that are bought in our Clothing Online business are actually click and collect with customers coming into stores. We have seen general merchandise grow by 3.5% and we have had a great performance particularly in our seasonal ranges during the course of the last year. So a great all round performance within our non-food business and something that we are really pleased about.

Again the Bank has had a good year. We now have 1.7 million active accounts. We have seen a big increase in our travel money volumes up 30% year-on-year. Personal loans up 15% year-on-year. John has already talked about the introduction of mortgage products. Our customers trust Sainsbury's as a brand when it comes to financial services, they are very happy to deposit their hard earned cash in our accounts which again as I say gives us the opportunity of broadening our lending products, not least through the launch of the mortgage products. And we have also introduced a Western Union ability to send money on an international exchange. So again a big step on. Very focused on our customers. You know our business has very, very low complaint levels, very high levels of customer satisfaction, which again is reflected in what we set out to do as a brand with great quality products and services at fair prices.

We have done a lot of work on our store layouts particularly in our large stores. Again we talked this time last year about our six trial stores and we have pushed the boundaries, we have done it a lot and actually during the course of this year we will start to rollout those learnings within our broader estate and we are planning currently around 20 significant refurbished or 25 significant refurbishments of our large out of town superstores. Key learnings, certainly 'food for now' part of our business has worked really well, the way we have brought those products together. And new counters, differentiating as patisserie, takeaway foods. And the balance between food and non-food has worked well and again one of the key drivers potentially of our business in the future. And we are seeing a lot of improvements in our customer satisfaction with the way that we have set up our checkouts and customer service desks. A lot of work on training, and as I say, we plan to rollout those learnings during the course of this financial year.

Our Convenience Business is a £2.3 billion business, so continues to grow, continues to represent an opportunity, continues to be in the heart of where customers are, shopping more frequently, and when they are shopping they are tending to buy less. We have opened a second micro convenience store in Richmond and we are looking to stretch the franchise both ways with smaller shops and larger shops. And we have been highlighted as the Convenience Retailer of the Year for the sixth year running. There is a disproportionate effect of some of the deflationary trends in the industry. They are largely in the fresh food categories and that has an effect on our convenience business because that business is largely driven by fresh foods. If you look around here you can see that reflecting in the stores that we trade here. We have opened 69 stores during the course of the year, John has already talked about opening between 40-50 in the next financial year and we currently have 773 convenience stores trading.

Groceries Online, again a great story for us during the course of the year. We have seen sales growth of 9% and that sales growth is accelerated as the year has progressed. We have seen all the growth of nearly 15%, 289,000 orders at a peak week. So we continue to see growth in the order accounts. We have announced yesterday that we are extending click & collect reflecting the fact that our customers want more flexibility in the way that they choose to shop with us, not just in our non-food business online, but in the grocery business. And we are running out of capacity in London, it is the most highly penetrated online grocery market in the world and we need to open a dark store fulfilment centre during the course of this year which we will do in the third quarter. And we know that throughout our business we have the Velcro affect, so we know that when customers shop with us online, they will spend more money with us overall just like when they buy our non-food products or our banking products, they will spend more money in the grocery business and it is important that we drive that virtual circle in the future.

Netto, we have 15 stores trading, we will open another one during the course of this month. And we continue to look at the business performance with our partner and look at what the trends are and we will continue to review that business opportunity as we move forward. And we will give a further update when we get to the Interims in November.

One of the areas we are very proud of, we have talked about the cost savings that we have made in the business, but we haven't done that as a result of a reduction in a form of our customer service. And if anything our customer service metrics measured internally and externally have improved during the course of the year and we are very proud of the fact that we consistently win the Grocer 33. I think we are now 19, so we will definitely win the Grocer 33 Award for Service and Availability this year and that will be the fourth year running. So I can't overestimate the sort of, the response of our colleagues' week in, week out in the way that they serve our customers and we do a brilliant job. I think we run the best shops in the UK consistently.

And we continue to invest in understanding our customers better than anyone else and we think that is a core part of our strategy as we look forward. We now have our single view of our customer database live, it is working. It gives us the ability to target our customers in a more sophisticated way and we have a new customer relationship management platform operating as we speak. Sounds like a statement of the blindingly obvious, if you currently try and sign in with Sainsbury's in our various multi-channel world, you probably need about 20 passwords and 20 different sign-ons. We now are in the process of rolling out a single sign on wherever you interact in the Sainsbury's digital world, just one sign-on gets you in, has all your payment details, your address, all your personal details and of course as we look forward to the Argos transaction, that is one of the critical building blocks which will enable us to bring the businesses together in a reasonably quick manner from a customer facing digital point of view.

Just want to mention also I would say this wouldn't I, but we had the most popular Christmas ad this year, certainly if you look at the number of You Tube views or Twitter re-tweets, very proud of the fact that Mog's Christmas Calamity was big news over the Christmas period. And actually raises a lot of money for charity. In the end we gave £1.5 million as a result of selling the Mog Christmas book. So a great story there.

And we must never forget that our values make us different. Our customers would say to us, number one on our list is Household Waste. And we are doing a lot of work to help them reduce their household waste and think about how we can move that forward over the next period of time. We have made a commitment to invest £10 million in an initiative to waste less and save more, starting with an in the round trial in Swadlincote in Derbyshire where we are working with the local community testing ideas, helping them work out how to waste less and save money therefore. And as we learn, we intend to rollout those initiatives across the country more widely.

Our customers also talk to us about health, I have already referred to some of the healthy ranges and the My Goodness range is a good example of a product range where it helps our customers get one of their 5-a-day if they consume one of those products.

The third area our customers have talked about to us a lot is British sourcing and one example would be our lamb sourcing, where although we can't sell British lamb the

whole year round, we certainly have managed to extend the seasons which means that we can provide better continuity as far as our British lamb farmers are concerned.

I have already talked about Mog's Christmas Calamity, but another example is that we are very proud of the fact that we have raised now over £100 million for Comic Relief for Sports Relief through that relationship since 1999 which I think is probably the largest corporate donation to any charity on an ongoing basis. Very proud of the fact that again we have done a great job for that charity.

And we have won the Climate Disclosure Leadership Index Award. We are the only UK retailer to get a Band A rating and that is all about the disclosure we give on the work we are doing to reduce the environmental impact that we make within our business and John has already referred to the fact that we have invested a lot of money in reducing particularly our energy consumption over the last period of time and that is reflected at least in part in that Award.

To some extent, we have covered this three or four times already, the Argos transaction, I am sure you will ask us some questions about it. I am not going to go through the detail today. As I say, I think we have probably done it to death over the last period of time. Just to talk a little bit about where we are in the process. We clearly have a recommendation from their Board for Sainsbury's as an organisation it is a Class 2 Transaction. It is a scheme of arrangement. So there is a shareholder vote on their side which needs a 75% approval and it is conditional amongst other things on, we have the get the acceptances as I said, we have to get CMA approval, there is no reason from our work that they should not approve it as part of a Phase 1, but clearly they have to apply on that, clearly they have a decision to make around that. And then FCA and Guernsey Financial Services Commission approval. But we would expect all other things being equal that we would complete that transaction during the third quarter of this calendar year.

So in summary, we think in a challenging market we have had a good year and certainly against the plans that we set out in November 2014, we think we are slightly ahead of where we expected to be. The important thing for us is to continue to drive the points of differentiation, the quality of the products that we sell, the service that we offer in our stores and also to invest in the channels for future growth, whether that is convenience shopping or online. And of course the acquisition of Argos gives us the ability to serve our customers needs in the future whenever and wherever they want.

That's it from me. Now we will hand over to questions. Thank you.

Q&A Session

Question 1

Bruno Monteyne, Sanford Bernstein

Good morning, Bruno Monteyne from Bernstein. I know you are limited in giving guidance on forecast profitability because of the Argos deal, but about two analysts sessions ago, before the Argos deal, you guided towards this year being the bottom of your margin path and therefore recovering on future years. Do you see any need

to step away from the guidance you gave before the Argos deal on the existing business?

Answer: Mike Coupe
I will refer to my colleague on the right in terms of what he can and can't say.

Answer: John Rogers
Bruno you know we are very restricted on what we can and can't say in this period so we will do the best that we can but you must understand there is a limit to what we can say. I am not going to comment on the short term guidance for obvious reasons, but what we did say at that time was that we expected the business in the medium to long term to deliver an operating margin in the range of 3-3.5%. Now clearly in a market with a lot of uncertainty, there are upside scenarios to that and downside scenarios to that, but our base case, our central case for the business is a business that returns to that 3-3.5% over the long-term. But we also at the time gave some trajectory as you said through that margin path, again because of the restrictions, I can't comment any more on that today. But hopefully that gives you at least a little bit of colour about the margin trajectory of the business.

Further question
And given the results you have today, you are clearly closer to the base case rather than the downside scenario and the upside is very much tracking in line with what you would have called the base a year ago?

Answer: John Rogers
Yeah I think, in terms of the performance that we delivered this year, as Mike has already argued that we are if anything, slightly ahead of where we would expect to be in our strategy. Now it is clearly a challenging market, it is clearly a tough market. But if you look back at the performance over the last 12-18 months in terms of our outperformance relative to some of our other supermarket peers, we are pleased with our progress, although clearly there is still more work to be done. I mean I think what is clear from our perspective is the key to our businesses maintain that differentiated proposition. So we need to be competitive on price, we almost need to remove price as a point of competitive advantage, but we need to outperform on the areas of food quality, service levels, availability in our stores. And I think some of the data we showed in the charts demonstrates that if anything on those fronts, we are stepping ahead of the competition. So we are neutralising price as a point of competitive advantage compared to our supermarket peers. Not saying price is not important, it is very important, but if we neutralise price then we can compete on those other dimensions that we are, that our brand is known for and that is what we have to continue to focus on going forward.

Further question
And in terms of net debt, your improvement on, can you talk about size of net debt improvement we should expect for the current financial year?

Answer: John Rogers
Yes I don't want to get drawn on the details of the net debt movement but clearly we are expecting a reduced net debt position year on year. If you again look at the trajectory going forwards and this is something that we commented on in the past, we do expect that net debt position to reduce progressively year on year on year. Some years it reduces more than others. So I think over the next year or so we will see some reduction but I think if you look in years 2,3,4 of the plan you will perhaps see an acceleration of that reduction in net debt all else being equal going forwards.

Bruno Monteyne
Thank you.

Question 2

John Kershaw, Exane BNP
Morning guys, John Kershaw from Exane. Just perhaps trying the same question a different way. Similar theme so might get the same answer, but I will have a go. The reality is you have set your stall out on outperforming the peers and you have done a good job of that today, but from a lower base they are coming back nipping at your heels and certainly some of the more recent data suggests perhaps they have reined you in. So how confident first of all that you can outperform and how would you view outperformance in relative and absolute terms, if you can help?

And then just coming to the profitability side, you signalling a short term a significant reduction in the savings you have got still 2% cost inflation. So how do you grow profit? Are you confident you can drive volume significantly or are you signalling it is another down year? I know you don't want to comment on consensus, but your bridge build suggests profits are down again on the core business before we consider Argos?

Answer: Mike Coupe
I will ask John to reflect on the second question. I suspect he will answer it in exactly the same way as he answered previously. I think a measurement of outperformance is a reflection of what we have done this year. So we have maintained market share. We have improved transactions, we have improved volume growth. And we have outperformed our peers. And I would view success as being a similar outperformance next year to John's point, we can only do that by improving our quality credentials, maintaining our lead on service availability in all the great things that Sainsbury's does whilst investing in the areas of growth channels of non-food, online and Convenience stores. And I think we have done a pretty good job in all of those areas over the last year. But to answer your question directly, if we ended up with a similar set of measures this time next year I think that would be a pretty good performance. Of course you are right, I mean it continues to be a very competitive market and it always has been. I think every time that we have sat in this room you will have made exactly the same comments which is sooner or later somebody is snapping at your heels. You know I have been competing with Tesco, Morrison's, Asda and the discounters for most of my career and will continue to seek to do the right things for our customers and ultimately that will reflect in our underlying performance. But you are right, the market continues to be challenging, but then it always has been.

Answer: John Rogers
And just to try and help you with your profit bridge and you will understand the restrictions under which we have to operate, I really can't comment on year on year profit trajectory nor on consensus. But maybe if I give you some of the building blocks and way of thinking about it, you can decide how you get there. Obviously kicking off with sales, I mean we said quite clearly we expect to see deflation continue through at least the first half of this year and in all likelihood the second half as well. So that gives you a feel for food deflation. But we have seen as part of the price investments we have made historically volumes increase and that is very encouraging. And we think we have a way of really understanding through the data on our customers, as to where we get best bang for our buck on our price investments. So it is a very empirical driven process, a very test and learn process and we think we have a very targeted way of making those price investments that gets results in terms of volumes.

Now who knows where price investment is going to go over the next year. Clearly it is a very competitive market. We have made movements last week alone on prices, sharpening our price position again versus the competition. And we will continue to remain competitive in the market on price. So you can draw your own conclusions as to what that means in terms of the sales and margin lines.

When you look at cost inflation, again we said at the bottom end of 2-3% range and I hinted it might even be below the 2%. So if you look at some of the key lines on inflation, things like rent for example. We are seeing rent inflation probably about at about half a percent now whereas in the past we have seen it a lot higher. We are looking at utility prices as well. If you remember last year we didn't really benefit from reduced utility costs because we effectively hedge about 12-18 months forward. This year we will start to see some of that benefit come through on utility prices. So some indications as downward pressures on some of the cost lines, it could mean that we fall towards the lower end of that range. And the savings of 120 that offset that.

There are other movements as well of course, it is probably worth highlighting that in the 2015/16 year we are reporting a bonus number for example of around £100 million. If you looked at our average over the last few years or so it varies from £50m, to £60m to £70m, so again from a quality of bonus perspective some movements there. So you have got to put all of these components together in order to start to take a view about future profit projections, but unfortunately I can't comment specifically on that, you will have to do the analysis and come back to us. But I hope that helps.

Mike Coupe
We look forward to reading your notes!

John Kershaw
Thanks

<u>Question 3</u>

Clive Black, Shore Capital
Thank you, Clive Black from Shore Capital. A couple of questions. Firstly, I know you don't particularly want to talk about Argos, but can you tell us how you are planning to not be distracted in terms of your core business by the Argos deal?

And secondly, do you think the industry has reached a threshold where profitability in the online segment is more important now than just driving sales?

Answer: Mike Coupe
Perhaps I will ask John to comment on the second point. Yeah I mean we have been very clear that the way we see it is the execution of the integration of Argos sits in the sweet spot of what we do well as an organisation. If you look at the buckets of synergies in the short term, there are three big buckets. The first one is property and given our history of what we do in the world of property, we think we are pretty good at that. And rolling out Argos concessions in a reasonably aggressive manner is I would argue a little bit simpler than perhaps opening in 60 Convenience stores as an example during the course of the year. So certainly that is one of the main areas if not the main area of benefit.

And clearly there are two other areas, one if the buying book and the other one is the potential opportunity to bring together some of the central functions and again this is

well within the remit of what we do day in, day out. We are buying a business that exists. It has 40,000 employees and it has a lot of skills and we talk very openly about the fact it is the best of both. And whilst we would expect some level of Sainsbury's involvement in the business week to week, day to day, we would plan to run it as a standalone entity, clearly reporting into the Board of Sainsbury's but nevertheless with its own trading dynamic, joining it together with the trading dynamic of Sainsbury's. And I look here, we would talk a lot about the strength and depth of our team. We have a group of people who have worked together now on average for over five years. We have been through the hard yards over the last period of time and I think generally speaking you would reflect on the fact that we execute pretty well day in and day out and the moment we stop doing that, the moment we stop having a relentless focus on the day job, particularly around running the supermarkets, is the moment that we start to lose that kind of potency in our business. So I fully expect and anticipate that it won't be without its challenges, but equally I don't think the executional risks relatively speaking are that high compared with other transactions we might have looked at in the past.

I guess the other thing to point out is the businesses are very culturally aligned. We have worked together pretty well for the last 18 months so there is a high degree of interaction. I talk to their leadership group last week and I felt there was a lot of warmth in the room about what we are trying to do together and I think a lot of buy-in into that. And of course we have the experience of the ten concessions, plus three click & collect trials already. So we know how this kind of works. So I am now, we are not naive we are not going into this with our eyes closed. We have a very strong sense of what the risks are. But equally we think it is in the sweet spot of what we do and we are not trying to integrate all of the back office systems any time soon, and not in my lifetime.

Answer: John Rogers
And Clive just coming to your point on profitability online. I am not sure we have quite got to that tipping point where the singular focus of the market is on online profitability as opposed to sales. But I think it is fair to say that we have seen some early signs of rationality coming into the market and I think it is fair to say that we in part have led that rationality and we talked 12 months or so ago about not simply just chasing sales promotional sales in the online market, which I think a lot of the market was doing at the time particularly through vouchering. And we have very much stepped down from that activity and really focused on delivering the best offer that we can to our core Sainsbury's customers. And yet having stepped down that marketing activity we still see good growth in the online business over the last 12 months, the 9% in sales to 15%. So it is a critically important part of the business.

But it is worth saying again, we made this point before, that frankly just trying to split out online profitability in of itself, slightly misses the point about wanting to have multi-channel business. We said in the past the whole rationale behind having online is about customer loyalty. We know this in the data, every time somebody switches to shopping with us from our stores onto online they become more loyal, we capture more of their spend and that is absolutely critical to our multi-channel, multi-product and services strategy. So I think it is right that the market is looking more rationally at this and looking at how to improve the discrete channel profitability, but at the same time it is the wrong way to look at it as well, we have to look more holistically at what our online offer gives and provides to our core customers and that is certainly the way we have approached the business over the last twelve months.

<u>Question 4</u>

Niamh McSherry, Deutsche Bank
Niamh McSherry, Deutsche Bank, good morning. I just wanted to ask some questions about the nice chart you have presented on multi-buys coming down. Two kind of questions on this. One is what has enabled you to reduce the multi-buy percentage of your sales relative to peers? Or an equivalent question is, do you think competitors could replicate this strategy?

And then secondly, given that you have made such good progress, is there a lot further to do or are there different areas and I guess the commercial strategy where you can differentiate yourself?

Answer: Mike Coupe
The answer to the first part of the question is that our customers would say to us increasingly that they want simpler pricing, they want to understand where the value is and ultimately that has the effect of simplifying the choices that they make and I talked a little bit about the effect it has on quality perception as well. So it is a kind of, it has a reinforcing effect if you get it right.

Second point I would make is you have to look at it in the round as far as our overall supply chains are concerned. So it is a customer focused strategy. We have to continue to simplify our pricing and invest back in the categories and products that make a difference to where customers choose to shop. And John has already talked about, we have a level of sophistication in our understanding of what that actually looks like. But one of the knock-on benefits is it does simplify our volume profiles. If you look at our waste performance for instance this year it has dropped quite significantly as a result of the fact that our supply chains are easier to manage, the demand volatility is less and of course that has a knock-on effect in our supply base. So when we talk about for instance our cost of goods reduction, that at least in part is driven by less volatility of demand on our suppliers and therefore we can demand of them that they reflect that in the pricing that they sell to us.

So it is a customer facing, customer driven idea, but equally it has significant knock on and benefits in the overall supply chain. And we will continue to test it, I genuinely have no idea what the sort of optimum level of promotions is. If you look at what we have done over the last year, I think we surprised ourselves by how aggressive, if that is the right term to use, we can be. And it is reflected in the volume and transaction growth and over the long term it will be the right thing to do in our view.

Answer: John Rogers
And just to build on that a little bit, I think you comment was partly aimed at what happens if the competition duplicate or copy what you are doing. Obviously imitation, maybe the highest form of flattery, but in the end as I said before, if price is a point of competitive advantage, is eliminated because we are all doing the same thing, and that may well be the case, others may copy what we are doing and follow what we are doing. In the end that will be a good thing for the sector because it will reduce supply chain volatility and reduce waste and so on and so forth, so that is a good thing. But then it means we are going to be competing on all the other dimensions and this is again the importance of having that differentiated offer. So the quality, the service levels, the availability, the ambiance of our stores. I think if you look at any of your reports, many of the market research that has come out over the last twelve months, it all supports the fact that if anything we are improving the gap between ourselves and the competition on those fronts.

And I think that is something that is quite difficult for the competition to replicate. I mean we have seen those gaps maintain themselves on the quality service levels

now for some time and it is quite difficult for the competition to duplicate. So again we recognise the challenging retail backdrop within which we trade, but equally we have confidence in our differentiated offer that we believe will continue to allow us to outperform in this market going forwards.

Further question
And sorry, can I ask one more. Just on market volumes, if deflation persists in H2, but presumably is a bit less deflationary than it is at the moment, would you expect volumes to improve equivalently? Is that kind of the base case?

Further answer: Mike Coupe
Yes I mean broadly speaking, if you could project the trends that we have shown on the chart earlier, forward, I think that wouldn't be an unreasonable set of assumptions to make. But like all of these things there is a degree of volatility so it is very difficult to predict the future, it is very difficult to predict where inflation will go and where volumes will go. But it is fair to say we have seen a sustained level of volume growth over the last year and that is not something we have seen for the previous 4 or 5 years. So in the end you will have to make your own assumptions but it would not be an unreasonable assumption to assume volume growth will continue in the market whilst there is a deflationary trend. And historically you have seen an, if inflation goes up generally speaking, you do see volumes come down. For reasons I am not sure I fully understand, not least because there are the same number of people in the country as there was previously, but there is an inter-relationship between the two things historically.

<u>Question 5</u>

Nick Coulter, Citi
Nick Coulter from City, hi. On price you have mentioned price, but could you talk about where you are versus the discounters? Certainly this time last year you were acknowledging a sizeable gap and that you needed to do more?

Answer: Mike Coupe
Yeah I mean I think we talked last year, we showed a chart which showed that prices on a basket of goods had come down from a gap I think approaching 40% to sort of in the 20s. And as we sit here today I think there is a survey out which would show sort of around 15% of that order. But the important point to make is that we are not going to close the gap down on a blanket basis. We don't necessarily see the need to do that, but what we will do is make target investments in the right places and a good example of that would be the investments we have made in whole chickens. We are now down to £2.95 and I think that is undercutting the discounters. We will make the targeted investments in the right place. We will do it in a thoughtful and we think quite sophisticated way and to the points that we have made already, it is important then that we invest in things that differentiate us, whether it is the quality of the products that we sell, the service we offer in our shops or indeed the broader opportunities within the channels and non-food businesses. But it remains the case that we will need to continue to invest in the underlying prices in our business.

Further question
Great, so that process very much continues. And if I may a follow-up on the Convenience opportunity. Could you talk about the medium term runway for store openings. Certainly from what you have said today, it seems like there is a diminishing opportunity or you are being a little bit more cautious or thoughtful about your expansion?

Answer: John Rogers
Yeah I mean I think we have said we will open in the new financial year 40-50 Convenience stores. I think in the end we will open as many as we can see a clear line of sight delivering the capital returns for. If you look at the capital returns of our Convenience estate it continues to outperform that of our supermarkets, so return on capital employed perspective, even reflecting that the leases at one and a half times that we are seeing, that continues to be the case, it is around a 16-17% ROCE for the Estate, so really good performance in the Convenience Estate, but we need to make sure that going forward we continue to open very high quality stores. And it is fair to say that the market as we see it today is a) becoming probably a bit more competitive out there in the market, and also the opportunities of having the right stores in the right locations, and we see. We have got good experience of knowing how to get it right, how to get it wrong as have others in the market. It is very clear if you look at the volatility of returns of the Convenience Estate it is quite broad. So whilst it is a high 17% or so, the range is quite broad. And that is all driven by location. And we are just simply seeing the number of locations that can deliver the right level of returns for us starting to diminish slightly. So 40-50 this year, I suspect going forwards probably a similar type number, but I am not going to give that as detailed guidance, we will provide that specifically year on year. But that is the direction of travel that is for sure.

Further question
Can I just check that that ROCE number is pre lease adjusted so not lease adjusted?

Answer: John Rogers
That is capitalising the leases. If you didn't capitalise the lease it would be even more. So they continue to be good investments, but the range of performance is very broad and hence why you have got to get it right because you can, dare I say there are others in the market have opened significant Convenience Estate and when you get it wrong those returns are very poor. So you have to really understand what makes a good store. We believe we have got the best team and the best model that allows us to identify the right sites, hence why we can keep those returns at those levels but the number of opportunities is starting to diminish.

Further question
Sorry just one final one. So what is the cash payback on those stores?

Answer: John Rogers
So if you looked at cash payback typically for a convenience store, you would be looking at 3-4 years would be a typical cash payback.

Nick Coulter
That was very helpful, thank you.

<u>Question 6</u>

James Tracey, Redburn
Morning Mike and John, James Tracey from Redburn. Three questions from me. The first one is on could you quantify the cost saving from cancelling the Brand Match, and comment on whether it is included in the £120 million of cost savings?

The second question is how much do you plan to invest in price this year? And if you can't say it, directionally more or less than previous years?

And the final question is on value simplicity programme. Can you comment on how you think it differentiates Sainsbury versus your major competitors and perhaps why other people can't copy that? Thank you.

Answer: Mike Coupe
Well I will have a go at the first and third and perhaps John can stonewall you on the second [laugh].

We don't include the Brand Match savings in our cost savings and we don't break the number out in simple terms. We look at our investment in our marketing activity including pricing in the round and that is one of the reasons why we are able to do some of the things we talked about doing, not least the value simplicity programme.

And to the point that we have made several times this morning, our customers, we start the customer end of the spectrum, at the end of the telescope our customers say to us they want simple every day pricing they want to be able to not have to have a maths degree to work out where the value is and that is reflected in the way that we are moving our overall pricing proposition. But above and beyond that, we see there are significant benefits in our supply chains and it is one of the things that enables us to run very high levels of service, very high levels of availability. If you look at the Grocer 33, they actually measure the percent availability. If you take the average for the year we are something like two percentage points higher than the next nearest. So we really do deliver consistently high levels of availability and in part that is reflected in the way that our customers look at our overall proposition.

And then again as we have reflected on, it enables us to highlight areas of quality and we are moving our offer in a thoughtful way towards taking products where there is genuine innovation and offering them to our customers in more prominent positions, not least promotional ends. And again we think that is a point of differentiation over time. We have to do it in a measured way, we have to do it in thoughtful way, we have to understand the balance of risk and reward. But all of those things have accumulative affect as far as our customers are concerned.

And on the investment in price, I will defer to my colleague on the right.

Answer: John Rogers
I am not really sure what more we can say on price other than to say.

Further question
I suppose I could just ask a more simple question. You are basically saying you are going to follow the market on pricing, could you say the market is becoming more competitive because Asda appears to be cutting prices and Tesco is?

Answer: John Rogers
You can see a myriad of scenarios in this market going forward and there is no question that the market remains competitive and there is no question that the market remains uncertain and potentially volatile. What I can say is that we have and we will continue to remain competitive on price. And that is something we have done over the last 12 to 18 months and we will continue to do so over the next 12 months. However it is fair to say, you know we are not by nature price leaders. That is not to say we won't sometimes initiate price reductions, of course we will from time to time. But we are not by nature price leaders. Why not? Well because we need to be competitive on price, but we don't need to necessarily always lead on price and that is in terms of being the cheapest or being the first to get there because we have other components to our offer on which we compete. We talk about having a

different, and I keep coming back to this, and sort of apologise for it, because in the end we have a differentiated offer, that is how we are competing in this market. It is differentiating on quality, differentiating on service, it is differentiating onto a store ambiance etc, etc. So we don't need to be price leaders in the market, but we do need to be price competitive. Now in terms of what the industry will do going forwards about pricing remains to be seen, but it has been a very competitive environment over the last 12 months and I am sure it will continuing to be going forwards.

The one thing I will come back to though is the point about, I do think we do price investment in a very measured and very empirical data driven way. We really do understand our customers, we have the data, we trial and test and learn the impacts of price movements on volumes, we look at the elasticity, we look at the cross elasticity's, how impacts different parts of our business. So I think we do it in a very informed way which enhances value for our customers and also for the business. But we will remain competitive on price, full stop.

Further answer: Mike Coupe
But I think it is worth just reinforcing the point that John has made, yes there are products where we would seek to just match our competitors, but going back to the level of sophistication we can look at, we will make targeted price investments where we think there is some material benefit for us as an organisation. I am looking at a list of products here. Whole chickens would be an example, where we know it will have a disproportionate effect on our business if we invest in that kind of product. So we look at these things in the round and we are moving to fine tune our overall value proposition including the pricing of the products that we sell and it reflects back on running a simpler business, a business that is easier for customers to kind of get where the value is, and ultimately that is reflected in volumes and transactions.

Question 7

James Anstead, Barclays
James Anstead from Barclays. Just one question on business rates. I think if I remember rightly, in the two years before the one you are reporting today, your business rates bill had gone up by £100 million or possibly even a bit more than that, whereas the year you are just reporting they have actually gone down by £6 million. So why has that happened and what kind of trajectory do we see from here because that is a huge swing factor I guess in your margins?

Answer: John Rogers
Well first and foremost it is still a big number and if you look at the business rates number over the last 4-5 years it is significantly increased, you know we are paying roughly £450 million of business rates so it is a big number in our P&L and that is significantly bigger than it would have been five years ago.

I mean in terms of why has it gone down, well successful renegotiations and to some extent we are impacted by the timing of the revaluations of course. But a lot of hard work into those negotiations. I think going forward we would expect to see inflation in business rates of the order of 1.5 – 2% in 2016/17 so to give you a little bit of guidance for your models.

Question 8

Rob Joyce, Goldman Sachs

Morning, Joyce, Goldman Sachs. Just a couple. First one, in terms of the bonus this year, will that number stay flat do you expect if you deliver a similar set of performance metrics to this year?

And the second one is, I don't know if you can give us any more visibility on how you see the national living wage impacting the P&L sort of on a multiyear basis and how much it is impacting that two percentage number next year? Thanks very much.

Answer: John Rogers
Just on the bonus. I mean, again what we can say is we know in this year's number we have a bonus of around £100 million or so. If you look back historically the bonus has varied in a range, but typically would probably be somewhere between the 50 to 70 to 80 million range. So that would be looking back historically.

We can't really comment, we are sort of 7-8 weeks into the new financial year so it would be wrong to comment at this point about where we are in relation to internal targets and so forth, but I think I would just point you to looking back at what we paid this year versus what we have paid on average historically to give you some shape and guidance as to where you might think about 2016/17 but clearly commenting on 2016/17 at this point is [sound dropout]

Answer: Mike Coupe
And as far as the national living wage is concerned, you are saying we gave a 4% pay rise this year so we managed to absorb that in the business overall and it is reflected in the performance of the profitability of the organisation. And as we look forward we will remain competitive, we would always seek to pay more than the national living wage, it would be wrong to comment on the detail of that, but wrapped up in John's summary of where we might be looking forward over the next let's say 3 to 5 years, are the assumptions around what we will need to do on the national living wage. So our underpinning of the projections, the sort of 3-3.5% margin that John has talked about over a longer period of time would be the assumptions that we would make around how we deal with the national living wage.

Further question
Okay, thanks very much. Just a quick one. On the underlying costs this year what were they? You gave guidance for just around 2 next year, what were they this year?

Answer: John Rogers
For 2015/16 just under 2% so £90 million or so.

Rob Joyce
Got you, thanks very much.

<u>Question 9</u>

Stewart McGuire, Credit Suisse
Good morning, Stewart McGuire from Credit Suisse. A couple of follow-ups I guess. Pricing. Can you give us some colour on the gap between Convenience stores and supermarkets and whether there has been any widening in that pricing over time?

And then just back onto volume. I would like a bit of colour on where this volume is coming from frankly. Your volume is up, Tesco is up, Morrison's up, Aldi is up, Lidl is up and as you said there is the same number of people in the country. Is that coming

from trading up? Is it coming from non-food, clothing, a little bit of colour on the mix would be fantastic? Thank you.

Answer: Mike Coupe
Well I think John might be able to answer the second question because I suspect it would be quite difficult to disaggregate. Typically if you look at our Convenience pricing it is of the order of 3-4% higher than the mainstream supermarkets, but it is very much on a product by product basis. So some products are at the same price and that has not materially moved over the last period of time. So the relativity would be the same today as it was this time last year and indeed over the last 3-4 years so we do charge a slight premium overall in our Convenience business. As I say there are some lines which are actually at parity, but it is on average 3-4%.

I mean the population of the UK as I said it is slightly facetious, the population of the UK has actually grown by three-quarters of a percent a year. So all other things being equal you would expect the volume to grow by around three-quarters of a percent a year on the basis that nothing else changes. But what we did see over a long period of time is five years where volumes stagnated so population growth of roughly 4% over that time, no volume growth and I suspect there is an element of catch-up at the moment, but it is quite difficult to unpick the numbers. If you can be bothered you can probably go through it with Nielsen data and work out exactly where it has come from. I am not sure I can give you any more colour than I have already given you. I will look at John to see if he can?

Answer: John Rogers
Well I think that is a very good perspective from the market perspective. I think if you look specifically within our business to the earlier point about how we target price investments it will be no surprise that where we have seen the best volume growth is where we have targeted price investments because we have done so on the basis we only target price investments where we can get that volume uplift. I think over the last 12 months or so significant deflation particularly in the fresh categories and indeed no surprises that is where we have seen a really good uplift in volume given our movement on price in those areas. So if I wanted to pick out one example, certainly on the fresh side, we have seen a good step up in our volumes.

Answer: Mike Coupe
And again if you look at something like By Sainsbury's as well as a brand, again we have seen a really good step up in our volumes there, again principally driven by the targeted price investments that we have made.

<u>Question 10</u>

James Collins, Stifel
Morning James Collins from Stifel. So just quickly on the Bank. On mortgages, I guess the question is, why now? I know it is something you have done before and stopped and likewise with your competitors, so why now?

And then just on the profit trajectory of both mortgages and if there is going to be any ongoing impact from interchange or if that is just one-off? That would be great please.

Answer: John Rogers
Maybe I will pick those up. I think on mortgages, I mean two reasons as to why now. One of which and probably most important of which is customer driven. I think it is a fantastic addition to our portfolio of products. I think it is very complementary to the

products we offer our customers. I think in a way our customers increasingly expect us to offer a mortgage product. I think it sits very nicely alongside loans, credit cards, savings etc. As Mike said, the Sainsbury's Bank brand, our customers really trust it and therefore it provides us with a great opportunity. So certainly there is customer demand out there for it in our view.

I think the second reason is just again looking at the overall shape of the balance sheet and wanting to make sure from a risk perspective that we have got the right assets and liabilities on both sides of the balance sheet. Again that is another reason to change the shape of the balance sheet over time to help diversify risk. And indeed if you look at, as I mentioned in the slides, if you look at the performance of some of the challenger banks that we have seen over the last 12 to 18 months, I think that should give you some confidence in our ability to really deliver profits through the introduction of the mortgage product.

In terms of the trajectory of the Bank going forward in interchange fees, it is fair to say that we will see a little bit of a continue drag from interchange fees going forwards. I don't really want to get drawn too much into giving guidance beyond the next financial year which we have been quite clear on. Not least of which of course is because we expect to complete on the HRG transaction in the third quarter of this year and subject to Bank and Board approval we would expect to bring the loan book of that business into the overall umbrella of the Bank. So if I may perhaps I can just sort of hold on that for a while and we will provide more guidance on the Bank trajectory going forwards once we have reflected how we think about combining the two businesses together. But stepping back from that detail, I continue to make the point, I do really think this is a tremendous opportunity for us in our business. We have said time and time again that the Banking model in the supermarket world makes a lot of sense. And we are never going to be a bank of scale, it is just not going to be the case. So we are not going to compete with the high street banks on scale, but we are going to be able to compete with faster, nimbler, more flexible banking platforms which we are creating through the standing up of the new banking platform with our partners FIS which will allow us to design product which is bespoke to our customers, the needs of our customer in a way that allows us to really tap into what we might call the halo effect or the fact that when customers take our financial services products they spend more in our stores. That is the heart of our banking model and I think we are very confident in our ability to execute against that plan. But I don't want to give too detailed guidance going forward on profit curves, given the potential overlay of HRG going forwards.

Further question
Okay, sorry just on mortgages, why did the bank stop doing them previously?

Answer: John Rogers
I just think it was a moment in time. I think we were doing them almost on an outsource basis. I think this is now very much the opportunity to bring the mortgages onto the balance sheet and the reasons I have already highlighted in helping diversify the risk of the balance sheet as a consequence. So I think now is the right point in time to reintroduce them back into the Bank's product portfolio.

<u>Question 11</u>

Charlie Storey, Macquarie
Charlie Storey from Macquarie. Two questions please. This time last year I think it was this time last year you said that Asda was the biggest risk you saw to your

business. Do you still think that? And if not what do you see is the biggest risk to your business? That is the first one.

And secondly, the product from overseas. You mentioned increasing Europe sourcing, I guess clothing majority source from Asia, which has a lag effect on FX. What sort of FX do you see coming this year hitting the P&L and how do we think of that going forwards? Thanks.

Answer: Mike Coupe
I don't recall, I will have to look at the transcripts, ever saying Asda are the biggest risk. I think that might be a bit of spin on what we may or may not have said. I mean in the end, go back to the point we have already made, it is a very challenging and very competitive market and will remain so in the future. You can see from some of the market data that has been published recently, there are particular companies that have particular challenges and clearly how they respond to those challenges will have an impact on the market overall and it is important that we look at that and respond appropriately. We come back to the same underlying point which is over the medium to long term, this business will win by differentiating itself on the quality of the products we offer, the services we provide, the service we provide and maintaining a competitive price position, but doing that in a thoughtful and targeted way. And if we do that, we would expect the underlying performance of the business to outperform our supermarket peers and outperform the market overall. But the challenge is always out there. I have been in this business for 30 years as I have already said and there is always an ebb and flow in the way the market operates. The important thing for us is to maintain our focus on doing what we do well and continuing to do more of it.

Further question
I suppose the question is, is it the high or low end that is more of a risk, do you see the pricing or the Waitrose's?

Answer: Mike Coupe
I think we have to balance it. We are a mass market retailer, we serve 27 million customers a week and we have to respond to all of our customers' needs. We would always talk about universal appeal, it is part of the ethos of the organisation and we have to reflect how our shoppers are changing their behaviour. One end of the spectrum our older shoppers still want a very traditional way of shopping with us, at the other end of the spectrum our younger shoppers increasingly look at their mobile phone as the way they interact with an organisation like Sainsbury's. We have to be able to respond to both of those needs and to do it in a way that is relevant and not just relevant today, but relevant in the future. So I don't think there is an easy answer to your question, it is about doing lots of things brilliantly well rather than one thing in particular.

As far as FX is concerned?

Answer: John Rogers
Yes, I don't want to get drawn into the detail of our FX exposure per say other than to say that we typically hedge forward on both the Euro and Dollar basis, sort of 12 months or so forward, so to protect ourselves in the budgetary year on movements in FX. So we can manage that through the cycle, but the forward hedges are relatively small in the overall scheme of things, I don't think would have a massive impact on the business overall.

<u>Question 12</u>

Edouard Aubin, Morgan Stanley
Good morning, Edouard Aubin from Morgan Stanley. I think there is a report out in the press saying that Amazon Fresh is about to launch in the UK and will open a fairly large DC within the M25 in the coming months, I think Lidl is expanding as well fairly aggressively in the South East. So could you just give us a rough idea of the share of your sales and profits generated within the M25 or maybe more broadly in the South East? I am not expecting any exact figure, but a rough idea [laughter]

Answer: Mike Coupe
That's good so you manage your own expectations. The short answer to that question is no. It remains a competitive market and of course speculation about Amazon has been out there for quite a long period of time, I thought they had already launched some of their Amazon Fresh offer in some parts of the UK. But nevertheless they will bring another dimension to the marketplace. You can never underestimate an organisation like Amazon, they have got very deep pockets and they don't tend to stick at things for a long period of time. Having said that, it is the most sophisticated and competitive online grocery business in the world. You are choosing to take on six very sophisticated competitors who I don't think will give up lightly and that is not an insignificant challenge. And running a fresh food supply chain with all of its volatility is a very, very significant capability that would need to be developed and you could argue that we have got systems that have run this business for 30-40 years that are very, very finely tuned to that. So the sun is shining at the moment and the volatility of the demand as a result of the sun shining is massive and we have systems and a sophistication that allows us to do that week in, week out. You can't underestimate them, they are always going to be a formidable competitor and they clearly have a point of view that they can compete in this market, in this industry.

As far as the sort of overall development of discounters, we have talked before about the fact that the way we look at the development programme of Lidl and Aldi is broadly speaking they are kind of improving or increasing their market penetration where they already trade. There is not a particular focus on the South East of England. Lidl are biased towards the South East of England already, Aldi are biased towards the north of England already and the Midlands. And where we see their store development programme developing over time, it is broadly speaking in line with where they currently already trade. So the idea that they are somehow coming to the South-East is a little bit of an exaggeration. We won't talk specifically about our market share inside the M25 or indeed. I think we have drawn a chart before where we have drawn a line between the Bristol Channel and the Wash where we would say we have 20% market share below it and 10% market share above it, if that is helpful.

John Rogers
I think we are running tight on time so perhaps if there is a last question otherwise we will draw a close. We do have the so called fireside chats tomorrow so plenty of chance to ask any further detailed questions then.

Mike Coupe
Any more for any more? Look at that. Thank you very much.

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