J Sainsbury – Interim Results
Thursday 9th November 2017 – 9.30 am

David Tyler
Chairman
So good morning everybody, good morning. Here we are again, Interim results for Sainsbury's for the 28 weeks to 23 September. Welcome to this Presentation, good to see you all. I will just make a very few words of introduction and then pass on to Kevin and to Mike.

So this was always going to be a half year where we showed a dip in profits as we guided previously. So it is good to be a touch ahead of our profit expectations and it is good also to say that the business throughout Sainsbury's is in extremely good heart. Our food business is benefiting from the improvements we are making to our offer and it is also achieving a very impressive cost saving.

In general merchandise we are well ahead of some people's expectations, we are making extremely good progress in achieving synergies from our Argos integration. In clothing a sales growth of 7 per cent, we have substantially outperformed the market yet again.

And in the Bank, profits have risen and our services have continued to widen in recent months as you have seen.

So where does all this come from? It is driven by a first rate management team, lead by Mike, which is extremely active and moving at pace across a range of initiatives and creating huge positive momentum in the Group. So I would just like to say thank you to them, and indeed thank you to all of our colleagues for what they have done in the first half. And with that, simply pass over to Kevin to talk about the financials. Kevin.

Kevin O'Byrne
Chief Financial Officer
Thank you David. Good morning everyone, welcome to our Interims. We had great momentum in the first half across the business delivering like-for-like sales growth and serving more customers every day. As guidance, the underlying profit before tax of £251 million was lower due to annualising wage cost inflation, price reduction so we remained very competitive, and the consolidation of Argos first half losses for the first time. In the period we benefited from the delivery of synergies and the Argos synergies from the transaction and from additional cost savings which I will talk more about shortly.

As you will recall this time last year we announced material profits from the Nine Elms Development and the successful sale of the pharmacy business. Due to these material one-offs, our headline profit before tax declined from £372 million to £220 million. We made good progress at Sainsbury's bank in the half and we also generated strong cash flow in the period resulting in reduced net debt. Our lease adjusted net debt to EBITDAR reduced to 3.4x. In October we refinanced our revolving credit facility increasing it and extending the maturity. Our interim dividend is 3.1 pence per share. As you know our interim dividend is set at 30 per cent of full year prior year dividend.

And finally, profit expectations for the full year remain in line with the current consensus of £572 million.

Group sales which included the Argos consolidation for the full half grew 17 per cent to £16.3 billion. Retail operating profit at £272 million was down 12 per cent year-on-year, due to the price investment and wage cost increases I referred to and the Argos first half losses, partially offset by synergies and additional cost savings. Underlying profits in the Bank increased in the period to £34 million as the Bank benefited from the inclusion of the Argos financial services business. The net underlying profit before tax of £251 million was down 9 per cent which resulted in earnings per share of 8.7p down 22 per cent as a result of the new shares issued at the time of the Argos acquisition.

Finally, we exclude a number of items from our results which don't reflect the underlying performance of the core Group businesses. These total £31 million in the period and I will explain these in a minute. This resulted in a profit before tax of £220 million for the half.

In the period, like-for-like sales grew 1.6 per cent with a small increase in space, total sales grew 1.9 per cent. As you know, we are being very selective in our new space openings. In the period we opened two supermarkets and 18 convenience stores. The grocery category grew 2.3 per cent in the half as we invested in our offer. Sales of our great Own Brand ranges grew as a percent of our total business. General merchandise declined 0.1 per cent in a difficult market. We are pleased that we gained share over the half, sales were impacted by space reduction due to closures of Argos stores in Homebase and changes in space allocation in Sainsbury's supermarkets.

Our Tu clothing business performed extremely well, growing sales by almost 7 per cent as the summer ranges sold well, gaining market share. And sales grew in all our channels as we served more customers across the business. We saw above market growth of over 8 per cent in our high performing convenience stores as we improved availability and ranges. We also had strong growth in our online grocery business with sales up over 7 per cent. In the period we improved our service and our availability, increasing the number of orders and growing average basket size.

As this is an unusual first half, impacted by a number of factors, including Argos being consolidated, we thought it might be helpful to include a waterfall slide to illustrate the material moving parts. In the half we saw margin reduced as we lowered prices and absorbed some price increases to give customers great value and remain competitive. We absorbed inflationary cost increases in line with expectations and this included the 4 per cent increase in colleague salaries we announced in the second half of last year. As we mentioned, we consolidated Argos first half losses for the first time. The team have been working hard to offset material elements of these three impacts. Firstly synergies were delivered in line with our accelerated plan and I will talk more about that in a minute. We over delivered on our cost savings target, this is getting a lot of focus as you can imagine in the business. And margin benefitted from volume growth, mix and new space.

Finally, we grew profits in financial services and we reduced our net interest as we reduced average net debt over the half. As we look to the second half, we don't expect to be impacted negatively to the same degree by a number of these factors, in particular Argos. We also expect to deliver strong synergies and cost savings.

As you know, we have robust plans in place to deliver £160 million EBITDAR of synergies, this is about £142 million of EBIT. And we are delighted that these are on track to be delivered 6 months earlier than originally planned, as we said before. We delivered synergies of £25 million EDITDAR which is about £23 million EBIT in the half. These are being largely delivered by procurement savings and savings related to opening Argos stores inside Sainsbury's stores. And this programme has real momentum.

This was another busy period for the Bank. Total income grew to £225 million as we consolidate Argos Financial Services. Excluding this, income grew 14 per cent. Underlying operating profit grew to £34 million with the majority of the growth coming from the inclusion of Argos Financial Services. Cost/Income ratio reduced as we managed costs tightly and in the period customer numbers grew 8 per cent to 1.85 million customers. And in addition we added the Argos Financial Services Customer base of 1.8 million customers.

Net interest margin was 5.1 per cent due to higher interest rates on Argos Financial Services products. The net interest margin on Sainsbury's Bank products remained at 3.8 per cent in a competitive market.

Bad debt as a percent of lending grew from 0.5 to 1.4 per cent in the year. About half of this change is due to higher bad debt profile of the Argos Financial Services loan book. This increase cost if of course reflected in the higher rates earned on these loans. The underlying rate is up 0.5 per cent in line with our expectations and is still market leading reflecting the quality of our customer base. Our Tier 1 capital ratio increased to 13.9 per cent from the year end when it was 13.3 per cent.

I mentioned earlier that we booked £31 million of costs that are not included in the underlying results. This is made up of 3 major items. £20 million related to the costs of transitioning to the new Bank systems as guided, £29 million relates to the Argos integrations and the Homebase separation costs. The other adjustments of £13 million relate to a number of accounting items. For example, we add back the cost of the perpetual securities as accounting standards determine these must be treated as dividends. In the prior year you will recall we booked material one-off profits from the sale of the Pharmacy business and property, the Nine Elms transaction. And as you can see these totalled a net £140 million in the half last year.

In the half we delivered cost savings of £100 million. These savings came from a number of areas, simplifying instore processes, reducing tasks and activity that customers don't value. Transport efficiencies, procurement savings and Head Office costs. Total savings in the period was ahead of our target, and as a result we now expect to save £185 million this year an increase of £40 million. These additional savings will fund investment in our customer offer and the above inflation pay increase we announced in August. This will bring our total cost savings for the three years to March 2018 to £540 million.

Our next wave of cost saving plans are well advanced. We expect to deliver at least £500 million over the three year starting in 2018. We are looking to simplify our business wherever we can and focusing on making things simpler for colleagues in stores, for customers and reducing and removing lower value added tasks.

As you know, free cash flow is a key metric for the business and one we will be focusing on increasingly. In the period we generated £898 million cash from operations after seasonal movements and working capital, a material increase of £94 million on the year. From this we paid our contracted pension contributions, interest paid was £3 million lower as we operated with £300 million lower net debt on average during the first half. And we spent £277 million on capital items which I will talk more about in a minute. So after capital, pension contributions, interest and corporation tax, we generated £494 million of free cash flow, up £74 million or 17 per cent year-on-year.

From the cash flow generated of £494 million, we paid our final dividend of £144 million. We have no further exceptional pension contributions as you saw in the prior year. We injected £110 million into the Bank in the half and we received £25 million cash related to property developments. This resulted in a cash flow surplus of £248 million. Net debt includes non cash movement on derivatives. In the period the value of FX hedge derivatives moved by

£158 million as the US spot rate at the end of the half was higher than the average hedge rate. This moves on a daily basis. This resulted in net debt in the period reducing by £90 million to £1.39 billion. And as I mentioned earlier, the average net debt over the half was £300 million lower year-on-year.

And the numbers on this slide differ slightly from the earlier slides as they were cash paid in the period and this slide shows capital that we committed to. Total capex in the period was £274 million. The retail capex of £239 million includes £36 million relating to Argos business as usual capex. Without this the underlying number was down 15 per cent year-on-year. And we expect to spend around £600 million on core retail capex in 2018/19. This includes addition Business as Usual capex on the Argos business, but excludes £90 million of Argos integration capex we guided to previously.

Balance sheet strength and financial flexibility is a key focus for us. In the period we reduced our net debt by £90 million from £1.4 billion. And we have undrawn facilities of £1.3 billion. Our lease adjusted net debt to EBITDAR has reduced to 3.4x and we refinanced our revolving credit facility as I mentioned in October increasing the facility by £300 million and increasing the length of the facility by up to 5 years. We hold freehold properties of £10.5 billion and our combined pension deficit under IAS 19 at the half was £723 million.

So we have seen positive momentum across the Business in the first half. The year-on-year key margin movements were as guided. We have made great progress on our cost savings delivery and our accelerated synergy savings are on track. And our results are underpinned by solid cash flow generation. As we enter our important Christmas trading period, our profit expectations remain in line with current market consensus and we expect the year end net debt to be around £1.5 billion.

I would now like to hand you over to Mike to update you further on the progress in the first half.

Mike Coupe
Chief Executive Officer
Morning everybody. So as Kevin as already said, we are pleased with the first half performance. We have delivered a number that is ahead of expectations and we have confirmed the consensus for the full year and we have made good progress in implementing the strategy that we outlined three years ago and we have lots of positive momentum in the business.

So last year I talked about the four priorities within the business and against each of those we have made good progress. So for instance within our grocery business we are innovating at pace. We have maintained, if not slightly improved our market share within general merchandise. Our clothing business continues to perform in an outstanding way, and we have made good progress within the Bank in the first half.

So I will talk more specifically about the food business. This half we have conducted 70 range reviews which account for roughly 40 per cent of our total sales and we are planning a further 50 in the balance of the year. We have grown our Own Label share and there are many categories where we have relaunched new and innovative products. So for example Chilled Freefrom as an example which is a range that we would not have been carrying previously. Dairy alternatives where we have had a big range review within our dairy category and it is a big and growing part of the overall market. And indeed in some categories where Own Label share is relatively low we are trying a different approach which is using Owned Brands rather than Own Brands to grow our sales in those categories. An example of that is My Hair Matters, which is doing extremely well and outperforming a number of the major brands in the Health and Beauty category.

We are also being more thoughtful in the use of exclusive brands. A good example of that is Godiva chocolates which adds an exclusive branded product to our overall portfolio and is currently in around 300 of our shops. And similarly with big branded manufacturers, we have launched exclusive products and an example of that would be Off the Eaten Path, which is actually a Walkers Pepsico product and something which is exclusive to Sainsbury's.

We have also introduced specialist food offers into our business, an example of that would be the Sushi range. We have Sushi Gourmet now in 30 shops and we plan to roll that further during the course of the next couple of years and indeed we have trialled Patisserie Valerie, or Pat Val as it is known in the trade. And we are rolling that out again during the course of the next period of time. And we have 28 Patisserie Valerie adding value to our patisserie counters and again something that is unique to Sainsbury's.

If we think about our Own Label development, this is a chart that we have shown you before. In the bottom left hand corner as you look at it, we have commodity products, a good example of that is toilet rolls. And if you looked at our toilet roll range today it is substantially rationalised from where it would have been a few years ago. The prices have come down and indeed the Own Label presence has increased and that is an example of a product very commodity driven and clearly an area where the discounters perform more strongly, and we need to be price competitive and range appropriate in those types of categories. But equally towards the top right hand corner of the chart, there are plenty of places where we could add value to our business and a lot of our product development and product innovation is going into those categories where customers, particularly Sainsbury's customers will pay a premium for the right kind of quality products. And that is where we seek to add value and there are many examples of where we are doing that.

One is our Slow Cooked range, this is a pretty substantial market £154 million. A market we believe is going to grow over the next period of time. We have 19 new and improved products introduced in November of last year and a further 19 lines during spring and autumn of this year. And we have seen our market share grow from 2.5 per cent to 11 per cent and 500,000 new customers are buying this range. So that is a good example of where we are seeking to innovate in the quality segment of our price quality framework.

We continue to run the business on a more simplified price proposition and we have maintained roughly the level of price promotion in our business that you have seen over the last few years and we believe that offers our customers everyday great value and we will seek to do that into the foreseeable future. The other thing about the first half is that we have seen an improvement in our price position as we would measure it relative to our mainstream competition.

Again our customers value the quality in our business and you can see that not only have we maintained the gap, but we have also improved our quality perception over the last half, and that is something that is very important to us as a business and important to our customers. And we have a new measure on the right hand side which is our net promoter score, and again we have seen our net promoter score improve during the course of the half as we have made the changes I have talked about overall in our proposition.

We are renowned for our service, we do run the best shops in the industry. I would say that, I am biased, but both our internal measures and our external measures would suggest that we offer the best service and the best availability in the industry. That is characterised by The Grocer 33 which we have won for 5 years running and again we are ahead of the league table this year. Our store manager in Redhill won the Grocer Gold Award for Store Manager of the Year. And that was in a store that was going through quite a significant amount of disruption as it went through a major refurbishment and extension.

We have launched our colleague values across the entire group now, so the culture of the organisation is gradually getting integrated as we bring the Argos business into the overall fold. For the third consecutive time we have got investors in people with gold accreditation which with a business of our scale is unique in the UK. And of course we have given our colleagues a 4.4 per cent pay increase which to some extent is paid for by some of the cost savings that Kevin has referred to earlier.

If you look at Christmas 2017 this, perhaps better than anything illustrates the amount of change in our business over the last year. So as well as what you might expect from a business like Sainsbury's, the 185 new Christmas food products in store and online and I would particularly recommend the Snow Globe turkey sandwich which is like a cold turkey burger, I would recommend that to you. I tried one yesterday. We will have 165 Argos stores in Sainsbury's stores by Christmas, and that is up from 30 this time last year. We have 218 collection points in Sainsbury's which is up from 36 last year. We have Smart Shop, our scanning app in 45 stores. We have Fast Track delivery sales, 32 per cent higher than last year. Remember the Argos Fast Track Delivery Service, the 4 hour deliver service is unique in the marketplace. And indeed as our customers demand more speed online we also have online grocery, same day delivery in 93 stores. That is representing 38 per cent of the population versus 29 per cent last year. So as I say, this illustrates quite well the amount of change and momentum in the business overall.

To look more specifically at the channels, to start with the supermarket chain. We have talked to you three years ago about the fact that we had about 1.5 million square feet of space above and beyond what we thought we would need in the future. We have repurposed 170,000 square foot of that space during the course of the half. We are roughly at 450,000 square feet to date and we will have re-purposed all 1.5 million square feet by around 2020. We have improved the customer proposition in about 15 per cent of our space, clearly some of that is driven by the Argos stores in stores, but also things like Sushi Gourmet and some of the reformatting of our shops as we go through those processes.

We have enhanced our distinctive offer. At the end of the half we had 112 Argos stores in Sainsbury's stores. We are at 150 and we will have 165 by Christmas, 200 collection points, 30 Sushi Gourmets, 28 Patisserie Valeries. And we are also more focused on our store refurbishment investments and so we are making investments where we know that the changes that we make really matter to our customers and that has a material impact on the capital investments we make in our overall stores.

And we have also upgraded the Cafe offer to represent our customers' needs as we look forward. So for instance introducing salmon as an example instead of just offering fish and chips, although fish and chips is still pretty popular as a line.

Our Convenience Business has had a very, very strong half, growth sales by 8 per cent underlying like-for-likes of around 5 per cent. We have outperformed the market overall, the IGD market. We have seen a strong profit performance and we have done a lot of work on optimising our ranges, so we are taking a more bespoke and more distinctive approach on a location by location basis. And that is one of the reasons our performance has improved during the course of the half. We have done 10 major range reviews representing something like 40 per cent of overall turnover. So again lots of innovation in our Convenience Business. And we continue to run the Euro Garages trial and we think that has been pretty successful in illustrating that we can franchise the brand with other third parties, and that has a potential route for growth in the future.

Again illustrating the changing shape of our business, our Grocery Online Business has grown by 7 per cent. We have seen order growth 7 per cent. We have seen value growth 7

per cent. So our basket size has now equalised. We have introduced a new picking system which has significantly improved our instore productivity. It is one of the big cost saving benefits we have seen during the course of the first half. We have got a 10 per cent improvement in our store pick rates. We are offering same day delivery, as I have already said, in 93 stores and we will potentially roll that our further during the course of the rest of the year.

And our Grocery online app now accounts for about 15 per cent of our store orders. So again a successful introduction during the course of the last year. And for those of you who can afford to live in Zone One and Zone Two in London, we now have Chop Chop, our one hour deliver service available to 1.7 million customers.

We have done a lot of work on looking at our customers future needs and we have introduced The Living Well Index in line with our overall brand proposition. We want to help our customers live well for less. And we have started a continuous tracking survey of 8,000 customers every six months to understand their needs, how we can do as a company, a better job of helping them live well for less. But also to contribute to the wider society debate overall welfare and wellbeing in the UK as a nation overall. And we have learnt a lot from this and we are doing a lot of work now on how we can bring the actions to bear on our business on a day to day and week to week basis.

Of course we continue to be underpinned by a set of values. We are a business that sets out to do the right thing and it is certainly something I feel very strongly about. As an example we seek to make a positive difference to the communities that we serve. As an organisation we raise roughly £5 million a year on a local basis, store by store basis. And we know that for every £1 of funds that we raise there is roughly £11 worth of benefit that accrues to the communities we serve. So absolutely, especially as a result of the Live Well for Less work that we have been doing, we know that our stores play a very important role in our communities and that we have a responsibility to increasingly serve those communities well.

Another example is Respect for the Environment. This is a good example of where our values not only benefit society more generally on the impact on the environment. They also have a cost benefit. So as an example, investing in LED lighting, it is a big programme for us. It has reduced our overall cost and reduced our energy consumption and clearly has an environmental impact as well.

We talk about clothing and general merchandise. We have had a good performance ahead of the market in the first half, albeit a challenged market. Strong performances in key categories like mobile, audio and nursery. We have introduced a wider range of well known brands, so Neff, Bodum, Joseph Joseph. We have done lots of work on continuing to improve and enhance the customer experience within the online world, particularly browsing, checkouts, the basket experience, and more consistency across mobile and tablets. Again big focus on the availability of the products within the supply chain. And we know by introducing Regional Fulfilment Centres, we can get more products closer to the spokes within our organisation and we have invested in two Regional Fulfilment Centres in the half and we will continue to do so as we look forward.

Now 56 per cent of Argos sales start online and we are really pleased with the progress of Fast Track, that unique delivery service that we offer where we can get around 20,000 products to most of the population within 4 hours. So if you are brave enough, you really can order your Christmas toys at 1pm on Christmas eve and have them delivered by 6pm that evening. So growth sales up 32 per cent in deliveries and 59 per cent in Fast Track collections. And as we say, we think that is a source of significant competitive advantage as we look forward.

We have talked about the fact we have opened 112 Argos stores in Sainsbury's stores. We are also trialling different formats, smaller locations. So we are trialling 8 micro stores which would potentially give us more opportunity to rollout into more Sainsbury's stores as we look forward. And of the 112, 38 of the stores are actually relocations. We now have 195 collection points in Sainsbury's and we are trialling Argos collection points in Sainsbury's local stores and we plan to have 100 of those over the next period of time.

We are very pleased with the performance so we outlined what we believe to be the synergy case and one year on we are confident in our ability to deliver the numbers. We still see a halo in the Grocery Business of 1-2 per cent. And perhaps more encouragingly, we are seeing underlying like-for-like sales at the end of the first year in the stores that are annualised at around 20 per cent. And over a two year period, 35 per cent. And so to be relatively straightforward piece of analysis, if you want to do the arithmetic as we look towards arriving at a portfolio of 250 Argos in Sainsbury's stores, you can see that will have a compounding affect in the business overall.

Not only that, when we repurpose the space, we put more space into clothing and we see a benefit of both sales and profitability in the underlying Sainsbury's business when we put an Argos store in a Sainsbury's store. So good case study, the Morecambe store, where we closed an existing Homebase, we closed an existing Argos store and we saw 88 per cent of the sales transferring to the Argos store in the Sainsbury's store in Morecambe. And we also saw a growth in the clothing sales despite the fact that we had reduced the overall space to general merchandising and clothing in that store by 7 per cent. So we are very confident in the business case and our ability to deliver the synergies and that comes through in the fact that we have delivered £25 million of EBITDAR, £23 million of EBIT in the half.

Another examples of where we are doing that. So we have now merged our buying offices in the Far East which means we are increasingly jointly procuring products and that will be reflected in ranges that you will start seeing coming through the business. So whether that is Black Friday or the Christmas ranges or the Halloween ranges, and increasingly we are integrating the buying trips together. We are selling Sainsbury's home products on Argos.co.uk and we have made a lot of central synergy savings, so for instance procurement of media would be a good example where both businesses buy a lot of media. And we have combined the buying of that together and that has delivered as one example of pretty substantial saving. So we will continue to deliver the synergies, and as we have said previously, we expect to deliver the £160 million six months earlier than we originally committed to in the outline business case.

Clothing had an excellent half. Sales up 7 per cent and a significant beat to the market. We are still the 6th largest clothing retailer in the UK, albeit from a slow base or low base, we have seen good growth in our online business, up 54 per cent with an improved customer journey and an increase improvement in our click & collect proposition. We have seen good growth in menswear, now accounting for 15 per cent of our sales and that is being driven by the introduction of a Tu Premium range and a Tu Formal range. And we have also got a new trial going on in our clothing business, so we have got six stores trialling a new format and again we see that as an avenue for growth in the future. So an outstanding performance in our Clothing Business over the last six months.

Talking quickly about the Bank. Continued diversification and growth. We have seen good growth in our loan sales, good sales in our credit card accounts, our new loans platform is on track to land in the early part of next year and we are well on the way to developing a new credit card and card platform by the middle of next year, towards the autumn of next year. Mortgages, we have had a successful launch, we have got about £150 million of loan applications received and in process. And as we get the customer experience right, we plan

to roll out to more brokers. So we started with one broker, I think we are now with two brokers. And over a period of time we will open that to more brokers to grow that business.

Savings has performed well on the new platform and the other part of our business is of course ATM transactions which are up 3 per cent. And we have seen, as you can see from the chart, significant growth in our travel money business, so up 60 per cent which is a result of our rollout that we made in our stores a couple of years ago. So a good performance in the Bank overall.

Our last part of our plan was to deliver cost savings and to strengthen our Balance sheet. We have delivered £100 million of cost savings in the half and as Kevin has already talked about, we now think we will get to £540 million over the three years, so that is an additional £40 million to the guidance we have given previously. And we now have robust plans in place to deliver £500 million of cost saving over the next three years. Net debt is stable, we are planning to reduce that over the medium term, and we do have an increased focus on cash flow and again Kevin talked about that earlier.

So in summary we think there is lots of positive momentum in the Group. The Grocery Business is innovating at a rate of change of pace that I don't think I have ever seen in a business like this, and we have lots of new and exciting things rolling out and rolling out quickly. The General Merchandise Business has grown share in a challenging market, Clothing, standout performance, growth on growth on growth on growth with a 7 per cent growth this time around. And the Sainsbury's Bank delivered a good first half performance.

So I think that is it from me. I was going to show some TV commercials, so I think I missed my cue half way through. So at this point I am going to show you some TV commercials. I am going to show you the Sainsbury's Christmas TV commercial which airs for the first time on Sunday, so don't tell any of the journalists about it. And also the Argos Christmas TV commercial. And then Kevin and I will answer questions. So do you want to show the TV?

[Viewing TV commercials]

Mike Coupe
Yeah we happened to get Kermit the Frog because he was in town. So we got him cheap. We had one hour of his time, but apparently the man that works him he actually can't come out of character which sounds really odd, anyway I am now sure how much we paid for Ricky Tomlinson, but I know we got Kermit on the cheap!

So do want to ask questions? Who wants to go first? Go on Bruno as usual.

<u>Question and Answer Session</u>

<u>Question 1</u>

Bruno Monteyne, Bernstein
Good morning, Bruno from Bernstein. Three from me please. When I look at your page 13 and net debt explanation, I was a bit confused when you said that the fair value of the derivative links to FX sourcing contracts. So if it is linked to FX sourcing, shouldn't you really include that negative movement with your free cash from operations? That would be the first one.

The second question, before we did the Argos transaction you had longer term margin guidance of the business going back to 3-3.5 per cent in the days of John. Now when I look at how the margin is going, excluding the Argos business and those synergies, it is at low 2s and it does not seem to get better in your forward guidance as well. Are you really moving

away from that guidance and actually it is now the total business including Argos going back to that and therefore lowering of that old guidance?

The third question is, there are so many pockets of great growth that you are showing, all the initiatives, but obviously at the top line in total, your sales aren't really strong versus the competition and seem to be further dropping as well. Surely, either what is going wrong, what does that bode for the profitability's of the old core business? Thank you.

Mike Coupe
The first one is so complex I have no idea what you were talking about but I will ask Kevin to reflect on that and I will have a go at the second and third one.

Answer: Kevin O'Byrne
£158 million, what that is, it is non cash because effectively we have taken out hedges. We have got twice the amount of dollars hedged this year than last year because of the Argos business. And the value of the spot rate at the end of the period was higher than, it happened to be about 1.35 at the time. So you have got this unrealised loss on the hedging effect. It was at 1.3 I think yesterday, so that moves all the time. It is a volatile number so it only crystallises effectively when we purchase the products and pay.

Further question
So therefore there will be further cash outflows, so it should link to the sales you had in the stores over the previous year?

Further answer: Kevin O'Byrne
Yes but as we pay for the products, the trading teams are working on the margin and the hedge, so all the business plans are based on that margin. So we fixed the margin so that is the value of the hedging, so they are working to that. So in effect they are not bothered by the day to day rate which will go up and down and could swing the other way, and last year in fact it did. So it feeds through in the margin but it is in our plans already.

Further question
Great, but if you want your staffing in the commercial department as a financial investor you still have to settle that debt linked to the transaction you had before. So some of the cash flow of the operations are overstated to give you to correct that future cash flow?

Further answer: Kevin O'Byrne
Bruno if I was to do it at 130, that changes materially, that number changes. That was locked in, that was 135 on the day at the end of the half. So it is already, that 157 is already reduced materially. Happy to take you through more.

Further answer: Mike Coupe
And to answer your second question, no we are not moving away from the guidance we have already given. If you take the consensus that we have confirmed for the full year, that implies that you will start to see profit increase half on half, second half on second half and effectively it will increase in net margin, so 3-3.5 per cent over a 3-5 year period remains our overall guidance.

And I am not sure I agree, I mean if you go back to the point you made about competition, our Grocery Business was 2.3 per cent up in the first half. If you take it in the round, there are always pluses and minuses in any half. Our Clothing Business outperformed the market, 7 per cent growth is I think pretty much the only one of two clothing businesses growing in the UK at the moment. And broadly speaking we held, if not slightly improved our market share in general merchandise.

Further question
But Mike, on the second question, the old guidance in the time of John, was pre Argos, pre the Argos synergies and all these kind of things you are planning to get back to the 3-3.5 per cent margin then. Most of the margin improvement you are expecting in the second half is Argos having a better second half, the synergies. So the old guidance is quite materially different from the new guidance which includes your Argos acquisition?

Further answer: Mike Coupe
Yeah and we would look at it in the round in the way you just described it. So yes but we would still expect over a medium to long-term period to get this business to 3-3.5 per cent net margins. There are lots of moving parts whether it is the cost savings, whether it is the Argos synergies, whether it is the profit delivery of the underlying supermarket chain. What we said previously is a lot of the levers are in our hands. So the delivery of the synergies, the delivery of the cost savings. Two examples, the management of the cash that Kevin has already talked about. And it is difficult for obvious reasons to predict exactly what is going to happen in our marketplace given the level of uncertainty in the world that we live in. And I think we have to be slightly careful not to make ourselves a hostage to fortune by nailing our colours to any particular mast. But we think in the round, in the way that I have just described it, we can manage our way to that level of profitability.

Bruno Monteyne
Thank you.

Question 2

Stewart McGuire, Credit Suisse
Morning, it's Stewart McGuire, Credit Suisse. A couple of questions from me. On the 250 store guidance in terms of Argos within Sainsbury's, any change in your thinking on that? Is there any reason why you are limiting yourself to 250, where you have 600 or so Sainsbury's supermarkets?

Also any comments on the synergies with respect to the lease expense potential, especially given the potential for more than 250 stores?

And then I guess just harping on Bruno's point a little bit, your like-for-like sales growth of 1.6 per cent, how much of that was driven by inflation? And can we see some volume growth expectations going forward? Thank you.

Answer: Mike Coupe
Yeah I guess on the first point, we are keen not to get ahead of ourselves. We made a commitment to get to 250. You can see that our rate of implementation given that we are going to get to 160 odd by Christmas is pretty fast. And we have got a number of trials going on as to what we may or may not do beyond that. So I think your premise is not unreasonable, that you might expect more in the course of time, but we are not going to confirm that today simply because we have not done that piece of work to any great level of detail.

If I turn to Kevin on the second part, I guess by implication if we were to do more, you would expect some lease savings so again we would be looking at that in the round and you would expect that to come through in some kind of benefit to the organisation overall.

Answer: Kevin O'Byrne
Stewart, the absolute focus on the organisation is to deliver the 160 and then I guess we will decide what next. And I think one of the most encouraging facts that Mike presented earlier was that the stores that were in their second year were seeing 15 per cent like-for-like on top

of effectively 20 per cent. So plus 35 per cent. So you would imagine there might be more opportunity, but we just haven't got there yet.

Further answer: Mike Coupe
And on the volume point, I mean you can pay your money and take your choice as to which version of inflation you take, but the underlying performance would have a slight reduction in volume. Of course we would like that to be positive, and there are lots of things we are doing that we talked about during the course of this Presentation which we believe will move it in that direction over time. But equally I am not going to chase unprofitable volume and there are many examples I can point out in the marketplace where people are doing stunts of various descriptions which may help them in the short-term, but I suspect over the medium to long-term, are not things they will necessarily benefit from. And you pay your money and take your choice as to who I am actually talking about.

Answer: Kevin O'Byrne
One of the points on your lease point is the average lease length in Argos is around 7 years so that clearly gives us flexibility.

<u>**Question 3**</u>

Dusan Milosavljevic, Berenburg
Just a question on your cost savings beyond next year, so the new £500 million plan. Can you provide a bit more detail as to why you are more confident on that and where should that come from?

And the other one. When can we start thinking about combining food and non-food online fulfilment between Argos and Sainsbury's because it seems to be, it could be I guess incrementally lower cost proposition with significant customer appeal?

Answer: Kevin O'Byrne
On the cost saving, we are just six months further down the line with the work. We have got teams very focused on this. We have got trials that we have completed so we just have greater visibility because there is a lot of work going on. So we are going to enter the financial year very well placed to deliver those plans.

Answer: Mike Coupe
And there is no once over bullet, it is just literally hundreds of initiatives of various descriptions that each add in some cases some fairly big numbers. So if you take Grocers online picking systems, it's James' is broker, yeah online picking systems that is quite a material improvement. Other things might be energy saving initiatives where perhaps the numbers on an individual basis are less, but overall we have got a much better line of sight and that is because it is one year on.

We are very firm believers in the one plus one plus one making more than three in the business and whether that is bringing Argos stores to Sainsbury's customers. In the end 250 stores in Sainsbury's stores will bring Argos to a lot of millions, literally 10 million plus customers week in week out. And we are looking very hard at how we integrate the offers in the right way to offer benefits to our customers. And that is a very significant part of the work that is going on in the organisation today. It is unlikely we will integrate the supply chains quite in the way you describe it, because that is a bigger and more complex job than you might imagine. But certainly showing up to our customers in a consistent way in the digital space is something that is front and centre of our agenda as we look forward and we think has the potential for a substantial benefit in our organisation and indeed we are uniquely placed to be able to deliver that.

Question 4

Dave McCarthy, HSBC
Morning, it's Dave McCarthy, HSBC. You have got an extra £40 million of cost savings but you said you are happy with consensus. So where is that extra £40 million being consumed in what areas were you not expecting that cost or margin, whatever the breakdown is?

And then on the cost savings themselves, you talk about £500 million, £540 million, are these gross savings? Are they savings that you do where you stop doing one thing but you have to do something else so that the net saving is somewhat different?

And then can you be precise on what you mean by procurement savings? Is this just you have taken out a number of buyers? Have you closed some departments down? Or are you including in that any improvements in your buying prices?

Answer: Kevin O'Byrne
When we talk about procurement savings Dave, we are talking about GNFR savings, so everything that we buy but isn't sold in the stores, we buy a lot of services and products.

Mike Coupe
I am going to take a rest at this point because I think Kevin can answer all of those questions for you.

Kevin O'Byrne
The fact your gross savings, I guess your question is what is going to drop to the bottom line. They are gross savings, do we know sitting here today where we might have some additional expense in the business, where we might choose to invest in the business to improve the customer offer? No, but we are very clear on getting sight of at least £500 million gross savings. And when you talk about the increased savings in the year, we just announced a pay rise of 4.4 per cent. We are budgeting as we guided inflation between 2-3 per cent. So we weren't budgeting for 4.4 per cent. So a portion of that is funding that. And just why we have pushed hard on cost savings because we wanted to give our colleagues in stores £8 an hour and we needed to fund that. And then there are some other investments in making the offer more competitive.

Dave McCarthy
Great, thank you very much.

Question 5

Niamh McSherry, Deutsche Bank
Niamh McSherry, Deutsche Bank. Morning. I have three questions. The first one is can you comment at all on gross margin progression at the Argos business?

The second one is you mentioned range review in your Convenience Stores, I was just curious, are you seeing any change in the kind of categories that are selling in Convenience? Is that business changing in a major way?

And then the third one was about the supply base. Tesco have been telling us that they are consolidating their supply base. Are you doing anything similar or is there any opportunity to do something similar?

Answer: Mike Coupe
I think on the first one, we don't comment on margin progression and neither would you expect us to, so that is a pretty straightforward answer.

In the Convenience business, we are being more tailored in the way that we approach our Convenience business is probably the best way of describing it. So if you look at the stores around here, generally speaking they are driven by Food for Now. So short life, chilled products, prepared products, sandwiches, ready meals. And we are doing a better and better job of putting those products and the right kind of products into those types of stores. Equally if you look at some of our other Convenience stores, they act more like small supermarkets, in which case you are going to carry a larger grocery range and you have to be quite tailored in making sure that grocery range is appropriate to the catchment area you are operating in. And it is an example of where we are using "Big data" to do a better and better job. We might have only had I don't know eight segments for our Convenience business a year or two ago, we now have a lot more flexibility in the way we run that business. And that clearly is reflected in the underlying results.

I won't comment specifically on consolidating our supply base, the reality is again to the point we made earlier, we will continue to make procurement savings in this business, sometimes that does result in changing suppliers, sometimes it results in consolidating suppliers and sometimes it results in having new and different suppliers. So it can be any one of the above to make the general comment that we would be consolidating on balance more of our business into less suppliers I think would be misleading, certainly not something that was overtly happening in the business overall. But clearly one of the big areas we would seek to make substantial cost savings in the business over time is procurement, as in growth, things that we buy and sell. And to some extent it is a pay to play in this industry. If you don't do it, you can't remain price competitive and that is something that has been there forever.

Niamh McSherry
Thank you

Question 6

Dan Ekstein, UBS
Thank you. Good morning, it's Dan from UBS. I have got two questions. Firstly, it is a two part question on the profit waterfall chart you have laid out. Thanks for presenting this it is very helpful. The biggest negative on there is price investment. I wonder if you could talk about where you feel you have got to in terms of price competitiveness and also market conditions as we move into the second half? And should we be thinking about a similar sort of negative chunk in the next waterfall or are we past that?

And then secondly on volume and mix. I am quite surprised to see that as a positive in the chart, given you have said volumes are running negative. You know Kantar has you with the worst volumes of the big four through the first half. So how are you generating that kind of positive volume and mix effect?

Second question is on your pension. You have got the triennial review coming up in a few months time, I just wondered if you had run any scenario analysis where the assumptions had been flexed more comparable to what some of your competitors have or their actuaries have put through when valuing their pension deficits? Thanks.

Answer: Mike Coupe
So on the first point, as I reference in my Presentation with CR price position relative to our mainstream competitors improving in the first half. So we are pleased with that. You are asking me an impossible question in terms of what might happen going forward because clearly it is a competitive market and lots of things could or couldn't happen. We are not anticipating any major price investments in the second half, but clearly we will make sure we

maintain our price competitiveness as we look forward. But it is fair to say that the most significant challenges of the current CT valuation after the Brexit vote have probably worked their way through the system. But as you know it is a competitive, dynamic market and sometimes unpredictable in what it does. So to make myself a hostage to fortune and say we definitely won't be investing in price in the second half, I think would be a little naive but nevertheless we are not anticipating that that will be the case and we are happy with our price position in the sense in that we think we are pretty competitive relative to where we were at the start of the half. Volume and mix?

Answer: Kevin O'Byrne
Well there was space in there as well Dan, and there is in some categories and particularly through that the 70 new products that the range reviews in the food business, we see volume growth and value growth in the areas of innovation so there is a mix in there, but there is also space.

Pensions, I wasn't really clear. I mean you can see in number 13 the details of how we are valuing at the moment, the pension. I think we might be mixing up accounting and cash. So the triennial valuation will effectively, the output of that is how much cash needs to go into the pension scheme, whereas the accounting moves around as discount rates move around. We would expect, looking at our pension scheme, across the two pension schemes together, that the commitment we have made to put cash in to date, should be sufficient to keep those pensions secure and it is obviously very important to us that those pensions are secure for all our employees. So we would not be expecting a material change to that cash number. That said, it is a discussion with the Trustees and it will depend on, and we start that in March next year and move forward.

As far as the difference in accounting in the marketplace, clearly you are probably referring to Tesco's accounting, which, they have taken a different view of bond projections. And it is interesting, we just watch that with interest. We have valued it on a consistent basis this time. There probably is some merit on questioning how bond rates are valued and the impact on pension schemes. If we were to account as Tesco are accounting right now with the same rate, we would have a pension surplus in our accounts. So it is quite different, so we just watch that space and stay close to it and understand how it moves.

Dan
Thanks

<u>Question 7</u>

Mike Dennis, Lazarus Research
Hi, it's Mike Dennis from Lazarus Research. I have got three questions. The first one is on Argos, and usefully as well, your flow diagram. If your cost saving synergies are £17 million incremental, are you telling us in that flow diagram that Argos' losses are £18 million this year? So the first part of that is are all the synergies going to Argos? Second part is, if not what has improved in Argos so much year-on-year? That is the first question.

The second question is, what are your input costs if your inflation is 1.7 plus? And what does that mean in the flow diagram in terms of the gross margin because that infers that the gross margin is down. Could you confirm that for the supermarket Group?

And thirdly in the sense of Argos as a business, it is very difficult to tell from all these figures as they are in store and stand alone. Can you tell us in terms of packages delivered volume wise how Argos is doing? Thank you.

Answer: Kevin O'Byrne
First of all Mike, the waterfall chart was illustrative. And we don't disclose, we are not disclosing going forward breaking out the different businesses. What you do see is you know Argos losses first half last year because that was published at £26 million. And the EBIT saving this year in the year is £23 million from synergies. And I think that is probably all we can say on that. We also don't disclose gross margin. The retail margin we did guide, would come down in the half because of the annualising of the price increases, annualising of the pay increase from last year and the Argos loss is the net with synergies and cost savings offsetting that. And there it is probably slightly better than we were guiding actually, just a little bit ahead of where we were guiding. And clearly that is impacted by the fact you have got the sales from Argos in this half and you have got no profit, you have got a loss from Argos in this half so that is impacting it and we will see that flipping in the second half.

Further question
Just to take you up on that point alone. You have on page 13 of your release, incremental synergies of £17 million?

Answer: Kevin O'Byrne
That is because we had some last year because the synergies in the period were £23 million. It was £17 million increase year-on-year.

Further question
But the flow chart says incremental as well?

Answer: Kevin O'Byrne
As I said, the flow-chart is illustrative of the movement.

Further question
And the answer to the last one about volumes? The question was Argos packages delivered online Click & Collect you said is a big part of the business. So I just wondered what the year-on-year volume growth was in that business just to give us a sense of how Argos is growing?

Answer: Mike Coupe
Argos packages delivered Click & Collect volume growth. Well we quote the Fast Track deliveries which are up 32 per cent and 59 per cent in the charts. 56 per cent is online. I am not sure I could give you, I am looking at John now, those are the numbers that are quoted directly. I think broadly speaking what it illustrates is that Fast Track works as a customer proposition and increasingly Argos customers and customers are more generally choosing to shop with us online and would expect that to be the case for the foreseeable future.

Answer: Kevin O'Byrne
But interestingly the growth in delivery Fast Track is growing faster with the collections. So people are actually going and collecting in store which clearly is more cost effective for us. So we have 32 per cent growth in delivery to home, 59 per cent growth in people picking it up at their local store. But the level of detail you want there Mike, we don't disclose that.

<u>Question 8</u>

Sreedhar Mahamkali, MacQuarie
It's Sreedhar Mahamkali from MacQuarie. Three questions as well for me please. First one going back a little bit in a slightly different way to Bruno's question earlier. Q1 to Q2 there is clearly a slow down and that is despite your price investments, despite your views on improving price positioning through the half year. So is that you are doing working? Do you

need to go back and rethink to kick-start the growth again or sector leading growth that you used to be able to enjoy a few years ago? That is the first question.

Second one, trying to understand bank operating profit growth of 17 per cent first half, you are still pretty much maintaining 10 per cent growth for the full year points to about pretty much flat year-on-year in the second half. Is there any reason why it wouldn't grow in the second half?

And third one, just looking out a year, do you have any view in terms of bank capital injections please over and above the 190 this year, any views there?

Mike Coupe
I will ask Kevin to talk about the second and third of those. On the first. I think you just have to look at the half in the round. There were some peculiarities around the way the weather played out first quarter compared with second quarter. So first quarter basically had all the sunshine and the second quarter didn't. And that had quite a material effect and it particularly affects a business like Sainsbury's which is more fresh food orientated and clearly in of the other categories, some of the non food categories we would benefit from that as well. So we would ask you to look at it in the round rather than at any particular break down of the two quarters. If you look at the market data in the back half of the second quarter if that makes sense, you will see that our relative performance was pretty strong and so that should give you some comfort. We think we are doing the right things and there is a lot of activity going on in the business. We are seeking to make this business more competitive, we are seeking to look to innovate in categories where we think we can add value to our customers. We are investing in the Channels for Growth, like Convenience, Online, and you are seeing good growth in things like Clothing. So as I say, we think we are doing the right things, and there is lots and lots of momentum, lots of change in the business that we think will bear fruit over the medium to long-term.

Further question:
Is there any metrics you can share with regards to the price and relative improvement, either specific measurement versus competitors or a price perception metric you might have?

Answer: Mike Coupe
Well I showed you the net promoter score which has gone up and that will be a function of lots of different metrics, whether it is quality, whether it is service, whether it is underlying pricing. And many of you conduct surveys and I think on balance the surveys that I look at conducted by people in this room, which if you took an average is probably representative of what is going on in the marketplace, would suggest that our overall price position has got better during the course of the half. You pays your money you take your choice. We have got an internal survey which is weighted across 16,000 products. You know what we have talked about today is representative of that, but equally you yourselves can look at each other's surveys and draw your own conclusions. And as I say over the half we would see our competitive position relative to our mainstream competitors improving.

Answer: Kevin O'Byrne
Just on the two bank questions, the profit in the first half of plus 17 per cent was impacted very positively by AFS being consolidated for the first time. So the underlying profit growth would be mid single digit in the bank and hence we wouldn't be expecting the increase that you mentioned in the second half and for the full year.

And on capital injections, we will give guidance on capital injections for next year at the Prelims, but that is just something that we keep under review as we look at the marketplace. We look at what is happening in the competitive marketplace, what products we want to offer

our customers. And mindful that we want to get a double digit return on our capital, we flex that as we go forward.

Sreedhar Mahamkali, MacQuarie
Thank you.

Question 9

Alistair Davis, Investec
Morning, Alistair Davis, Investec. Just one question on Argos. You are saying around a 20 odd million loss in the first half. Just thinking back to pre-acquisition, it used to make £10-20 million of profit in H1. Has that move to loss just a currency impact on cost of goods or is there other inflation business disruption?

Answer: Kevin O'Byrne
Alistair we are not giving a profit number of loss number for Argos in the first half. The only number that is in the market is what was last year. We are not breaking out the businesses. The idea of that waterfall chart was just to give you some sense of the movements in the business. And clearly we do have an Argos loss in the first half, but we are not getting into detail of giving exact numbers on that. We look at it as a combined business and more and more running it as a combined business. John runs all of the GM business across Sainsbury's and Argos and its integrated teams. So it becomes a more meaningless number.

Alistair Davis
Ok

Question 10

Rob Joyce, Goldman Sachs
Thanks, Rob Joyce, Goldman Sachs, three from me. Firstly, just to confirm on your answer to Dan's question. You are saying that the guidance you have given in terms of the full year PBT, is implying a step down in that price investment versus the first half in the second half of this year. Could you just say, confirm that is the case and say what in the market gives you confidence that is the right strategy at this point?

Second one is just on the Argos financial services business. Can you say what percentage of the Argos sales are now coming through that business and what has happened to the bad debt to loan ratio over the period there?

And then thirdly linked to that on the Bank, you said the underlying bad debt to asset ratio has also increased. Can you comment on whether that has been driven by the riskiness of the new business you are taking to drive the revenue or whether it is being driven by the performance of the existing loans on the balance sheet there? Thank you.

Answer: Mike Coupe
Well I will do the first and you can do the second. I think you are putting words into my mouth. What I said was that we are confident in the year end consensus and there are a number of moving parts in any business like ours and one way or another we think we can manage our way to that number. There are levers we can pull as we run the business on a week to week, day to day basis, but as we sit here today we are confident that we will get to the yearend consensus and we are also confident that half on half, second half on second half last year that will show profit accretion. I can't predict just like you can't predict what is going to happen in the marketplace overall, but we think we have the capacity to deal with what we would expect to come our way during the course of the second half.

Answer: Kevin O'Byrne
And Rob maybe just building on that. The price investment that you saw, a chunk of that that you saw this year was what was annualising decisions that were made in the second half of last year so that was why we were able to guide on it when we spoke back in May because we made those decisions and we knew it was going to flow through. And I guess if we had any clear guidance now we would give it to you for the second half.

Further question
So there is no new price investment programmes planned or anything?

Answer: Mike Coupe
Well we wouldn't say anything to you in this room even if that may be not be the case. What we are saying is we are confirming consensus, that we have a lot of levers in our own hands, whether it is delivery of synergies or delivery of cost savings. And we believe that we can manage our business in the round to deliver that consensus. Clearly there are some external factors that may not influence that, but as we look forward and from what we can see, we are comfortable with our position.

Answer: Kevin O'Byrne
And on the AFS mix, it is around 16 or 17 per cent so it is lower than others that you see in the marketplace, but fairly consistent. We have seen a little bit of a tick up in that, but not much. Clearly when you get into certain categories it is more important. So the higher tick is white goods, furniture, TVs etc. But across the whole business 16-17 per cent. And the bad debt in the underlying book is as we expected. And it is related more to the existing book, but our outlook was given the current climate we would need to take a little bit more provisions for bad debts.

Further question
Is that the same in the Argos book, are you seeing similar?

Answer: Kevin O'Byrne
The Argos book hasn't changed materially. Our view of the Argos book remains broadly the same, a little bit of a tick-up but not material.

Rob Joyce
Thank you.

Question 11

Andrew Gywnn, Exane
Let's go for two questions. So for the first one, you have commented a little bit on the market, but essentially it feels like volume is pretty tough to come by. So you have got your Q2 sales performance which is pretty soft. And we also have those attempts in the market to sort of drive this unprofitable growth I think you called it. So what is your read of the market overall at present?

And sort of connected to that, the Kantar market share data would suggest that since Q2 your sales performance has improved a little bit. Is Kantar barking up the wrong tree or is that the case?

And then the second one unfortunately again to return to Argos very quickly. But on the number of stores relocations, I forget the exact number but it looks like net/net you are actually opening Argos space at present. Is there, you have got 112 new stores and 38

relocations within that. Is there a case that at some point we are going to see a significant acceleration in the rate of closure of the old Argos stores? Thanks.

Answer: Mike Coupe
You know that we wouldn't comment on current trading performance, you would have to draw your own conclusions from the market data that is available. I alluded a little bit to the relative performance in the second quarter and relatively soft summer performance mainly driven by the fact that it was raining a lot in the south-east of England. You are right, volume in the marketplace is hard to come by and like always a very competitive and tough environment, twas ever thus. Broadly speaking volume in this marketplace is linked directly to population and the population of the UK isn't growing very fast. So if you took a sort of macro view over the medium to long-term you are going to see relatively low levels of volume growth in the market for the foreseeable future above and beyond some of the other channels that are available to us. And one of the reasons why we think non food is an attractive area, clothing and general merchandise because they are relatively unconsolidated markets where we think we have the potential to win over the medium to long-term.

I would have to do the arithmetic on the Argos space, I honestly couldn't tell you the answer to the question. I am looking at John, but net with the closures of Homebase and the number of openings and number of relocations, off the top of my head I would say almost certainly the space is reduced not increased. But I would have to double check.

Answer: Kevin O'Byrne
The point at present would be up slightly, but the space would have reduced.

Further question
And sorry just very quickly on the first question. The volume is tough to come by, it is always thus, as you said but has it changed significantly in say the last two months or so? Is there a reason why Tesco is doing very aggressive promotions for instance? Is it down to market conditions or Tesco's specific?

Answer: Mike Coupe
Far be it for me to comment on others. But I refer you to my answer. Having sadly been in this game for a very long period of time, there are things you can do in a business like this to spike a short term volume, especially when you have got some financial capacity to do that. Eventually you will live to regret it. It might take a year or two, without being specific about any particular competitor, but you can see behaviour in the marketplace is related to what may or may not be going in competitors underlying volumes and trading performance. It does not take a genius to work out that if you are doing deep discounted promotions you have probably got a bit of a challenge in your underlying sales performance that you are trying to address.

Further question
Okay that is message received. And just very quickly then, so for H2 just to be clear it seems like your priority is profit over sales growth or have I misread that slightly?

Answer: Mike Coupe
No we are balancing the two, but we are also taking what we believe to be a rational and objective approach to linking the two together. We are absolutely clear that we have to make our business more efficient and that enables us to be more competitive. But equally we have to balance that with making sure that we are making rational and objective medium, to long-term decisions and we are also managing the cash in the business as well. So we are trying to manage the business in the round to deliver consistent returns for shareholders.

Answer: Kevin O'Byrne
And whatever we do this year Andrew, we have got an anniversary next year. So clearly it doesn't make a lot of sense to do lots of unprofitable stuff.

Question 12

James Anstead, Barclays
James Anstead from Barclays. Two questions. Firstly following up on one of Andrew's points. Is it logically consistent to say on one hand that you are becoming price competitive and on the other hand saying you are not chasing some of those unprofitable volumes? Given I guess those are things that people are interested in buying?

And secondly, I am a bit surprised in a way that the wage settlement you have given was higher than you expected, given that a) you made a similar one last year, and b) the Government has given a pretty clear trajectory of where minimum wage is going over the next few years. So I suppose my question would be, might we be here in a year's time and again you are saying that you had to pay more than you expected and there is another cost increase you would not have expected?

Answer: Mike Coupe
Yeah I think to try and answer your paradox, what I would say is logical is to make medium to long-term investments in the underlying proposition rather than spiking short-term volumes for the sake of spiking short-term volumes and as Kevin says, quite often you will live to regret that the year after or the year after that. And you can see that behaviour across a number of our competitors over a number of years. It is not a game that we are going to play to the extreme that some of the others play it. So I would always take the judgement that we should make investment decisions which are for the long-term not the short-term. So for instance investing in pricing toilet rolls on a EDLP basis in my view is a much better use of the company's money than spiking a short-term volume driving but profit dilutive stunt as an example.

On the wage settlement, we work in a competitive environment and the reality is we have to respond to what our competitors are doing. We had a number in our minds when we began the financial year and that number went up a little bit as the year progressed, simply because of the competitive dynamic and the wage awards that were made by a number of our other competitors and we have to be very mindful of that and £8 an hour we think is a great rate for our colleagues and we will continue to seek to be ahead of the national living wage. And again that in part drives our thinking.

Question 13

James Tracey, Redburn
Good morning, James Tracey from Redburn. Three questions from me. The first one is that general merchandise growth was basically flat in the half. Can you disclose what the Argos revenue growth was because I imagine general merchandise is mostly Argos?

Second is, are you able to say what the Sainsbury's supermarket EBIT margin did year over year so we can get an indication of a like-for-like progression over time?

And the final question is on value perception. The UGov survey show your value perception deteriorating on an absolute and relative basis. This is something we share with M&S and Waitrose. So do you think there is a squeeze on UK households which is negatively affecting high end grocery chains such as yourself? Thank you.

Answer: Mike Coupe
Yeah I am sure I can pull out surveys that might show the opposite as well so I am not sure I can take one particular survey as being indicative of how our customers might be thinking about our price position. As I said, if you look at our net promoter scores they have actually improved and there is nothing in the data that I look at, our internal basis that would suggest what you have just suggested to me. So I guess it depends what question you are asking and what the base of the survey is.

I think the answer to the second question is we don't disclose a supermarket margin so you wouldn't expect us to. And increasingly we are running the business on an integrated basis because you would have to make all sorts of assumptions that you would then start questioning as to which bits you attribute to which parts of the business. And equally we are not going to break out the general merchandise performance between Argos and the underlying Sainsbury's business. I would say a couple of things about the performance in the half. Firstly, we grew our relative share. So we were pleased with that. Secondly there was a negative impact from the closure of the Homebase, Argos within Homebase stores which would have peaked during the course of the second quarter and will gradually unwind over the next period of time. And thirdly, when we repurpose the space within Sainsbury's stores, we generally speaking take it away from some general merchandise categories. So electricals being a good example of that because Argos as a business is a lot better at selling televisions than Sainsbury's historically has been. And put it towards, for instance, clothing, where the Sainsbury's business is pretty good now at running a clothing business and therefore that does also have an effect on the relative balance. But we don't and won't disaggregate the performance between the two businesses because increasingly they become interlinked.

Further question:
Just a follow-up on that. Are you able to say what your clothing space did, the amount of space year-on-year?

Answer: Mike Coupe
I couldn't tell you off the top of my head, but what I could say is that the clothing business was in underlying like-for-like growth and if I said it was mid to low single digits, that would probably be an accurate representation. But we are one of only two clothing retailers growing in the UK at the moment I think.

James Tracey
Thanks Mike.

<u>Question 14</u>

Nick Coulter, Citi
Morning, Nick Coulter from Citi. Sorry to come back on core volumes in the grocery business again, but over what time frame do you expect them to turn positive or I guess the other way of asking it is, do you have the flexibility to carry negative volumes for the second half or for the near term? And I have a couple more for Kevin after.

Answer: Mike Coupe
Well I am not going to make myself a hostage to fortune in answering that question. We are doing everything we can within our business to manage what is within our control. As I have said already, we need to reduce our costs, make ourselves more efficient. And that will enable us to make sure we can compete whether it is adding value through the quality of the products that we sell, the service that we offer or being more price competitive. Of course we would like our business to be growing its volume and that would certainly be our underlying objective. What we can also point out is the fact we have a record number of transactions.

So one way or another the Sainsbury's proposition seems to be working for our customers, but there are some categories where we clearly need to do a better job over the medium to long-term. And that is a lot of the work that goes on in the business. To say we are going to see volumes go positive at any particular moment in time as I say would be making myself, making ourselves a hostage to fortune, but we stick with the medium term guidance that we talked about at the beginning. One way or another within the things that we think we can control, synergies, cost savings, underlying trading performance of the business, investment in space, investment in groceries online. We think we can get this business to 3-3.5 per cent net margin.

Further question:
But do you think in the categories where there aren't stunts or the halo effects from those stunts as you called them, are you making progress on your core volumes? Are the levers that you are pulling actually impacting the business?

Answer: Mike Coupe
Yes I think Kevin referred to it during the course of the Presentation, we have seen our own label share of our business grow and that would give you some leading indicator that the changes that we are making are positive. And we could probably take you through a few categories. I took you through the Slow Cook range where we have made significant changes. And dairy would be a good example of a very large category where we have made a significant investment in dairy alternatives because that is a very significant part of the market and we will be seeing volume growth in that category. Similarly Freefrom products, that is another area where we significantly over trade. We have a market share in excess of 25 per cent. Invested a lot in that business and again we will see volumes grow.

Further question
Thank you. Then a couple for Kevin if I may. I think we all define pre-cash flow a bit differently with everyone in the room. But there is a positive £25 million I think in the use of retail free cash flow slide which I think is property and strategic capex which I guess is a net number. Is it possible to have a kind of two gross figures for that please?

Answer: Kevin O'Byrne
Not really but it isn't too massive numbers there. That is largely a cash inflow from the Nine Elms development. So there is nothing untoward there.

Further question
But just to have the underlying capex number, maybe it is disclosed in the meat of the release?

Answer: Kevin O'Byrne
Yes we don't. If you look, I can't remember which note it is, but it lays out, you can see a cash in, cash out in the notes.

Further question
It is just that it has been netted to a job positive number. Thank you.

Answer: Kevin O'Byrne
If there is a problem with that Nick, shout afterwards, but I am sure it is clear in the notes.

Further question
Then on the bank bad debts, on an underlying basis is creeping up and you said that is in line with your plans. What are your expectations for the second half or moving forward? Obviously consumer credit and the credit cycle is a question mark at this point in time, but what do you have in terms of flexibility around that?

Answer: Kevin O'Byrne
Putting it in line with plans might sound like something we want to happen. We expect that in the current climate we might need to tighten rates. We would expect to keep that under a close watch during the second half and clearly day to day decisions being made by the risk and finance teams in the bank on that. So we wouldn't be surprised if it does nosed up a little bit in the second half.

Nick Coulter
Okay, thank you.

Mike Coupe
I can't see any other hands. Thank you very much for being a lively audience today. Thank you. We will see you all soon. Thank you.

End of Presentation.