J Sainsbury – Preliminary Results Presentation
Wednesday 3rd May 2017 – 9.30 am

David Tyler
Chairman
Good morning everybody. Welcome again to Sainsbury's. This is our Preliminary Results Presentation as you know for the 12 months ending 11th March 2017.

We continue to concentrate as ever in this business on the quality of our food proposition and we continued to make good progress this year on all of that, and Mike will take you through some details on that shortly.

But this in fact has been a pivotal year in our business. As you know, we are very focused on the long-term trends in our markets and we have made investments this year with these firmly in mind. We believe that they will create real value for shareholders in the years ahead.

The acquisition of Argos is already differentiating our offer to consumers and its sales and its profitability in the first 6 months of its life within Sainsbury's have been very encouraging. Together with Sainsbury's we now offer a multi-product, multi-channel proposition with fast delivery networks and it is unmatched by our competitors. The Management Team are extremely excited about what more can be done in terms of our offer to consumers in the years ahead. So Argos has had a great start.

At the same time this year Sainsbury Bank has transferred much of its offer onto new IT platforms and it has launched a mortgage proposition. All this gives us a lot of confidence that the Bank will achieve strong profit growth in the years ahead, especially as it has a low customer acquisition cost and because it has real ability to use Sainsbury's data to great effect.

Sainsbury's underlying profit for the 12 months we are announcing today is £581 million, 1 per cent down and our underlying EPS is down nearly 10 per cent to 21.8 pence. It has been the third very challenging year in a row in the grocery market and I believe that shareholders can take some comfort from the fact that our sales and earnings have been a good deal more resilient over this period than our direct competitors.

Our shareholders will have also have seen that we have cut our net debt this year to below £1.5 billion and we have continued to pay our dividend throughout this difficult three year period. I can also assure investors that we have a very strong management team, led by Mike, and I would like to take this opportunity to say thank you very much to all of our colleagues for their tremendous enthusiasm, commitment and effectiveness over the last 12 months.

And with that I am now going to hand you over to Kevin O'Byrne our CFO who joined us in January and is already making a great contribution to the business, and he will take you through the numbers.

Kevin O'Byrne
Chief Financial Officer
Thank you David, good morning everyone. I am delighted to be here presenting my first results for Sainsbury's.

In the year the food business delivered a resilient performance in what was a challenging market, growing like-for-like transactions in the period in all our formats. We delivered strong growth Online, in Convenience, in General Merchandise, in Clothing and in Argos since we acquired the business. Margins reduced in the year due to price investment and higher cost inflation in the second half as we guided. Argos stores within Sainsbury's are performing well and exceeding our returns hurdles and we now plan to accelerate these openings and deliver our synergies we committed to, six months early.

It has been a good year for Sainsbury's Bank as David has mentioned as we completed a number of key systems acquired the Argos Financial Services business and launched mortgages. We are now set up to deliver strong profit growth going forward.

We continue to deliver on our cost savings target and have started to work on new plans to deliver an additional £500 million from 2018/19 as we strive to simplify our business further. We have a strong balance sheet and during the year we reduced net debt by £349 million and finally we paid a dividend of 10.2 pence in the year. Group sales grew 13 per cent helped by a half year of Argos sales of about £3.1 billion. And as we reported Sainsbury's total sales grew 0.2 per cent in the year and like-for-like sales were down 0.6 per cent excluding Argos. Retail profit of £626 million included a contribution of £77 million from Argos. As you know Argos makes more than its annual profit during the second half because of the Christmas peak. Sainsbury's profits were therefore down about £85 million year-on-year due to price investment and cost increases, partially offset by cost savings. And this resulted in retail profits down £9 million or about 1 per cent.

Underlying profit in the Bank increased in the year with a change in interchange fees and the investment in the new mortgage platform resulted in a net reduction in the year of £3 million. The net underlying profit before tax was down 1 per cent at £581 million resulting in an earnings per share figure of 21.8p down 10 per cent as we issues new shares with the Argos acquisition.

Finally we exclude a number of items from our results which we don't believe reflect the underlying performance of the core business. These total £78 million in the year and I will explain these shortly. This resulted in a profit before tax of £503 million in the year down 8 per cent. As I said retail sales figures of £28.7 billion included £3.1 billion sales from Argos and while sales grew about 12 per cent underlying EDITDAR grew 9 per cent, the result is underlying operating profit of £626 million and underlying operating margin of 2.42 per cent. We expect cost inflation in the year just started to be in the range of 2-3 per cent. And as you know we also expect first half underlying profit to be lower than the second half due to the full year impact of cost increases and price investment made in the year to March. And of course the first half losses of Argos, which we expect to follow the same profile as the year just completed.

Total sales in Sainsbury's grew 0.2 per cent due to space contribution of +0.8 per cent. We delivered very healthy sales growth in our Convenience and Online channels, and in Clothing and in General Merchandise. As you know we are watching our capital expenditure carefully and are being very selective in our new space openings. In the year we opened 4 supermarkets and 34 Convenience stores, 72 per cent of this new space was in London and the South-East. We will continue to selectively open good sites in 2017/18, 3 supermarkets and about 25 Convenience stores.

The Argos business delivered strong like-for-like sales growth of +4.1 per cent in the second half. And in addition to the strong like-for-like sales growth, Argos delivered £72 million of underlying operating profit in the period since acquisition, at the top end of expectations. Synergies of £5 million were also delivered, a total synergies figure of £7 million was delivered but £2 million is accounted for in the Sainsbury's business. As we said, we are pleased with the performance of the Argos stores opened in the existing Sainsbury's supermarkets and in the year just started, we expect to open 135 new Argos stores and have already opened 20 since 11th March, giving 59 stores within Sainsbury's today. We also closed an additional 39 Argos in Homebase stores, leaving 18 trading at year end. And you know we have robust plans to deliver the £160 million of synergies, we have delivered £7 million as I said in the year just finished. We plan to deliver £58 million this year and as I said we expect to deliver the full £160 million 6 months early. In the year to March 2018 we will incur one-off costs of £60 million and one-off capital expenditure to deliver these plans. These are in line with the total cost guided to previously.

This slide shows the financial structure of the Argos transaction. The gross purchase price of £1.3 billion, including £226 million capital returned to HRG shareholders. There is just a slight error in the slide where it says consideration including capital return on the left hand side, that does not include capital return. The business had cash of £548 million and a loan book with Argos Financial Services of £615 million, so in effect Sainsbury's paid £156 million for the remainder of the assets and capabilities of the Argos business. As we previously guided, we expect to spend £270 million on integration, capital and revenue.

It was an important year of transition for the Bank as we acquired the Argos Financial Services business and made material progress landing ATM and Savings IT platforms. Total income grew over 4 per cent driven by good growth in net interest income of over 6 per cent and commission income up almost 2 per cent. Cost: income ratio increased as we built the mortgage platform during the year. We would expect this to reduce materially over the coming years as we grow the business. In the year customer numbers grew by 4 per cent to 1.77 million and in addition we added the Argos Financial Services customer base of 1.8 million customers. Net interest margin was 4.4 per cent due to higher interest rates on Argos financial services products, offsetting lower interest rates on Sainsbury's Bank products in line with changes in the market. Bad debt as a per cent of lending grew from 0.4 per cent to 0.8 per cent in the year. Half of this change was due to the bad debt profile of the Argos Financial Services loan book. This increased cost is of course reflected in higher interest charges earned from these loans. The overall rate is market leading reflecting the quality of the customer base. And we had a prudent but more efficient Tier 1 capital ratio of 13.3 per cent at the year end.

As you know, we have been working hard to separate the bank systems from Lloyds Banking Group and this is a complex project. Very good progress was made this year in delivering the core systems with ATM and Savings completed and the loans platform is now in test. Our new website and contact centre systems were also delivered. In addition the Insurance Broker platform was completed and our mortgage offer was launched in April. In the new financial year the loans platform will be fully operational. In 2018 we would expect to launch a combined Argos Financial Services and Sainsbury's Bank card platform. I discussed previously following the Argos acquisition, we changed our plans to deliver a combined, more comprehensive solution. In 2017 we expect to spend £85 million on the loans and card systems.

So we are developing a strong financial services platform and are therefore optimistic about the profit growth opportunity we have in the coming years. Profit will be driven by growing our existing cards and the loans business and our new mortgage business. We currently have a 3 per cent share of the cards market and a 7 per cent share in loans.

Following the launch of our mortgage offer in April we are targeting a 1 per cent share of the mortgage market over the next 5 years. There are two drivers here; firstly we believe we can build a profitable loan book taking a relatively small share of a large market. And secondly we want to balance the risk in our Bank loan book which is currently unsecured, with a secured element.

I mentioned earlier that we had booked £78 million of costs which are not included in underlying results. And this is made up of a number of items. £60 million related to the cost of transitioning the new bank systems which I have discussed. £53 million related to the Argos deal and these included deal related integration and Homebase separation costs. £33 million related to restructuring actions to make our business more efficient, particularly in store as we change our structures and work practices. Examples include removing some night shifts in store. And these decisions typically deliver a pay-back of less than 18 months.

The property gain of £36 million is the net of the profit on the Nine Elms disposal offset by onerous lease impairments and changes in fair value of investment properties. The £15 million gain is the net of a number of decisions taken in the year as we focus the business on our 4 key priorities which Mike will talk more about.

There are two key areas here. Firstly we rationalised our portfolio. We sold the Pharmacy business at a profit and closed Netto, Sainsbury's Entertainment and Phone shops. Secondly, we have had a thorough review of all of our projects and stopped a number which resulted in an IT write-off of investment previously made. It is important in a competitive market that we remain focused on fewer areas.

Finally the other adjustments 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.

Our net finance costs were slightly lower in the year at £119 million and our underlying tax rate moved to 23.2 per cent in line with guidance. The prior year benefited from changes to deferred tax. We expect our underlying tax rate to be in the 23-24 per cent range in the new financial year.

In the year £130 million of the targeted 3 year cost savings of £500 million was delivered. This gives a cumulative total of £355 million and we have detailed plans to deliver the remaining £145 million. These savings were delivered in all areas of the business. Store costs, store salaries, logistics, warehousing and Head Office. As I said, we are working on plans to deliver a further £500 million of savings starting in 2018/19. We are looking to simplify our business wherever we can for our customers and our colleagues and focus on the most value adding activities.

In the year we generated over £1.2 billion cash from operations. We spend £588 million on capital items and I will talk more about that in a minute, after our annual pension's contributions, interest, corporation tax and capital expenditure we generated £345 million of free cash flow up £49 million on the previous year. And free cash flow is a key metric for the business and one we will be focusing on increasingly.

From the free cash flow we generated £345 million; we paid our dividend of £230 million. We also paid exceptional pension contributions in the year of £199 million. These were to both schemes and will not be required this year. We generated £28 million net from sale of freeholds in the year. We received cash from Nine Elms as I mentioned and purchased our store in Chiswick which we think is good development potential. We injected £130 million into the Bank, £100 million of this relates to the refinancing of the Argos Financial Services loan book, the net cash inflow relating to the Argos acquisition of £457m is detailed on the table at the bottom of this slide, and is largely driven by the cost effective refinancing of the Argos Financial Services loan book using customer deposits. The result is a reduction in the year of net debt by £349 million.

Our dividend policy is to pay 50 per cent of our profits to shareholders. In the year we will pay 10.2p per share including a final dividend of 6.6p per share. Over the last 5 years we have returned over £1.4 billion to shareholders by way of dividends.

The numbers on this slide differ slightly from earlier slides as they were cash paid in the year while this slide covers capital committed to in the year. Total capex in the year of £639 million including freehold acquisitions of £74 million, £18 million related to the Argos integration. In 2016/17 you can see we spend significantly less on new stores than in 2015/16 and we expect to spend around £600 million on core retail capex in 2018/19 and this includes business as usual capex on the Argos business, but excludes the £90 million of Argos integration capex we guided to previously.

Balance sheet strength and financial flexibility is a key focus for us. In the year we reduced our net debt by £349 million to £1.5 billion and we had undrawn facilities of £1.2 billion at the year end. As you know we had freehold properties of £10.3 billion and our combined pension deficit under IAS19 at year end was £850 million.

Before I hand over to Mike, I wanted to make sure you had our financial reporting dates for the year just started. There are two changes of note here. First we have removed the separate Q2 and Q4 announcements in line with our competitors and will update you on those quarters at the Interims and Prelims. And second, as we integrate the Argos and Sainsbury's businesses further, we will report one total retail like-for-like number. We will of course continue to give you separate detail on food, on General Merchandise and on Clothing.

I will now hand you over to Mike to update you further on the year's performance.

Mike Coupe
Chief Executive Officer
Hello everybody. I am not quite sure why they chose that photograph! But anyway, looks like my dad! I will just take us back to November 2014, when we outlined a very clear strategy. And that clear strategy was to adapt our business to our customers changing needs and actually play back a lot of Sainsbury's DNA. So the idea of great products and services at fair prices sold by colleagues that we value and do a brilliant job of serving our customers, underpinned by the values of the organisation which have existed since 1869. But also introduced two broader ideas. The first is that we had to know our customers better than anyone else in a world which is increasingly being driven by digital and mobile technology and that we had to satisfy our customers whenever and wherever they wanted. And we had to adapt our business to those changing customer needs particularly in the world of online. And we think we have done a pretty good job, albeit we have now got the building blocks in place to adapt that strategy and grow that strategy as we look forward. And in that backdrop, against that backdrop our food business has been pretty resilient and of course the acquisition of the Argos business gives us the opportunity of accelerating that strategy and to really drive the component parts of that strategy and work together, such that one plus one plus one equals more than three.

And I thought it was also worth reflecting on the relative performance of our food business over the last five years. And you can see from this chart, it has been incredibly resilient and I will come back and talk a little bit about why over the last five years. So whether we look at our relative market share performance or indeed our relative like-for-like performance against a very competitive market backdrop, we have done a remarkable job of maintaining our market share and shows how resilient our underlying food business is.

And as we look forward, four pretty straightforward objectives that we have. The first is to enhance our food offer and to continue to differentiate our food offer. Secondly we think there is a fantastic opportunity within General Merchandise and Clothing, even with the acquisition of Argos, we have a relatively low share of the General Merchandise and Clothing business, so we believe there is a significant opportunity to grow that. Kevin has already talked about the Bank and I will talk a little bit about that as well. But we put the replatform in place and we now have the opportunity of diversifying and growing out Bank. But we must not ever lose sight of the fact that we also need to make our business more cost efficient and so we need to deliver not only this year's cost savings, but the £500 million we have committed to for the subsequent three years and make sure we have a resilient balance sheet to finance our business.

And we have also got a fantastic Management Team in place. And so Simon Roberts has joined us as our Ops Director in our food business to help me and help Paul Mills who sits on the Commercial side to really think about how we adapt our food business to the market conditions as we look forward. John Rogers who you will all know or a lot of you will know is now running our Argos business and is really getting his teeth into that and really driving that hard. Peter Griffiths, the CEO of our Bank, has been with us for now four years to help us to grow the Bank and again we see lots of opportunity. And then Kevin and Angie on the HR front will help me and help the business more widely make the cost changes and cost improvements we need to make in our business over the next period of time. So we have a fantastic group of people working closely together on executing this strategy with very clear accountabilities for who is doing which bit.

I will talk about our food proposition. This is a slide actually we have put up in November 2014 and helps explain how we think about our food business. So in the bottom left hand corner you have got pretty much commodities like toilet rolls or salt or sugar. Then you have got everyday essentials, anchor products which make a big difference to our business, particularly fresh food products. And then speciality products in the top right hand corner. And we know we need to be price competitive in the bottom left hand corner and that is therefore where we have invested a lot of money and that is where we have concentrated our pricing fire power over the last period of time. And some of the changes we made are quite remarkable. So if you take chicken breast fillets. A couple of years ago we were selling those for £6 for 650g, we are now selling them for £3.95. Mince we were selling for £3.95, we are now selling for £2.75. Cheese we were selling for £3, we are now selling for £2.20. So there has been a very significant investment in the products in the bottom two boxes, in everyday essentials and commodities. Equally in the top two right hand boxes, we can actually invest in quality and add utility to products where we think our customers are prepared to pay a premium for Sainsbury's quality and for Sainsbury's recipes and for Sainsbury's products in those categories. And again I will talk a little bit about that in a second.

So we have improved 3,000 products in our ranges over the last couple of years. 20 per cent of our food sales have now been subject to a range review in the course of the last financial year. We have seen a significant investment in our core by Sainsbury's range and seen volume increases around 2 per cent in that part of our business in the last year and will continue to invest in the quality in growing categories. So this year we plan to do another 70 range reviews which will cover around 40 per cent of the food business overall. So as well as investing in underlying price and adapting our offer we are also continuing to invest in the quality of the products that we sell.

And if you look at our value simplicity, our value strategy, we have done the hard yards on making our business less dependent on promotions and investing in underlying price. And you can see form this chart how dramatic that change has been. So our Spend on Deal from a volume point of view has changed from just under 35 per cent to now around about 20 per cent. So we have lowered our regular prices, particularly in the categories on the left hand part of the chart. And that helps us actually run our business more operationally efficiently.

So we have talked before that by having less volatile supply chains, less promotional dependency, it actually helps us lower our operating costs and particularly in the area of food waste and our in store operations. And actually we have seen our customer satisfaction rise on the back of that and we are pleased with that performance and we have continued to maintain the gap versus our mainstream competitors.

Just one case study, just to show some of the changes we have made. So if you take produce, we took out a lot of promotions and multi-buys a couple of years ago. We have tightened the ranges in our stores, and that means that we get faster turns so it means we offer our customers better quality products and of course by simplifying pricing and promotions, it actually helps us maintain availability in our shops.

And then we started to make quality improvements in our underlying produce ranges so for instance more added value products like prepared fruit. And also looking at how we can adapt products in a different way. So for instance courgette lasagne, or cauliflower rice, are all examples of how we can add value to that particular category and perhaps bring some newness in areas where there has not been a lot of product innovation in the last few years.

And you can see again that although our promotional participation has dropped dramatically, actually our volume and market share performance has remained remarkably resilient against that backdrop.

And we must never forget that we run what we believe to be the best shops in the industry. And we do a pretty good job and against the backdrop where we have made significant changes in our operations and simplified our business and made ourselves more operationally efficient, for the 5th year running, we think we will win the Grocer Gold Award for Service and Availability. And again we see in our internal measures that our customers really value the service that our colleagues offer, that our stores are clean and tidy, easy to get round, easy to get in and out of. And actually if you look, with a few, I think we have now got six weeks to go, we think we will maintain the gap relative to our competition. And I think again if you look at The Grocer data, it would suggest very strongly that we run at the availability in our stores, at a much higher level than our competitors, and indeed broadly speaking we have maintained that gap over the last 3-4 years.

And again we have done a lot of work with our colleagues and for the third year running, we have been accredited Gold Status for Investors in People. And again we are very proud of the work that 190,000 colleagues do in Sainsbury’s and now Argos, in serving our customers week in, week out, and it does make a genuine difference to the underlying performance of the business and we believe it is one of the reasons why we have been resilient in a business in a challenging market.

Again a slide you have seen before. On the right hand side of this chart, we showed this two and a half years ago, and broadly speaking the market dynamics are playing out as we expected them to. So we have seen a growth in the penetration of online, growth in discounters and we have also seen a growth in the convenience business. And of course that has had an effect of having the pressure on the supermarket chain. But we do have an advantaged store portfolio. We have the right sizes in the right locations. We continue to invest in our supermarket chain. So we have changed about 20 per cent of our space so we have space initiatives around 20 per cent of our supermarket chain. If you went back to 2014, we acknowledged that around a million and a half square feet of our space would be surplus to our requirements over a five year period. Actually we are repurposing that pretty aggressively so we would have repurposed around 250,000 square foot of space during the course of last year. Clearly Argos is part of that, but there are other things that we have done to adapt our space for Clothing and General Merchandise to introduce things like Sushi bars into a number of our stores, and even something like Patisserie Valerie which is now in trial in ten of our stores, are all the things that we have done to make our underlying supermarket business more attractive to our customers.

We have 59 Argos stores in Sainsbury's stores now. And I will talk later about the number we plan to roll out. We now have 207 digital collection points of which 90 also offer the Argos service as well. So we are adapting our supermarkets pretty rapidly now to the changing market and our job is to accelerate that change over the next period of time.

Our Convenience business has been great over the last number of years. Growth again at 6 per cent like-for-like positive in the year. We opened 41 stores, albeit 7 of those were actually franchises with Euro-garages. And actually if you look at the weight of where we have invested in Convenience stores, it is broadly in the big metropolitan areas in London and South-East of England. And if you look at our underlying sales densities, they are significantly ahead of any of our competitors. So we think we run brilliant shops. It is a great opportunity for investment in the future, but the number of attractive sites is diminishing over time, which is why we have said we will open less stores so around 25 stores this year and we will only open stores where we think we can make returns which are attractive to the business overall.

And we will see where we go with Euro-garages. We have so far got 8 stores trading, so far so good, but it is very early stages. But we do think there is a broader opportunity for growth within franchising as we look forward. So this is a different way of bringing more points of presence for our business in the future, if we can get a formula that works for us and works for any franchise partner.

And again our Grocery Online business has had a strong performance during the course of the year. We have always talked about the fact that our Grocery Online business was about providing a service to Sainsbury's customers. And against that backdrop we have seen sales grow by 8 per cent, orders grow by 12 per cent. We now have all of our Grocery Online assets, digital assets together, so our recipe site, our in store smart shop app, our groceries online presence are all now under the same leadership team. And if you think about that as we look forward, that means our customers will be able to access say recipes or their shopping lists wherever they are in the Sainsbury's ecosystem. So if they are shopping in the shop they can download their shopping list, if they are shopping online they can download their shopping list, they can look at their shopping history and they can even as I say, now look up recipes and download then straight into their grocery online order.

Our Grocery Online app was launched last year. Actually last week was about 14 per cent of our sales, so has already moved from an average of 10 per cent. And every week it grows in its importance as far as our Online Grocery business is concerned.

We opened an Online Fulfilment centre and still our predominant model will be picking from our shops but London is one of the most if not the most penetrated grocery online market in the world and we were just running out of capacity, so we needed to open a fulfilment centre and that gives us 2-3 years' worth of growth opportunity as we look forward.

Another big part of our programme this year in online is to introduce a new picking system that makes us more accurate, allows us to pick faster and also allows us to deliver fresher products to our customers and that has now been successfully rolled out. We now have around 200 sites doing Click and Collect, and around 40 sites doing same day delivery. And as we look forward, our customers demand more flexibility and faster service in all of our business and particularly in the online space and we are adapting our grocery business to be able to deal with that customer demand.

And of course our food business and indeed our business more generally is underpinned by the values of the organisation. Our values make us different, but also look through the lens of making sure it is the right thing for the business from a reputational and commercial point of view. So not only do we look for new growth opportunities. So for instance the things like the ranges, the FreeFrom ranges that we have brought into our business, we have a significant market share. It plays to a particular customer need, a particular customer agenda. And we know it brings customers into our shops and we have a relatively high market share of the FreeFrom market. I have already talked about Pre-prepared vegetables. It helps us reduce our operating cost. So we have food donation partnerships in about 80 per cent of our stores 4 out of 5 stores which enables us to do a better job of dealing with our waste. We have more healthy baskets. So we have reduced the sugar content in our cereals by 13 per cent in the year and we must not forget our relationship with Comic Relief. I think we handed over the largest charitable cheque in corporate history again this time around with an £11.6 million contribution to Comic Relief.

Also our values programme helps us to mitigate risk. So looking at water and energy security, we have reduced the energy costs in our business by over 10 per cent despite the fact that our space has grown by over 50 per cent over the last 5 or 6 years. So we continue to have a significant energy reduction programme to make sure that we can mitigate the risks in our energy and water supply chains. We work with our farmers to help them reduce their costs through the Farmer Development Groups. And we have reformulated a lot of products by taking sugar, salt and fat out.

And lastly, but by no means least, one of our values is to be a great place to work. And we increasingly are focusing on diversity and inclusion and have significantly increased or improved the gender balance for instance within our store management. We have now got 500 apprenticeships in our business and we continue to make sure that we reward our colleagues appropriately. And during the course of last year as you will know, we gave our colleagues a 4 per cent pay rise, and we are staying ahead of the national living wage.

So on Clothing and General Merchandise, we now have one of the largest businesses in the UK, round about £6 billion. But if you think about the market size, it is around £130 billion of which probably from our perspective, £100 billion is a market that is accessible to us. And we believe that there is a significant opportunity to grow our Clothing and General Merchandise business during the next period of time and to grow that market share.

If you look at our market positions, now with the acquisition of Argos, we are number one in toys, we are number one in electricals, we are the third largest retailer of outdoor furniture. Argos has the third largest or the third most visited transactional website in the UK and we are now the 6th largest retailer by volume in Clothing, and that business to all intense and purposes did not exist ten years ago. And we have now achieved over a £1 billion of sales through the Argos business through mobile technology. So you can see how rapidly that market is changing, but also that we have very strong market positions in a number of key General Merchandise and Clothing categories.

So if you look at our General Merchandise business within the Sainsbury's portfolio, it grew by over 2 per cent and we grew our market share particularly in big seasonal events and that is primarily led by higher margin own label categories, design led products like homewares, bedding and indeed things like kitchen essentials and kitchen utensils. And our Clothing business has been remarkably resilient and has again grown its market share growing by over 4 per cent during the course of the year in an extremely challenging market, we continue to grow our market share and now around 8 million customers a year shop our Tu Clothing range. We have added additional ranges, whether that is premium ranges or the Admiral Menswear ranges which allows us to grow share in some markets where we have underperformed. So for instance Menswear still represents a significant opportunity for us to grow share relative to some of the other market positions that we have.

So onto Argos. Great progress. We are saying today that we will deliver the £160 million of synergies 6 months earlier than we told you last time and that is because we are now confident with the business model and we can execute at pace. We are already at 59 Argos stores within Sainsbury's stores, in fact that is when this slide was written, we are now at 63 because we have opened another 4 during the course of this week. The business is focused on delivering the synergies and the underlying performance has actually surpassed certainly our expectations, probably your expectations as well, with an underlying performance since we have owned the business of 4.1 per cent.

Of the 59 stores, 46 are new stores in new spaces and we have now got 13 relocations and I will talk a little bit about our success in that area as we have said before that is the one part of the equation we didn't know because we hadn't done it before. And now we have some experience to base our models on and it is one of the reasons why we are confident we can go faster. And what we are seeing with the stores that have annualised the first 10 that we opened that we are seeing growth of between 20 and 30 per cent and that growth has been sustained during the 6 months of the annualisation. So it gives again a high level of confidence that the business model really works. And it also enhances the one plus one equals more than two case. Because we know when we do a brilliant job of Clothing, when we do a brilliant job of General Merchandise, when we add Argos concessions to our existing supermarket space, we will grow our grocery business by between 1-2 per cent. And again we have seen that trend continue as we have launched the Argos stores in Sainsbury's stores. So we will open 250 Argos shops over the next period of time and we will complete that programme 6 months earlier than we originally said, which of course means we will deliver the synergies 6 months earlier than we originally said, in 2.5 years rather than 3 years.

Just to give you a little bit of flavour about replacement stores. So this is Hereford. We moved the store a mile, closed the old store, opened an Argos store in the Sainsbury's store and we have seen actually a sales increase because generally speaking Sainsbury's stores attract more footfall and therefore customers are more inclined to want to shop at Argos as a result of that. So we have seen a sales increase of 2.5 per cent. We are actually seeing an improvement in the Argos product availability with a more efficient stock holding. And a not insignificant reduction in operating costs. So in that site we have saved £280,000, as a result partly of the rent role, but also being more efficient in the way we operate the store. So that is worth as I say £280,000, a 6 per cent reduction in the operating costs of the store. And again as I have said already, we see the halo effect on the supermarket sales of between 1-2 per cent. So that is why we are driving hard at this opportunity and it gives us a lot of confidence now about the substantiation of the business model we put to the market when we first acquired the business.

And it is a digital business. It is incredible how quickly Argos is changing. The internet and mobile penetration is increasing fast. As I have said already, it is the 3rd most visited website in the UK. A billion annual customer visits and with mobile visits now up from 66 per cent to 76 per cent. Something like fast track delivery which we think is a unique proposition in the market place, the ability to order on your mobile phone and have it delivered to somewhere convenient to you within 4 hours, has grown by 59 per cent and fast track collections are up by 48 per cent. And indeed when you look at the Sainsbury's stores with Argos's in them, actually those numbers are higher. So that business actually is even more mobile, even more click and collect even more fast track than the underlying Argos business.

And outside the synergies I already identified, we think there are other significant opportunities. And I won't go through all of these, but as an example, international sourcing, the Sainsbury's Clothing and General Merchandise is roughly 40 per cent direct sourced. The Argos business is about half of that. So that suggests there is a significant buying opportunity, an opportunity to bring our buying offices together in the Far East and to do more direct sourcing.

We have got a great 2-man delivery service. So whether it is furniture or white goods, again that represents an opportunity that we haven't factored into our overall synergy case and we can grow the financial services penetration of the Argos business. It currently runs at about 16 per cent, but if you look at the kind of norm for many businesses in the same space, it is let's say around 25 per cent, so we believe that there is a significant opportunity through the Bank to grow the financial services business as well. But there are many other opportunities, so again as we look forward we think we can adapt the business quite significantly as well as delivering the synergies we have already outlined.

If I talk a little bit about the Bank. First of all it is a major asset for us as a Company. It is a business which has a strong brand and customers really trust. And they like giving us their money and they like borrowing from us. And of course we can use our customer data to help us manage risk, whether that is insurance or credit risk, but also it helps us significantly lower the cost of customer acquisition. So we get much better targeted customer offers and we also find our conversion rates are enhanced by the use of our transaction data. And again it is one of the examples where one plus one can make more than two. Where customers own a Bank product they will spend more money in our supermarket chain, whether that is a credit card or indeed a house or pet insurance product.

As I said already, the finance offer, the Argos Financial Services offer, has the ability, the opportunity to help us grow our Clothing and General Merchandise business, and we believe that is an opportunity to grow the penetration of consumer credit and will also help us drive our sales of the bigger ticket items and as I say that is particularly the case where we have a 2-man delivery service which we think is pretty competitive in the marketplace we operate in.

The business has performed well, so we have seen strong credit card and loan performance, new savings accounts up 60 per cent and that helped us finance the Argos book. We have changed our insurance model to have a pool of insurance providers which allows us to get much higher market penetration. The new Sainsbury's Bank website was launched in 2017 and we are seeing online visits up 50 per cent year on year. Travel money transactions up 25 per cent, the ATM estate grew by 5 per cent, so I think we give out something like one in ten of every pound note that is taken out through an ATM in the UK. And of course we have launched mortgages in April with a plan of getting to around 60,000 mortgages over the next period of time, as a way of balancing our loan portfolio in a more sensible way as we look forward.

And last, but by no means least, we are on track to deliver £500 million of cost savings. We will have delivered £130 million in this year to get to the first £500 million we need to save another £155 million during the course of this year and they come from lots and lots of little projects. There isn't a silver bullet, I think in the past we have talked about around 80 things we have been doing, whether it is investing in online picking systems or energy reduction or looking at the logistics flow within our supply chains, all of these things which require small incremental changes which add up to a very large number over a period of time. And we are also confident we can deliver a further £500 million from the beginning of the next financial year and for the subsequent 3 years roughly at a rate of £165 million and we stand by our track record of being able to deliver that. I think we have got a pretty consistent track record of delivering cost savings that we set out.

And that means that we have maintained and indeed improved our Balance Sheet strength. So as Kevin has already outlined, we would expect our core retail capex, including the business as usual capex with Argos to remain around £600 million. We have an increased focus on maintaining and improving our cash flow. We would expect to see our net debt to reduce over the medium term. We have got pretty stable balance sheet metrics and we continue to pay a dividend. And if you have been a Sainsbury's shareholder for the last 5 years you would have received 69.5 pence in the form of dividends. And again, we believe that makes us an attractive investment and will maintain the underlying dividend cover at two times.

And of course I have talked about the in individual components within our organisation and I have talked a little bit about how we see some of them joining together. But we believe we can join this Group together, particularly through the use of our customer data to share across all of our organisation, and also by consolidating areas within our back office, for instance our HR teams or our finance teams and we have already made quite a lot of changes in our organisation to make that happen. So with 26 million customers a week, we know our customers better than anyone else and we can simplify the shared services across the Group and really harness the opportunity, not just in the individual businesses, but on a Group wide basis. And as I say, as I have gone through the presentation, hopefully I have given you some flavours of how the one plus one, plus one, plus one can equal more than three.

So in summary, it has been a pivotal year, lots of changes. We have made some brave decisions about things we will stop doing. We have acquired the Argos business which we think gives us a platform for growth in the future. The food performance has been resilient in a challenging market and a market that we expect to be challenging for the foreseeable future, but we continue to adapt our business to that changing market dynamic. And we would expect having replatformed the Bank and having done the hard yards, to see strong profit growth out of our Bank over the next period of time.

So that is it from me, I think at this point we are going to open up to Q&A. So Kevin and I.

<u>Question and Answer Session</u>

<u>Question 1</u>

Bruno Monteyne, Bernstein
Good morning. Bruno Monteyne from Bernstein. Three from me please. If I read your guidance correctly, are you really implying that H1 of the next for the current financial year, will be the low point of profitability for Sainsbury's?

The second one is you are generating about £350 million of retail free cash flow with guidance for flat net debts, so where is the use of that cash going out of the free cash flow?

And third of all, could you indicate a little bit the size and the growth of click and collect and online food? Is it of the order of about 10 per cent of the overall? Is it growing 2-3 times faster than the rest of online market? Can you help us size a little bit what rate that is changing the online food market? Thank you.

Answer: Mike Coupe
Shall I do the third one and then the good news is Kevin can do the first two. So yeah I mean it is still a relatively low level of the Sainsbury's grocery business, so less than 10 per cent albeit growing in penetration and we are now at around 200 stores. So it is something that our customers demand of us but it is particularly important at certain times of year. So it does allow us to offer more capacity in the run up to Christmas and the other big seasonal peaks. So what we have found during the course of the last year is penetration does

increase quite significantly in the run up to Christmas because it is just a more convenient way at that time of year for shopping for your groceries. Of course the Argos business is very much founded on the idea of click and collect and it is one of the things that we think is unique in our offer, the combination of that 4 hour fast track delivery window and the fact that with a combination of the existing Argos real estate and of course the Sainsbury's real estate, you have got a fantastic array of points of presence, places that customers can pick things up from and we would expect over time that that part of the Argos proposition will grow and of course help drive the supermarket business.

Further question:
Out of the 8 per cent online food growth you quote would the click and collect be a material contributor to the 8 per cent?

Further answer: Mike Coupe
It would be small in the overall scheme of things. The online growth has been driven by 12 per cent order growth offset by a slight reduction in baskets albeit actually the reduction in basket size has started to stabilise. One of the things we have done is to link our recipe menu site directly to our online site and that is one of the things that has helped us drive the number of items that we are selling within our online groceries business. And it is one of the things that gives us some belief in the possibilities for the future. Kevin on the first two?

Answer: Kevin O'Byrne
Yeah just on your cash question Bruno, clearly the focus on generating free cash flow and then we make some choices, pay the dividend, buy freehold properties if we think there is good development opportunities or invest in the Bank. And next year the two that we see is definitely dividend and investing, injecting capital into the Bank which will broadly leave us neutral if you like when it comes to net debt.

And then on the first point about the shape of profits next year, it is an unusual year because in the first half we will get the impact of changes made on prices and on salaries in the second half of this year will come through in the first half and bring the first half down relatively to last year. And we have got the Argos losses in the first half. Of course we will have some synergy savings coming in, but they are somewhat weighted to the second half as well which means the second half gets the benefit of the synergies and does not have those other drags relative to the second half of this year.

Mike Coupe
Which has made it a bit more difficult for you, rather than just taking the first half and doubling it; you now have to do a little bit more work to get to the numbers.

Question 2

James Tracey, Redburn
Hi Mike, hi Kevin. James Tracey from Redburn. Two questions from me. The first one is on the evolution of market share in the grocery business. So it looks like you have been losing market share for the past 44 weeks. If we had this discussion perhaps a year ago, you were broadly holding share and before that it was gaining share. And so are you happy with this? Do you expect it to change any time soon?

The second question is on the EBIT margins. Excluding Argos and looking at the supermarkets business, they fell slightly more than 50 basis points in the second half versus 20 basis points in the first half. Your new guidance seems to be indicating a similar 50 basis point or so decline in the first half of the coming year. How do you expect to evolve going forward in the second half of the coming year and future years? Thank you.

Answer: Mike Coupe
So I will take the first one and Kevin can comment on the second one. I mean clearly we don't like losing market share and we would point, as I have done at the beginning, at our relative resilience in what has been an extremely difficult and challenging market. And I suspect for the foreseeable future that will be the case. We need to continue to adapt our food business in that environment. So the success is, we have invested in Convenience stores and they continue to do well. We have already talked about online groceries and we are starting to make quite a lot of changes in our underlying supermarket business. So not only the Argos concessions, of which there will be well over 100 Argos stores within Sainsbury's stores over the next period of time, but also around 60 refurbishments. And all of these things will add to the appeal of the underlying supermarket business. And of course it is inevitable against the backdrop where some of our competitors are in some form of recovery, but judge us as we have said a million times before, in the long-term, because we believe we are building a resilient business model, we have made some pretty courageous choices about how we want to run that business on a much less promotionally driven basis, much more stable basis and we believe over the long-term that will pay off. Of course we are only just annualising literally in the last couple of weeks, the removal of all the multi-buys in our business as one example. And we will see how the performance plays out over the next period of time. But the components are there. There are things we cannot control, inevitably, but actually we have more of the levers in our own hands today than perhaps we would have had even 6 months ago and we intend to pull those levers as hard as we possibly can over the next period of time.

Answer: Kevin O'Byrne
And James one other comment on that, while we are never complacent about shares, you can imagine you have to look at some of the changes in things like alcohol and you can change your share in a quarter with some special deals. It is over the medium term we are more concerned.

On the EBIT point, there is no new guidance today to be clear. The pressure that you are seeing in the H1 we talked about is because of the decisions we made in H2 which we guided to round the price investment and the increase in salaries which went through in August of about 4 per cent. So we are just seeing that flowing through into the first half of next year.

James Tracey
Thanks guys.

<u>Question 3</u>

Niamh McSherry, Deutsche Bank
Thanks, Niamh McSherry, Deutsche Bank. I had two questions. The first one is on the 13 relocations Argos. I was wondering what is determining the kind of pace of store relocations. Is it a complex job and would you have capacity to accelerate that now that you are more comfortable with the results?

And then the second question was actually about recent trading. So we had some Kantar data out this morning which suggested that April was a very strong sales growth for the market. And I was wondering, obviously there is Easter timing impact, but even taking that into account, it appears that there is strong growth in UK groceries. I wonder if you had any comments on consumers shopping behaviour recently.

Answer: Mike Coupe
Yes, I mean the criteria for the relocations driven by a combination of things. One is how easy to do, you are right. Secondly how attractive is it, but probably more significantly, when

does the lease run out of the one you are planning to relocate. So we triangulate all of those three things and have a programme laid out for the next period of time. I am sure that programme will change it inevitably does. But we have got a pretty clear idea of the sort of running order, the batting order of what things we are going to do and when.

Going for 250 over 2.5 years is no mean achievement. It means that we will be doing, when we can, outside Christmas and outside the main holiday seasons, around 4-5 stores a week we will do, 4 this week as an example. Which is probably about the limit of our capacity. If we can do them faster we will, but I think at 2.5 doing it in 2.5 years given the underlying physical constraints, that is going some.

As far as the Kantar data is concerned, I would not get too carried away at this point. We have said it before in our last quarterly Trading Statement, Easter and the timing of Mother's Day is incredibly significant. It is unfortunate the way that our financial year end fell. You will have to wait and see when we next publish our quarterly trading statement which will be now at the beginning of July. And by then I suspect a lot of the noise, the pluses and minuses of the timing of Easter, the timing of Mother's Day, the timing of the various bank holidays, the pay days, will have worked their way through the system. So I would not read too much into the data if I was you. It does look strong on the face of it, but it is significant skewed. I have not looked in any detail at it, but I suspect it is significantly skewed by the timing of Easter and the timing of Mother's Day.

Further question
Great. Just back on your 250 stores comment, I think that is all new stores and I am asking specifically about relocations?

Answer: Mike Coupe
Yes, we haven't broken out the number of relocations as part of that 250.

Further question
I guess the question simply is, can you do it at a faster pace than you have done in this first 6 month period? Do you have the bandwidth for that?

Answer Mike Coupe
Yes without being specific about the numbers, you would not expect the number of relocations, the 13 out of the 59 to remain at that kind of proportion; you would expect the number of relocations to go up and pretty significantly over time. We have been unhelpful or circumspect about being specific about the number of relocations simply because we want to make sure that our colleagues hear first from us. You have got 40,000 people who have been acquired by another business and we want to make sure that they have got confidence in us as a leadership team. One of the great things about the relocations that we have done is that we have been able to place everybody that has been affected by that change somewhere in our organisation, usually in the relocated store, but sometimes somewhere else. So that gives us confidence, but it is important for us that our colleagues hear first and we don't make some kind of announcement about the number of stores we intend to relocate. But what I would say is it would be more than 13 out of 59 or 13 59th as we look forward.

Niamh McSherry
Great. Thanks.

Question 4

Dan Ekstein, UBS
It's Dan Ekstein from UBS. Morning, I have got two questions please. In the past you have talked about when all is said and done with the strategic plan an ambition to deliver a 3-3.5 per cent margin for the Group, could you sort of just talk about your confidence in that today?

And also in terms of direction of travel within that, retail ex-synergies, do things stay the same to deliver that? Do they get better? So within that 3-3.5 what is the direction of travel in terms of retail margins ex-synergies?

Second question, Argos is performing as well as you would have hoped at the top end of expectations. You have given a little bit of colour in the Presentation, could you be a bit more specific about the areas where it is performing better in terms of the concessions? Is it infill's, is it relocations? Is it range, is it cost, is it margin? I think that would be interesting. Thanks.

Answer: Mike Coupe
Well I will have a go at both of them but Kevin might want to comment as well. Yeah we have stuck by what we have said previously, that we believe that Sainsbury's as a Group can deliver margins of 3-3.5 per cent over a 3-5 year period. And you can see the building blocks very clearly from the slide that outlines the 4 areas that we think we can do that, whether it is the underlying resilience of the food business, whether it is delivering growth in non-food and delivering the synergies through the Argos business. Whether it is growing the profitability of the Bank or indeed delivering another £500 million of cost savings. If you add all of those up, some of which you will have to estimate, but if you add all of those things up you get to a number which is substantially higher than the 3-3.5 per cent and inherent in that is some assumption without being specific that we will need to invest in areas of our business whether it is the quality of the products that we sell, whether it is prices or whether it is in colleague wages is another example. So I don't think I can give you a direct answer to your question, other than we have many of the things that we need to do to deliver the 3-3.5 per cent in our own hands. We can't mitigate for market conditions inevitably and I would always caveat whatever I am saying by making that point. But if you add up all of the components that we have talked about and then you discount for some of the things we will need to do in our business as we look forward, some of which have not come our way yet, but I am sure will at some point, you can kind of get to those numbers over that period of time.

I guess as far as the Argos business is concerned, you listed a load of things and I would kind of say all of the above. You know, whether it is improving underlying availability, whether it is improving the digital proposition so that the business has a great digital team that is constantly iterating and improving the way that we market to our customers. The in-fills and relocations are performing as we would have expected them to. So nothing dramatic in terms of one particular piece working better than the others. And again I think we have been pretty up front about the areas that we have seen the business growing. So big ticket electrical, mobile, wearable's, whatever the Play Station was that was launched recently which I can't remember off the top of my head. All of these things are things which have driven the business. And in many of the sectors we operate in, we have grown market share. So not only have we grown the business well, we have also grown our market share. So it is difficult to pick out any one thing. We have done a lot of work on improving business, we have got a great team of people led by John getting on and delivering the strategy. And above and beyond the things we have already overtly identified in our synergy case I have outlined again if you look at the slides, other areas, where we are not going to quantify what the opportunity is, but we believe there are opportunities as we look forward. I don't know if there is anything, you can add?

Kevin O'Byrne
No that's good.

Dan Ekstein
Thank you.

__Question 5__

Rob Joyce, Goldman Sachs
It's Rob Joyce from Goldman Sachs. A couple from me. First one just on the cost inflation in the year just gone. Can you tell us what that underlying cost inflation ran at?

And the second one is to elaborate I guess on the previous question. In terms of the grocery business, it looks like over the three year window of the current £500 million cost savings period, EBIT margins will be down broadly 80-100 basis points. Is that the way we should think about the grocery business over the next £500 million cost saving period? Thank you.

Mike Coupe
Do you want to have a go at both of these?

Answer: Kevin O'Byrne
Yes, just on the EBIT margin, I think just repeating Rob what I said earlier. There is no new guidance today on what is happening with the margin. So all we can see is what we can see at the moment which is the decisions we have made in the second half being reflected in the first half, the price investment etc. Clearly the world can change and we can't predict the future, so we are not seeing that changing.

As far as the price, we saw about a 2.5 per cent inflation and we are guiding broadly the same this year between 2 and 3 per cent. Clearly the one element which is impacting on the first half of this year more so is just the timing of the wage rise which was clearly an above inflation wage increase of 4 per cent. But underlying we saw around 2.5 per cent across the year.

Further question
And just very quickly to follow-up, I mean I guess on things like wage inflation, given the kind of targets for the minimum wage in the UK, is that 4 per cent, do we think of that as one-off or do we think of that as a kind of multiple year increase?

Answer: Mike Coupe
One of the reasons we have to make our business more efficient is that underlying pressure. And we don't know. There is a target that is being put out there. Whether or not that remains the target we will see, but we would endeavour to make sure that we pay our colleagues above the National Living Wage as it is currently called. And if you take the end point at £9 per hour as being a kind of target by 2021 you would get to that kind of number on-going. And that is one of the reasons why it is imperative that we make the cost savings and the efficiencies we need to make. But we have to look at it as an overall package. As I say the way that I would suggest you think about the business is to think about the component parts add it all up and then you, like we, have to make a kind of underlying assumption around where we might have to invest. But I am pretty certain that whatever plans we may have in our minds today and whatever construct you can come up with, it will almost certainly change and it will change very quickly. The important thing is from our perspective, we have got a lot of the levers, whether it is the cost saving initiatives, the delivery of profitability in the Bank, the Argos synergies, making our food business more differentiated and adapting it

to the changing markets, we have got a lot of those levers in our own hands, whilst we can't mitigate for some of the broader macroeconomics and customer dynamics.

Answer: Kevin O'Byrne
And Rob, maybe just one final point, we clearly in our cost saving targets as we look to simplify the business, we would be looking to more than cover the annual inflation.

Rob Joyce
Thank you.

<u>Question 6</u>

Andrew Gwynn, Exane
Hi, good morning, it's Andrew Gwynn from Exane. Let's go for 3 questions if I can. I will be a bit greedy. The first question a little bit connected to Rob's. Obviously we have the currency pressure working its way through. So could you just elaborate on where you are in that journey, maybe splitting it into the food and the non-food side of the business?

Second one, discounters unfortunately. If I get my ruler out and we go back to that chart where you think they will be in 2022, it looks like they are approximately double the size of where they are now. So is your intention just too sort of manage the decline or take a bigger share of the smaller slice of the market effectively?

And then the third one, I suppose the elephant in the room is the balance sheet. With the pension deficit obviously becoming materially bigger, still relatively elevated level of net debt, what do you think you can do on the balance sheet just to give investors a bit more confidence on the Group as a whole?

Answer: Mike Coupe
So if I take the first two and Kevin can have a go on the balance sheet. Yeah the currency pressure is there. I think we have talked about it ad nauseum. Some of the extreme rhetoric that was talked about hasn't come to pass because we have done, I suggest the market more generally has done, but we have done a particularly good job of mitigating costs within our supply chains and making sure that we look at all aspects of our business to reduce the impact as far as on-going retail prices are concerned. And I think as I say it is little short of remarkable how much has been mitigated through that process. I mean it is uncertain. You know we always use fuel as it is probably the easiest example to talk about the dynamics. On one hand you saw a significant cost and ultimately retail price increase post Brexit as a result of currency devaluation. We then saw the price come down because the commodity price, the price of oil had come down. And as we sit here today, fuel is about 10p a litre more expensive than it was a year ago. But it is 5p a litre less than it was at the peak somewhere earlier in this calendar year. And that is true then of many other commodity markets. And you know we have seen the value of the pound go up a little bit and therefore perhaps some of the other dynamics get mitigated to some extent. So we stand by what we said. Our job is to make sure that we don't pass on input prices as far as we can to our customers, but we will be the first to acknowledge as we said at our Quarter 4 Trading Statement, we are seeing price inflation and you would see that again today, albeit the rate of food price inflation has dropped from 1 per cent to 0.9 per cent I think in the index that was published this morning.

As far as the discounters, we have again never shied away from the fact that we think the discounters will get to 15 per cent of the market and indeed the charts that we showed, that I showed in this Presentation is now 2.5 years old. And actually the shape of it hasn't materially changed since we presented it 2.5 years ago. And therefore the underlying premise for our food strategy of investing in the areas of growth like Convenience stores, like

Online groceries continues to be the case. And to adapt our supermarket chain and find different ways of utilising our space so that we can continue to make our supermarket stores attractive places to come. And that is one of the reasons why we made the Argos acquisition, it is one of the reasons why we continue to invest in Clothing and General Merchandise, but also within the food offer things like Sushi Gourmet, things like having a relationship with Patisserie Valerie and things like launching 3,000 new products, things like simplifying our pricing etc, etc. All things that we believe should allow us to remain in a good position as we look forward. But it is inevitable that the supermarket sector will become a smaller part of the grocery market overall. We have never shied away from that and our job is to make sure that we can do everything we can to mitigate that risk as we look forward.

Answer: Kevin O'Byrne
Just on balance sheet just quickly. Andrew I guess, I probably would challenge a little bit about the starting assumption that we have got a weak balance sheet. That is not to say that we would be complacent and would not want to strengthen it. But when I look at the balance sheet with £10 billion of freehold property and just under £1.5 billion of debt and the pension deficit we talked about £850 million, I would not describe that as a weak balance sheet. Our focus will clearly be on driving free cash flow and looking at what we can do in areas like stock and areas like capex. And you have seen that our average capex over the last 5 years was something like £930 million a year and that is dropping to £600 million. And clearly we are looking at capital light ways to develop the business, things like the franchising with Euro-garages and we will continue to do that.

If you look at the pensions, we have injected £324 million this year alone into the pensions, that will drop to £124 million so annual payments. And we will work closely with the pension trustees to make sure we have the right investment strategy, they have the right investment strategy that manages that cost from a Group point of view, but it is clearly very manageable and we will stay close to it.

Answer: Mike Coupe
You can see, Kevin showed the chart that shows how the pension deficit in the way it is calculated, has bounced around all over the place in the last year. I think at the low point it was £300 and something million. I think at our half year it was something like £1.5 billion and so it is very much dependent on the on-going annuity rates.

Further question
Just very quickly, on the first question, how far are we through the cost transfer? The currency weakness specifically.

Answer: Kevin O'Byrne
Are you talking about hedging Andrew?

Further question:
Not necessarily hedging, but just in terms of to the extent that you have had cost increases coming through as a result of weaker currency. Has that now more or less fully washed through the business on the food and the non-food side or is there more pressure to come?

Answer: Mike Coupe
The way you characterise it, it sounds like it is something that started and at some point is going stop. That is not the way I would characterise it. It is a constantly moving landscape. Clearly there was a direct and in some cases immediate impact of the currency devaluation, the devaluation of sterling. To some extent in some categories we were hedged and we have talked again very openly about in some parts of our business being hedged for a year. So you know you might expect some of those positions to unwind. But to characterise it as something that somehow is going to finish, there are so many moving parts, whether it is

underlying commodity prices, currency fluctuations. I suspect it is a never-ending, well it is a never ending dynamic that we have to actively manage. But I would argue very strongly that we as a business have done a pretty good job of both absorbing those underlying cost pressures and not passing them onto our customers, and maintaining all of the numbers that we have talked about during the course of this Presentation.

Andrew Gwynn
Okay, thank you.

Question 7

Nick Coulter, Citi
Morning, Nick Coulter from Citi. Two from me please. Firstly on the capital injections into the Bank which I think you guided to between £160 and £190 million for 2017/18. Clearly that is a material amount and a big drain on the free cash flow. Could you say what the return criteria is for that capital allocation? Also beyond 2017/18 how much more we are going to see because clearly those amounts and costs are way ahead of the initial projections when you bought in the other half of the Bank?

And then secondly, just to clarify on the volume uplifts in the range review categories. Did you say 2 per cent for the ranges thus far? And is that across the ranges or just within certain elements of the range categories that you have reviewed?

Answer: Mike Coupe
On the second, I will ask Kevin to talk a little bit about the first one. But on the second one, the Sainsbury's standard own label products, so By Sainsbury's volume in total went up by about 2 per cent last year.

Nick Coulter
So that is roughly half of that category then basically?

Answer: Mike Coupe
Well it is about half, our standard own label business if you take out Taste the Difference, is probably around forty something per cent of our business.

Further question
So within the branded element you have also changed presumably the branded element of those categories. You haven't seen an uplift there?

Answer: Mike Coupe
Broadly speaking, the business if you characterise the business, it has become a little bit more Own Label and a little less branded in the last year by that factor. So whatever volumes have gone up in the Sainsbury's Own Label products, particularly By Sainsbury's would have come down broadly a corresponding amount because it is roughly 50:50 in terms of the split between the two parts of the business.

Nick Coulter
Thank you.

Answer: Kevin O'Byrne
Just on the Bank, as you say, we are forecasting injecting between £160-190 million. There are three reasons for the injections this year. There is a regulatory amount of capital which is probably the smallest, well it is the smallest element of it. It is about £60 million on the system changes as we develop loans platform and the cards platform, and we have ear marked around £70 million for growth as we grow the loan book we have to put more capital

in to help grow that. We are targeting about 15 per cent, mid-teens return on invested capital. We would expect to see it slightly lower than that through 2018/19 as we do this investment phase. And then increasing in years 3,4,5 as we go out. And one of the things you will see improve a lot there is this cost ratio as well which you saw at 72 per cent today. That is clearly, we are investing ahead of growing the business. And if you look at other peers in the marketplace you will see significantly lower figures. So we will see that going through.

Further question
So are you saying basically we will see hundreds of millions of capital injections in the Sainsbury's Bank over the medium term?

Answer: Kevin O'Byrne
I can't sort of forecast. My estimate this year would be a high and then you will see it coming down in the next few years and that will depend largely on the growth of the loan books and clearly in the current environment we have ambitious plans for the Bank, but we also need to just be careful as we see how the environment changes from a lending point of view. But I could see it being maybe half of what is going in today per year in the outer years, but it's probably a bit too soon to be really clear on that, but it will reduce.

Further answer: Mike Coupe
I will just reinforce the point that Kevin made at the end. We believe the business; the outcome for the business over the medium to long-term will be a very attractive return on equity or return on capital invested, otherwise we would not be making those choices. It is fair to say and I think we would hold our hands up. It has taken us a year and a half to two years longer to make the transitions we have made but actually a lot of the hard yards have been done and we have the platform for future growth. So yes there is an element of jam tomorrow about this, but actually having done the hard yards, we believe and we would not be making the investment unless we believed that we can get a pretty attractive return on the capital that we have injected, albeit later than we would have expected.

Further question
Can I just follow up on a maturity profile of debt as well? I think it is a couple of years since those have been extended. Are you comfortable with the maturity profile and do you expect to have to do any work in that area?

Kevin O'Byrne
In the Sainsbury's Corporate debt?

Nick Coulter
Yes.

Answer: Kevin O'Byrne
We have got some debt as you know, relatively short on the Eddystone financing and we will look at that over the summer as I settle in and decide what we do. We may or may not need to refinance all of that, but comfortable as we stand today.

Nick Coulter
Okay, thank you.

Question 8

Stewart McGuire, Credit Suisse
Good morning, it's Stewart McGuire Credit Suisse. If I may a clarification before I ask my questions. The second part of your capital for the bank, you said £60 million in system changes, is that non returning capital i.e. you are not going to get a return on that?

Answer: Kevin O'Byrne
No when I talk about the return I am including that capital that is building the platforms to separate from Lloyds Bank so that is the cards platform, which we would expect absolutely to get a return from.

Further question:
Okay thank you. And now three questions. So first question. They are all regarding Argos. The case study, you had £280,000 of annual cost savings, can you say whether that is estimated to be typical for a relocation?

And secondly, on the other relocated Argos stores that you have had, can you give us a little bit of colour on what the sales impact has been from closed to then reopened within Sainsbury, if there has been a positive or negative impact?

And then finally, the 250 relocations that you have talked about seem to be related to timing of your three year programme. Are there any reasons why this number could not continue increasing over time? Thank you.

Answer: Mike Coupe
Yes, I have to be slightly careful about what I say about the first one, because we have actually given a synergy number associated with the relocations and therefore you can back solve the arithmetic. So it would not be atypical, but I would not go as far as to try and avoid answering the question and be slightly more circumspect at the balance between relocations and new sites. But we did back-solve the arithmetic so it made enough sense for it to not to be completely implausible. We did not want to do a Diane Abbott this morning! So avoided that.

As far as the Argos impacts. I think we have put it explicitly up on the slide, wherever we do this we see an average of 1-2 per cent halo impact as an improvement on the Sainsbury's 'old business' so whether that is Clothing, General Merchandise or the grocery business more generally. Clearly there will be outliers, having done 59, but we are seeing a pretty consistent result as far as that is concerned.

And the last question which is, yes we have done 250 location, or we will do 250 locations and a proportion of those will be relocations, a proportion will be new sites and if we think there are more to do we will tell you when we are ready to tell you, but you can draw your own conclusions from that answer because I suspect when it actually comes to it, we will continue to adapt the model and I suspect there will be more to come at some point in the future, but that will be making myself a hostage to fortune. Let's get on and do the next 2.5 years and then worry about what we do next over the next year to 18 months.

Further question
Just to clarify, the sales impact I was talking about was actually at Argos. So if you had 100 sales at the old Argos stand alone, and then you relocate it within the Sainsbury, are those sales still 100 or do they drop a little bit or increase a little bit?

Further answer: Mike Coupe

Well the slide we showed in the particular case was the 100 became 102.5, so there was a 2.5 per cent increase as a result of relocating the store or closing the store and then relocating it in the Sainsbury's store. There are pluses and minuses, but the important thing from the synergy investment case is concerned, is that in effect it confirms the case that we put to the market and that enhances our confidence that we can deliver what we said we could deliver and it was the only variable that we didn't have our arms around when we bought the business. We already knew what opening a new store in a Sainsbury's store would do, but we did not know what would happen when we closed a store and moved it.

Perhaps the other thing just to reflect on is it is not quite as straightforward as you close one and you move it into a Sainsbury's store, you actually see the turnover redistributing in a way that presumably satisfies whichever customers we were serving in the store that we closed. So it is not just about transferring the stores, the sales into Sainsbury's stores, we quite often see uplifts in geographically co-located Argos stores as well. But the quick answer to your question is 100 becomes 102.5.

Stewart McGuire
Thank you.

Mike Coupe
Are we done or do you want to go round again? Well thank you very much everybody. I am sure we will get a chance to talk to you individually and collectively over the next period of time. Thank you.

End of Presentation.