**J Sainsbury plc – Q3 Trading Statement**
**Wednesday 10th January 2018 – 8.45am**

**Mike Coupe**
**Chief Executive**
Good morning everyone and Happy New Year. Welcome to the Quarter 3 Sainsbury's Trading Update Call which covers the 15 weeks to January 6th. I am joined here today by our CFO Kevin O'Byrne and I am going to ask Kevin to run through some of our Q3 highlights in a moment and then we will hand over to you all for Q&A. Kevin.

**Kevin O'Byrne**
**Chief Financial Officer**
Thanks Mike and welcome everybody. I will now take you through the key numbers. Turning first to like-for-like sales growth. Retail like-for-like sales grew 1.1 per cent over the quarter, slightly ahead of the 0.6 per cent we reported for Q2. We have also disclosed total sales growth for the three product categories, groceries, general merchandise and clothing.

On grocery first, we have seen a good performance over the quarter reflecting a strong operational performance with great availability in stores and strong online growth. Grocery sales grew 2.3 per cent, a better performance than Q2 with a broadly unchanged inflation contribution, so an improved volume performance quarter on quarter. We continue to generate strong growth in our online business up over 8 per cent and our Convenience stores up over 7 per cent.

General Merchandise saw sales decline of 1.4 per cent outperforming a weak market despite the continuing drag on sales from the closure of the Argos stores in Homebase stores. That impact accounted for the majority of the sales decline and was broadly in line with Q2. So this represents an improvement from Q2.

At Argos we saw a second year of very strong growth from our market leading fast track delivery and collection offer over the peak Black Friday and Christmas trading periods. And we continue to be pleased with the performance of the Argos stores inside Sainsbury's Supermarkets. The stores in their second year of trading are delivering average growth of 15 per cent and stores in their third year are showing average sales growth of more than 30 per cent, higher than across the two year period. A good number suggesting consistent maturity of these stores as customers become more accustomed to using them.

Market conditions weren't easy over the quarter with weakness across the whole market in some key categories like toys, but we had great availability and strong growth in areas such as video games, smart audio and mobile phones.

Finally on Clothing, headline sales growth of 1 per cent was impacted by the well documented warm weather period in October, but consistently outperformed the market with stronger growth through the remainder of the quarter.

So overall a good trading performance through this key quarter and good progress with the Argos integration. So we are expecting a higher contribution from synergies this year than we have previously guided. As a consequence we have stated that we expect underlying profits for this year to be modestly ahead of the published consensus of £559 million UPBT.

We will now open the call up for your questions.

**Question and Answer Session**

**Question 1**

**Bruno Monteyne, Bernstein**
Happy New Year Mike and Kevin. Three questions from me. So if I look at the negative growth in general merchandising, could you quantify how much is that due to the space impact of whether it is closing some general merchandising space in stores, moving stores around. How much of the decline is due to that?

Which leads into my second question which is, do you see any impact of weakening consumer confidence in general merchandising? Are there any categories where you can say, yeah we see softer demands?

And my third one is on the synergies, you are clearly bringing them forward, is there no indication that the synergy will be higher given how much quicker you can read them or are you very firm they are definitely not going to increase any synergies? Thank you.

**Answer: Mike Coupe**
Well I will talk about weakening GM and ask Kevin to talk specifically around the sort of space in and outs which is slightly complex so we can work it out. And in answer to your last question, we committed to £160 million and we will deliver them as fast as we possibly can and then we will draw a line under that and get on with managing our business on a day to day and month to month basis. So this is a bringing forward synergies as you quite rightly talk about.

I mean in terms of the weakening marketplace, clearly where customers are finding their disposable income being squeezed a little bit, where they can defer certain purchases, they are, and I think we can see that reflected in things like car sales. If you look specifically at categories, actually tech was reasonably strong so things like games consoles and some of the more new tech stuff, I think overall the performances were strong. Where we saw weakness was probably in things like toys where certainly year-on-year there was probably a bit more pressure in the marketplace. Whether that was because people were buying games consoles instead of toys, quite difficult to unpick. But that was kind of the area that felt like it was under most pressure.

And I think you can see from other people’s results perhaps again areas where perhaps the market was a little bit weaker, certainly clothing is an example, with the warm October that was pretty challenging. But the quarter actually got better as the weather got colder and people were then able to then to buy scarves and gloves and woolly jumpers which is always helpful to our business.

But if there is one category we would kind of pick out it was toys, but that was offset by games and things like tech and wearables and those types of technologies. On the GM space I'll ask Kevin to

**Answer: Kevin O'Byrne**
Well as I just said, it is the majority of the decline is due to sales growth, I think you can probably infer from that it is more than 100 bps points and clearly we closed Argos stores that were inside Homebase stores. We also closed some stores in the estate as we went through the period so we are in a sort of complex period of, we are going through this change but I think the majority would point you in the right direction.

**Further question**
Okay, none of that sounds very much like you are feeling a big consumer squeeze just yet in your consumers. Most of the impact you are seeing is either self inflicted on space or the weather from clothing. Is that fair enough?

**Answer: Mike Coupe**
Well we have grown our market share in general merchandise and grown our market share in clothing, but if you unpick to the underlying markets, I think you would find that both general merchandise in its general sense, in its wide sense and indeed clothing would have been challenged in the quarter and I think we will see that reflected. And we have seen it already reflected in some of the results announcements of others.

This time last year we saw close to 4 per cent growth in the general merchandise business so the comparatives were relatively tougher. But I guess the fact that it was broadly speaking flat year-on-year versus 4 per cent growth last year would probably be reflective of how consumers are feeling and how they are perhaps just starting to be slightly more thoughtful about some of the discretionary purchases they are making. And realistically you would expect that to be the case for the next 6-9 months.

**Bruno Monteyne**
Okay, thank you.

**<u>Question 2</u>**

**Clive Black, Shore Capital**
A couple of questions if I may just about the part of the grocery business. Firstly, are you able to just give an update where the Convenience and Online combined grocery extended a rough participation in the business at this stage?

Secondly, could you perhaps characterise how you saw the mix of the grocery business over Christmas? Did you feel year-on-year people were enjoying themselves to the same level or trading up or whatever?

And lastly, in that respect, how did your private label perform within the grocery business? Thank you.

**Answer: Mike Coupe**
I think on participation, online is around 7 per cent of the grocery business and Convenience is about 12 or 13 per cent so roughly 20 per cent of the business in online and Convenience and that has probably doubled in size over the last five years just to put it in perspective.

Actually we had a good performance in Taste the Difference. You will know that we significantly over trade in the premier end of the market, but we saw 6 per cent sales growth on Taste the Difference. We saw growth in our Own Label products overall. I haven't got a number off the top of my head, I am just looking at Kevin if we can give you a specific number in terms of the growth of the Own Label participation. So actually there was a general sense that customers were prepared to trade up over the Christmas period. I think that is reflective of the offer we had within our Christmas ranges. But when we look at the growth our Taste the Difference product ranges, you always have to remember that that is from a much higher base than many of our competitors. We massively overtrade in Taste the Difference compared with our mainstream competitive set.

**Further question**
And sorry a quick...

**Further answer, Kevin O'Byrne**
Sorry just to add there just picking up on Mike's point, we saw the participation of Own Brand in the mix growing by about a percentage point in the mix, so good growth.

**Further question**
Thank you very much. And then just very quickly guys, how was availability over Christmas? Maybe there was some mischief out there, but there was one or two photos flying around of empty shelves in one or two stores. Was availability consistent year-on-year or any different to that?

**Answer: Mike Coupe**
No we would take completely the opposite view. We thought we did a spectacular job of managing our online, sorry, our overall operational standards including availability and we did it in a context where we actually saw our Christmas waste performance at record low levels. So we think we did a good job. There are a couple of stories that always get written post Christmas. The first one is the rancid turkey story which somebody else got nailed with and secondly it is pretty easy, you could do it on a Saturday afternoon if you really wanted to in most grocery stores of taking photographs of empty shelves.

We actually thought our post Christmas recovery was pretty good and better than it was last year. So no worries from our perspective. You know as well as I do that we basically sell out of many, many fresh food products completely on Christmas eve and we reopen our shops in many cases on Boxing Day and in effect have to refill them, particularly in the fresh food area from scratch. So that is by no means a small undertaking. So inevitably if people wanted to they could take photographs of empty shelves and in this particular case a journalist or some journalists chose to do so, but we were in fact more than pretty pleased. We thought we did a very, very good job, probably the best job I have seen in my time in Sainsbury's of managing of both the operations, whether that is the Sainsbury's food business or indeed the Argos business as well.

**Clive Black**
Okay, thank you very much for that guys, well done.

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

**Sreedhar Mahamkali, MacQuarie**
Morning, hi, a couple of quick questions please. In clothing you suggested it is to be expected growth in October, but can you talk through an exit rate please? Was that back to Q1/Q2 levels?

And the second one, in terms of inflation, are you are able to give a sense of what it was? I know Kevin you said on the wires that market inflation of 3.7 which I think you are quoted in Kantar. But more broadly, what level of inflation do you think yourself and the market could start to be a bit of a tipping point with consumers getting out of traditional grocery stores into discounters? Is there something that looks like a concern for you or not really at this stage?

**Answer: Mike Coupe**
Maybe I will ask Kevin to reflect on the second of those although I might chip in as well. We don't, we would never give you an exit rate on any part of our business so sorry I can't really help you with that. What I would say is that remember it is a 15 week quarter and I think any market data would suggest October was particularly challenging for the clothing business. And you can surmise from that that the performance of our clothing business got better as the quarter progressed. And if you compared let's say the 54 days that Next published with our performance, would have significantly outperformed the numbers that they talked about last week. So without giving too much of the game away, clearly the performance has got better as the quarter progressed. And that is not least because it got a lot, lot colder at the back end of November and early part of December.

Maybe Kevin can just reflect a little bit on inflation and I might come back on the sort of the competitive dynamic.

**Further answer: Kevin O'Byrne**
Yeah as we said, we saw a situation where inflation was a little bit below what we are seeing published in the market and we are pleased that our value position improved versus key competitors during the quarter. We are also seeing quite rational markets, you know if you look at things like dairy, where there is some commodity pressures, we are seeing people act rationally right across the piece, whether it is the discounters or the big four or other chains. And I guess we would expect this in the second half of this year we would see a lot of the inflation pressures we have seen, largely driven by currency will have flown through. So

hopefully a more, if ever there is a normal market with the usual ups and downs of commodities and seasons etc, probably more into a more normal situation.

**Further Answer: Mike Coupe**
Yeah and I think the sort of pig has probably gone through the python as far as the sort of the Brexit related currency changes and the pressure that has had on input prices. We live in uncertain times so who knows what is going to happen over the next 3,4,5,6 months in the political arena and what that may or may not do as far as either commodity prices or indeed exchange rates. But all other things being equal I suspect we might see inflation gradually drop out of the market over the next 6-9 months.

Again in terms of our business strategy, whilst investing in making sure that we maintain our very high operational standards and the quality of the products that we sell, we did make some quite significant price moves pre-Christmas, so amongst the lowest turkey prices, 25p veg. And indeed again we have realised some prices in the last few days to be much, much more competitive on some key commodities relative to the discounters. And we have been able to do that in the context of also upgrading our profit forecast for the year. So we think we are doing pretty good job of delivering against the synergy number, of lowering our costs. And we talked about last time, about increasing this year the delivery of that by £40 million and that gives us the wherewithal to pay our colleagues more money and also to continue to make our proposition more competitive.

**Further question**
Thanks. Very quickly to come back on the point Kevin you made, value position improved. Are you able to give a sense, versus who and how much perhaps? Maybe that is too much to ask, but give us a bit more if you can?

**Answer: Mike Coupe**
No. Well maybe a little bit. You know we would say relative to the discounters actually our value position would have got stronger in the quarter. And relative to some of our mainstream competitors and you can choose which ones you might want to look at. I think the Kantar data actually might give a few clues, some of the published data might give a few clues as well. But generally speaking in the round our overall value position has got better during the quarter. And clearly with some of the investments we have talked about in this week, we would expect that to step on again over the next quarter.

**Sreedhar Mahamkali**
Thank you.

**<u>Question 4</u>**

**Kiranjot Grewal, Bank of America, Merrill Lynch**
Morning. Could you maybe give us some colour on what the speed up of synergies this year was driven by?

And also you mentioned Argos with record sales over Black Friday, maybe some colour on how much the sales improved or to what extent are the Black Friday sales dilutive as well? Thank you.

**Answer: Mike Coupe**
Unfortunately you broke up, I think you asked for more colour on where the synergies came from and maybe Kevin can talk about that.

We won't put a lot more colour on Black Friday, it is no longer a Friday, it is actually two weeks so that is probably a reflection of the market we operate in. And we think we did pretty well in the kind of three big critical trading periods around the Christmas, New Year period so we did a very good job both operationally in terms of value delivery on Black Friday. The run-up to Christmas again we held up well and that continues to be a key trading period as well. We are into the January sales now, but they went off pretty well as well. So we will reflect more on that when we talk about our Quarter 4 Trading Statement.

To the colour of synergies or colour on synergies?

**Answer: Kevin O'Byrne**
It is across three big buckets. There is the store in store as we open, close stores and open stores inside Sainsbury's and there are 56 stores that have closed as we have opened stores in Sainsbury's. So clearly we are saving on costs there and we are getting the benefit of the store in store and margin contribution as well. The goods not for resale is another big bucket where things like media and anything you can imagine we buy, uniforms etc, just going through line by line and putting the two volumes together and getting savings. And then of course overheads. So for example combining back offices, putting Argos back office into our Manchester sort of accounting back office etc. So it is right across the piece and we are just, we are not changing the overall 160 number, but we are getting after the synergies faster. The team are doing a great job.

**Further question**
Do you think the lines such as not for resale and you are combining the back offices, that you will see the full extent of these synergies this year or will they continue to roll into 2019 as well?

**Answer: Kevin O'Byrne**
No they will continue to roll into 2019. We will complete the work in 2019 where we will get to the £160 million EBITDA. So more to do on that.

**Kiranjot Grewal**
Okay, thank you.

**<u>Question 5</u>**

**Disan Milo, Berenburg**
Hi, good morning everybody. Just a quick question from me. You have said that over the, generally the Homebase closures accounted for most of the sales decline and that would imply flatish like-for-like growth in GM, is that also in line with what you

expected or is it better or worse than what you expected given the market conditions?

**Answer: Mike Coupe**
No it is broadly in line with where we expected to be and we knew about the Homebase closures and we talked about that in the previous updates. It kind of is the low point of this quarter would be the low point of that effect, in that it will have the most significant impact in this quarter.

The other moving parts that you have to be aware of is that as we put Argos stores in Sainsbury's stores we tend to take away space from some of the general merchandise categories. Actually in the round it makes the Sainsbury's business more profitable and that is one of the synergistic benefits. But it will have and does have a detrimental effect on the headline general merchandise sales associated with the original core Sainsbury's business. So that is another moving part which makes the numbers actually quite difficult to unpick. But in the round the performance was broadly in line with where we expected it to be and there is nothing in the quarter that would be anything other than giving us confidence that the basis on which we bought the Argos business still holds true. And to the point we make in the Trading Statement actually we are delivering the synergies faster than we expected and we will get on with making it happen. And indeed if you look at the second and third year growth of the stores in stores that gives you lots of confidence. It gives us lots of confidence that over time the space effects we are talking about will unwind and we will see that business continue to grow market share.

**Further question**
And a quick one on food growth. You said you, would you be willing to say what it was kind of over the Christmas period or in December given that peers are reporting on the different time periods than you are?

**Answer: Mike Coupe**
No. The only thing we point out is the fact it is a 15 week quarter and has lots and lots of ups and downs in it. I have given you a little bit of colour on clothing. We don't break out the quarters otherwise. We end up having to dissect every part of our business, but it is roughly a third of our total annual sales in that quarter in that 15 weeks. And we think it is a pretty robust performance and indeed if you take the food business in isolation, an improvement on the previous quarter. So in the round we think we did a pretty good job.

**Further answer: Kevin O'Byrne**
And overall just looking at the numbers today, we are happy with the profit we expected coming out of this very important period to deliver the year end. We were happy with right across on balance the retail business and the moderate upgrade to do the synergies. So we are kind of where we expected to be over a very important trading period.

**Further answer: Mike Coupe**
I think the one other reflection in terms of some of the published data. So because of the way that Kantar is calculated, the effect that I have talked about on space in general merchandise in Sainsbury's effectively comes out of that number. So it will

tend to under report us. And of course we don't get the benefit and Kantar don't measure the effect of Argos stores in Sainsbury's stores from a sales point of view. So there has been lots of commentary about the Kantar numbers, but as we look forward they become increasingly unrepresentative of the underlying performance of our business and I just think it is important that people recognise that. As I say people draw all sorts of conclusions both on the 4 weekly and 12 weekly numbers but increasingly the effective general merchandise will distort those numbers as we go forward.

**Further answer: Kevin O'Byrne**
And of course the new Argos stores in stores are not included in our like-for-like.

**Further question**
Very clear. And can I just clarify on one more quick comment that you made. So in respect to the GM trading, you upgraded synergies and Argos came. It was my understanding that Argos came kind of in line with what you expected in profitability in terms of margin?

**Further answer: Kevin O'Byrne**
I was commenting on our overall business. We don't break the business out. Because they are so integrated now we run this as one retail business. As you can imagine with 164 stores in stores, pick-up points in about 220 supermarkets and convenience stores, we have one P&L. So overall the profit for the retail business across this very important trading period was in line with our expectations.

**Dusan Milo**
Very clear. Thank you very much.

**<u>Question 6</u>**

**James Tracey, Redburn**
Morning Mike, morning Kevin. Three questions from me. First question is on inflation. So Kevin said on the wires this morning that he saw inflation being around 3.7 per cent for food in the market. So could you confirm that is where you see it and where you see the direction of that going and why?

The second question is on Argos/general merchandise gross margins. They have been performing steadily over the past decade really in the Argos accounts. Are the synergies that you are getting from combining with Sainsbury's enough to offset this sort of long-term trend and the weakness in the market we are seeing recently?

And the third question is, could you please say what percentage of Argos sales are in the standalone Argos stores versus concessions today and what the target for this would be in 2019? Thank you.

**Answer: Mike Coupe**
Okay, I think I will have a go at correcting Kevin on the inflation number or at least correcting you on what Kevin I think said rather than what you thought he said! And then I will ask Kevin to come back on the Argos gross margins and the synergy of sales breakdown.

We haven't talked about a specific inflation number, we just point at the Kantar data, I think that is where the 3.7 per cent comes from, or the ONS data which again would show around 3.5 per cent. And again we have commented on the inflationary underpin in our business where we would see numbers which are lower than that, but nevertheless in that sort of area. And the inflation numbers that we see in our business reflect in the fact that our price position relative to where we were in the summer has actually got better and better versus most of our competitive set. So I think we have already commented on the general shape of it. But I don't think you will hear either of us talk about a specific number in our business. And so if that is the impression you have got, that is not right. As I say the number that we look at is Kantar number and use that as a kind of the reference point for any commentary that we are making.

I will ask Kevin, well on the gross margins we just won't talk about.

**Answer: Kevin O'Byrne**
Yeah James, I mean I think all we will say unfortunately on the gross rate is the overall profit which we run as an integrated business. The same teams run general merchandise across a Sainsbury's store and an Argos store etc. and overall the profit for the period we were happy with it, in line with our expectations as I said earlier. Unfortunately we don't break out the sales between the stores in stores and the standalone Argos sites. As you can imagine over time you know we have talked about having 250 Argos stores in stores, it may get higher than that in time, we shall see. In time you will see a greater shift to stores in stores and you will see some shift to pick up points as well. We have 37 of the Convenience stores where you can pick up your Argos products coming up to Christmas and they performed very well and in time clearly we will have more Convenience stores in the mix as well. So it will change quite materially but we are not breaking that out and we will talk total general merchandise regardless of channel. We are focused on the customer offer and we have used all the channels available to grow sales.

**Further question**
Are you able to give an indication of the percentage of the Argos space that is within Sainsbury's because surely that is one of the big drivers of the synergies on the operating profit side?

**Answer: Kevin O'Byrne**
Yes we probably could, we don't. But I am not sure how meaningful it would be James that is the problem because in some of the stores we have actually got relatively small space and they are effectively a spoke for products and we have got a hub down the road where we deliver in. So we keep a tight range in store of the most popular products and then within a few hours you can get the full range available in some stores, depending on the amount of space we would have a larger range. So I think it wouldn't be a helpful number for you, but it is not something we break out currently.

**James Tracey**
Alright, thanks Kevin, thanks Mike.

## Question 7

**Rob Joyce, Goldman Sachs**
Hi good morning guys. A couple of areas from me. Just to follow-up on the Argos side. Sorry if you could remind us how many Homebase concessions you have now closed?

And then just on the Argos concessions themselves, in terms of sales per square foot, are they performing better than the general merchandise space they replace in general? I would have thought they might have done. That is the first one.

And then the second is just looking at the year ahead. Sorry 2019. It looks like the market is assuming higher profit growth next year, despite what I think looks to be lower cost savings and lower synergies. Is that reflecting the easier sort of path of inflation, is that what you were implying earlier Mike? Thanks very much.

**Answer: Mike Coupe**
Well I will let Kevin talk about 2018/19 such as we have got line of sight. First to answer your question is roughly 100 Homebase stores, I think it is 97 if you want to be specific. But it is in that kind of order of magnitude. And it is about just over 1 per cent drag on sales which I think we have already commented on.

I can't give you an exact sales density number but I would be pretty confident that the Argos stores in Sainsbury's stores are materially ahead on sales densities compared with a typical Argos store. You know, certainly as I say, meaningful percentages ahead of a typical Argos store and that is one of the reasons why it drives a profitable model. And in fact the smaller footprint like the 1,000 square foot versions, the micro stores that we are doing, deliver pretty spectacular sales densities. Of course a lot of it is click-and-collect. A lot of it is reflective of the fast track proposition. So in many cases the smaller stores, the smaller points of presence are just acting as pick-up points for online delivery which again is one of the things which over time we think will become a bigger part of the offer. So as well as the already committed 250 Argos stores in Sainsbury's stores, we would expect click-and-collect to roll out to more places. And depending on how you want to allocate the space for click-and-collect, you know the sales densities on click-and-collect would look pretty spectacular in some of our convenience stores.

So that is one of the reasons why we have confidence in the underlying model, because it is inherently more efficient, more sales dense and again we have reflected on the fact that the one year growth and two year growth continue to be very strong at 15 and 30 per cent. So again gives us confidence that, back to the previous question, the proportion of business going through Argos stores in Sainsbury's stores and click-and-collect more generally will continue to increase.

As far as profit outlook is concerned, I am now looking at Kevin.

**Answer: Kevin O'Byrne**
Rob, first of all there is a wide range of consensus out there. It looks like consensus at around £620 million for the '18/19 year at the moment. But it is something we will

really talk more to at the May update as we go through our budgeting process and we can give you more colour then.

**Rob Joyce**
Okay thanks. And just very quickly Mike, sorry on the Argos point. I guess why I am struggling with the 1 per cent drag is that it looks like you have closed 97 Homebase, 56 I think you said Argos stores, so give or take 150. But you have opened 164 it says in the release now in total in Sainsbury's supermarkets. So I am trying to tally up. I can't work out why there is a space drag?

**Answer: Mike Coupe**
It's a timing effect. I am sure James can take you through a little bit more of the arithmetic. It is a question we have been asked several times. And of course the other effect is that we do take space away from the Sainsbury's general merchandise business when we put Argos concessions in Sainsbury's stores which as a drag on the headline GM number as well. So all of that kind of plays out over time. The underlying point that we would make is that we still have high levels of confidence in the model that we bought the Argos business on and that we are seeing an over delivery in the round against our original expectations, our original models and that is one of the reasons why we are able to bring forward the synergy number.

**Rob Joyce**
Thanks very much.

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

**Andrew Gwynn, Exane BNP**
Hi there. Just two from me quickly. So the first is on market environment. You commented at the first half results that there were some in the market chasing unprofitable sales. I am just wondering how thing stand and how you expect that to evolve into the new year? Whilst we are there, Happy New Year.

And the second one is on the pig in the python. You talked a little bit before about the food side of the equation, but obviously with a longer hedging, I am just wondering how far that pig is through your python?

**Answer: Mike Coupe**
Crikey. We are going to stretch our metaphors quite a lot.

**Andrew Gwynn**
You love a metaphor.

**Mike Coupe**
So we go back through the choreography of the last, what is it now, best part of 18 months. So Brexit vote 18 months ago. You know you would have seen, again it has been well commented on, some cross price pressures coming through reasonably quickly because many trading commodities are bought on a day to day and week to week basis. And at the other extreme as you say, some products hedged in some cases for a year. So I think sort of a balance of probability and assessment would

say that we are probably at the peak of price inflation and that we would expect it to mitigate over the next 6-9 months. I don't think we will see a massive drop off over the next quarter, but over time you would expect it to reduce all other things being equal. And as you say again if we take non food in the round, we would hedge that typically as we buy it. So on a 9-12 month buying cycle. But there is a level of uncertainty, with the political environment it is still uncertain. Who knows what is going to happen over the next 3-6 months? Again we don't know exactly how commodity prices would move. We have seen reasonably significant increases in oil prices over the last period of time which as a knock-on effect in terms of input prices as well as a knock-on effect in pricing of fuel at the pump which clearly has a knock on impact on customers disposable income. So there are lots and lots of moving parts. I don't want to get carried away in making myself a hostage to fortune other than making the observation that all other things being equal you would expect food price inflation and inflation will generally drop out of the market over the next let's say 6-9 months.

As far as unprofitable sales are concerned, yes the market continues to be very competitive. We ourselves made some quite significant price investments on things like turkeys and 25p veg. and indeed have announced today a further set of price reductions on some core commodities. But actually in the round you could take the view that the market is also behaving reasonably rationally against the expectations that have been set. I think again we have observed before that sometimes it takes longer than perhaps the input price pressures would suggest for the market to behave rationally and for those input prices to be passed on in the form of retail prices. But I think it is fair to say that the market is behaving reasonably sensibly from our perspective and that is particularly the case if some of our mainstream competitors were to hit the kind of targets that they have set for themselves.

**Further question**
Okay, that's great. And I am going to have one last stab on the Argos synergy number. To the extent that you have, well to put it another way. Have you found costs that go beyond your original and even actually the revised synergy target to get for Argos? So without mentioning the 160, but are there avenues that you have found and said, well that is a surprise, we didn't deliver that.

**Answer: Mike Coupe**
I'll have a go. So the way that we looked at it, we would look at this is we will deliver £160 million that we have committed to the marketplace and we would expect that to fall through to the bottom line of the business. We would always look for opportunities above and beyond that but we would take the view that those opportunities will be one way or another reinvested back into the business. We have acknowledged that the market conditions are probably still a bit more challenging than we would have expected at the time we bought the business and so we don't want to make ourselves a hostage to fortune by making commitments above and beyond the £160 million. So we will deliver the £160 million as quickly as we possibly can. We will draw a line under it and then we will stop talking about the synergies and we will just talk about the business in the round.

But it is often commentated that the market is competitive and that we will need to continue to be competitive and anything we can find above and beyond the £160 million I would imagine one way or another would be invested back into underlying proposition. But don't lose sight of the fact that there is a degree of scepticism about whether or not we will deliver the £160 million to the bottom line. And hopefully the upgrade today and the commentary today will increase the level of confidence that we will deliver the £160 million to the bottom line and you will see that come through in the fullness of time. Above and beyond that we are not going to make any further commitments.

**Andrew Gwynn**
Okay, I think that is as clear as you can be. So thank you very much.

**Question 9**

**Niamh McSherry, Deutsche Bank**
Morning everybody. Most questions have been asked. But I had two quick ones. On online grocery, can you make a comment about maybe basket size versus volume growth?

And then secondly on Argos online growth, you did talk a little bit about this, but the future for click-and-collect. Can you say whether click-and-collect sales within Argos grew faster than delivered sales or anything about that? Thank you.

**Answer: Mike Coupe**
Yeah, online there was a slight increase in basket which is a slight move away from the trend that we would have seen this time last year where baskets were tending to fall as a result of things like delivery path which made it easier for customers to order. And therefore they tended to spend a little bit less on average. But you know sometimes again people lose sight of the fact that the relative size of our online grocery business and we continue to run a pretty significant business and seeing 8 per cent year-on-year growth and indeed 20 per cent year-on-year growth in Christmas week in that business we think is a pretty good performance, particularly against the context where we are looking to serve Sainsbury's customers and we are not out there "buying sales" we are looking to make sure we manage a sustainable business in the medium to long-term.

Click-and-collect. I think we said on the face of the Statement, we saw sales growth of 39 per cent and home deliver saw 25 per cent growth as well. So you know that gives you an idea of the changing shape of the business and overall online sales grew by 8 per cent within Argos. So that means that the overall mix of online became even greater than previously which again reflects changing customer habits and the shape of the business going forward. And again we have talked very openly about the fact that over the quarter 20 per cent of our sales as a business were online, which is just incredible if you think about the progress in this business over the last 3,4,5 years. And we think although we have talked a lot about some of the short-term pressures in the marketplace, let's not lose sight of the fact that there is a very significant long-term changing customer shopping behaviour. And the whole basis of our strategy is to set ourselves up for that changing customer behaviour, whether it is in the groceries online business or whether it is in the general merchandise and clothing business.

Now the Argos acquisition helps us accelerate that, but the long-term trends are there to stay. And let's take a 3-5 year view, not just a one quarter view.

**Niamh McSherry**
Okay, thank you.

**<u>Question 10</u>**

**Stewart McGuire, Credit Suisse**
Morning. Hi Mike, hi Kevin. I had two questions and now I have got three. Sorry. Just some clarification. You quoted on the wires that volume growth was slightly negative in Q3. And with the increase in Taste the Difference, can you give us some colour as to where the losers are in volume growth? And I guess also that implies that inflation was slightly higher than 2.3 per cent, given that was where your grocery numbers were. So some clarification on that would be great.

Question number two, on PBT, you kind of hinted that you expected PBT to move up, but am I reading too much into this in saying that you are not expecting it to go up by the additional synergies that you are talking about, the £15-16 million that you are pulling forward?

And then question number three, I think it was a follow-up to Andrew's question. Did you just say that anything above the £160 million in synergies would be reinvested in the business? Thank you.

**Answer: Mike Coupe**
Yeah the answer to the last question, I think I have gone as far as I can, but we will deliver the £160 million. We have always said we would expect that to be delivered to the bottom line of the company. We would always look for opportunities above and beyond that. But in the round, in the way that we think about our business, the way that we plan our business, we would make assumptions that one way or another we will invest that back into either paying our colleagues more money, mitigating inflation, improving the competitiveness of the offer, whether that is investing in the quality of the products that we sell or the prices that we sell them at. And that we look at it in the round so that we don't look at it as an Argos in isolation number, that we would always seek to optimise our business with any efficiency savings we can make or synergy savings we can make. And we would look at that indeed from a cost reduction point of view as well.

So we have talked before about the way we look at the components of our business. Hopefully from this Trading Statement you can see that we are delivering against what it is that we said we would deliver against and we have confidence that we will continue to be able to do that in the future.

I think you have narrowed down the corridor of inflation from somewhere between 2.5 to 3.7 per cent so let's not go any further than that. We talked a little bit about the fact that we saw good growth in Taste the Difference and indeed we saw our Own Label participation go up in the quarter. I guess from that you can surmise that the other part of the equation, i.e. branded sales would be less good against that backdrop in the round, that is probably helpful to us rather than a detriment. So we would see that as a broadly speaking positive outcome. But I don't think we would go any further in terms of breaking down the specifics of any categories other than the other observation we make in our Trading Statement which is, we think we served a record number of Christmas dinners this year because of our price competiveness on turkeys and on 25p veg. Did that help?

**Stewart McGuire**
I think so yes, thank you. And on PBT am I reading too much into that?

**Answer: Kevin O'Byrne**
Yeah on the underlying PBT, the consensus is currently £559 million and we have said on the basis on that we see the opportunity to moderately beat that number. And I guess you can decide what does moderate mean, but I think people are coming at it two ways. One they are looking at, is moderate around 5 per cent? And then you have got the increased synergies which is really. What we are saying the base retail business delivered the profit and it is delivering the profit we expected and is on track to do that. And because of the synergies we are going to moderately be ahead of that consensus. That also would put us slightly ahead of the previous consensus which was £572 million back in July which has dropped slightly. And so on either number we are going to be a little bit ahead, moderately ahead of the £559 million and slightly ahead of the £572 million.

**Stewart McGuire**
That's great, very clear, thank you.

**Mike Coupe**
So multiply 5 per cent by £559 million to be absolutely clear?

**Stewart McGuire**
I think that is even bigger.

**<u>Question 11</u>**

**Nick Coulter, Citi**
Hi good morning. Just one from me please. Is it possible to have a sense of the quantum of the headwind from the reallocation of the general merchandise space in your supermarkets? Obviously you have referenced it a number of times. Or are you able to expand on what you are actually doing there? How much space you are typically reallocating and where that space is going? And what impact that reallocation is having on the recipient category? Thank you.

**Answer: Mike Coupe**
I think we have probably already covered it in as much detail as we can at this stage. Given the line of questioning, I suspect that maybe when we come to our next trading update we might try and give a little bit more clarity around it. We don't have the numbers, I don't have the numbers in front of me. Just make the observation, typically if you are putting a 5,000 square foot Argos store in a Sainsbury's store, some of that is space that you can achieve without having an impact on a Sainsbury's clothing and general merchandise footprint. But if you took I don't know 50,000 square foot store, maybe 15,000 square feet of that store is given over to

clothing and general merchandise pre the Argos store in store you might lose somewhere between 5-10 per cent of that space typically as a result.

The observation we would also make is that the mix is much more beneficial. So the kind of categories that we give space over to within any of these types of refits is clothing, soft goods and the more own label driven, more profitable parts of our business. So actually the space becomes more profitable but the sales do in the case of general merchandise sometimes go down because of that reallocation of space.

But I think on the basis of the questioning that we have had we will attempt to give a little bit more colour next time around and perhaps give a little bit more guidance and direction because there are a number of moving parts that will make it quite difficult to unpick.

**Further question**
But just for clarity, if I may, the total of the space reallocation in the supermarkets and the impact of store closures and concession closures for Argos, that sum is greater than the decline that you have disclosed of the total sales decline in general merchandise?

**Answer: Mike Coupe**
Yes.

**Nick Coulter**
Thank you.

**Closing Remarks**
**Mike Coupe**
We are all done. So thank you everybody. Thank you for coming on. I am sure we will see most if not all of you over the next few weeks and months. Happy New Year to everybody and look forward to updating you next time around which is, I can't believe, 2 May, so 15 weeks time. Thank you, see you then.

**Kevin O'Byrne**
Cheers.

**End**