Sainsbury's Supermarkets Ltd
Wednesday 1 May 2019
9:30 am

Preliminary Results 2018/19

Martin Scicluna
Chairman
Good morning everybody. Good morning. Thank you for joining us at the Prelim Results Presentation. I'm here for a very brief couple of seconds. I took over as Chairman a few weeks ago so I thought I'd introduce myself. I'm Martin Scicluna. I know why you're here, you are here to listen to Mike and Kevin. First off is Kevin. So Kevin, the floor is yours. Thank you.

Kevin O'Byrne
Chief Financial Officer
Thank you Martin, good morning everyone. Thank you very much for joining us for our Results this morning. Just to kick off with a summary of the year. The Results we're obviously presenting today are for the 52 weeks to the 9th March and in that period we delivered underlying profits of £635 million up 8% year-on-year. This was driven by good profit performance in the food business. The delivery of synergies from the Argos integration and reduced interest costs. And we delivered £220 million of cost savings in the year ahead of the target that we'd set.

In the period profits from financial services were down in line with the guidance that we gave you last year. We incurred one off costs of £396 million in the year, now this is an unusually high number which I will explain in a minute. And in the year we invested £518 million in our stores and in our technology while at the same time generating increased free cash flow of £461 million, up 7%.

Our net debt was reduced again this year by a further £222 million, £162 million excluding the benefit of fair value movements. And that was ahead of our £100 million target that we'd set. And over the full year we are proposing to pay a dividend of 11p per share which is up 8% year-on-year.

Sales in the year were up 2% or 0.4% excluding the impact of fuel sales. Retail operating profit was up £67 million, up 11% driven by good food performance and synergy delivery as I've said. Financial services profit of £31 million was down £38 million year-on-year as guided and I will talk a bit more about that in a few minutes.

Interest costs were down £23 million year-on-year. You will recall that we repaid £568 million of secured debt in April 2018. That resulted in an underlying profit before tax up 8% and profit after tax was down 29% with the impact of the one-off items offset by a tax credit in the period.

Retail sales grew 0.4% with a modest like-for-like decline offset by a small contribution from new space. In terms of channels, supermarkets grew 1% in the year helped by sales growth from our 281 Argos store in stores.

Now as you know when we open an Argos store inside a Sainsbury's supermarket, we reduce the space allocated to some of the general merchandise categories, particularly electricals and those sales transfer to the Argos store in that business. This is more profitable for us. It is actually more efficient from a stock point of view and for better customer experience.

Convenience and online grocery channels continue to grow strongly, up 3.7% and almost 7% respectively.

Financial services profits decreased, as I said to £31 million as we guided, primarily due to additional bad debt charges following the adoption of IFRS9 as well as a more cautious approach to unsecured lending and higher costs. We focused this year on growing our secure mortgage book and our commission products. Higher costs were due to increased appreciation on the new bank as we start to use the new bank systems during the year. Net interest margin reduced to 3.8% largely impacted by the fact that we grew our secured lower interest mortgage book. And the bad debts as a percent of lending was 1.6%. Now the year-on-year increase you see there is largely as a result of implementing IFRS9 with the arrears performance in the book stable.

We guided to a spend of £80 million on the programme to exit the relationship with Lloyds Bank in the year to March 19 which is an important milestone this year, successfully completing the transfer of £1.1 million credit card customers to our new platform. We actually spent £70 million with the additional £10 million phasing in to next year. And we are guiding to a total spend of £30 million this year, down £40 million year-on-year and this will complete the bank transition programme.

In the current year we expect to inject £80 million of capital into the Bank and is a reduction from what we previously guided of £100 million. We expect Financial Services underlying profits to be in the region of £45 million this year, but that will include a £10 million transfer pricing change. So the Financial Services business will have £10 million more profit. The Retail business will have £10 million less profit as we give Financial Services a risk free return on the increased capital. So no impact on the Group, just transferring.

And we continue to look at ways of limiting the capital requirements of the Financial Services Business. In the year we grew our mortgage book as planned by 23% and it now accounts for 21% of our borrowings which are secured and this should reduce future volatility and result in lower regulatory capital requirements.

As I said, we incurred material one-off costs in the year of £396 million. Now we expect one-off costs to be substantially lower this year with a cash impact of no more than £100 million. Now just looking through that list, the first item on the list £118 million related to pension with the majority, £98 million, being a non-cash accounting adjustment required due to the recent Court ruling on pension equalisation which will not reoccur this year.

We incurred £46 million relating to the Asda transaction. We completed the integration of Argos this year spending the final £40 million. And as noted we expect the final Bank transition costs to reduce to £30 million in the current year.

We incurred accounting losses of £22 million as we disposed of properties, and these were properties that we no longer planned to trade from or to develop. This actually generated a cash inflow of over £30 million in the year.

Now Mike will talk later about the material retail restructuring that we made during the year and you can see the charges there. And the final item of £19 million relates to non cash acquisition accounting adjustments for the Nectar and the Argos acquisitions and this number will reduce materially and fall away over the coming years.

Core Retail capital expenditure was £518 million and we continue to be very disciplined in how we allocate and invest our capital and we are seeing our returns improve. Looking forward this year we will be increasing and accelerating our investment in our core supermarket estate which will benefit over 400 of our 600 supermarkets. Broadly we would expect growth retail capital expenditure to be around £550 million this year.

Now this is a busy slide. The key message on this slide is that we delivered strong free cash flow of £461 million in the year, up almost 7%. The free cash flow generated was primarily used to pay our dividend of £224 million and reduce our net debt. You can see there, £162 million before fair value movements on derivatives. And our changes in cash flow and our focus on cash flow are better illustrated by this slide. On the left hand side you can see that over the last few years we have materially increased the free cash flow generated, resulting in dividend cash flow cover increasing from 1.3 times to 2.1 times. And on the right hand side you can see we have also focused on reducing our leverage and our lease adjusted net debt to EDITDAR has got reduced from 4.3 times to 3.5 times. And to that end we are committing to reduce our net debt by at least a further £600 million in the coming three years.

This year we will see the Group adopt the new lease standard IFRS16 for the first time and I am sure that fills you all with joy. This is highly complex, the changes will have no impact on our cash flow, no impact on our buying arrangements, no impact on how we run the business. We'll adopt the standard on a fully respective basis as if the new leasing standard had always applied. And in doing so the 2017/18 Group balance sheet will be restated to recognise 1) a lease liability of £5.9 billion. 2) right of use assets of £5.1 billion. Other working capital adjustments of about £0.1 billion combining with overall reduction reserves of £0.9 billion. The lease liability of £5.9 billion is in line with the amounts used for the Group's lease adjusted net debt calculations. Following the adoption of the new standard we estimate that the Group 2018/19 underlying reported profit before tax will reduce by approximately £30 million. We expect this difference to reduce over time as leases mature. The first results that we will publish will be in an IFRS16 basis will be our Interim Statements in November. In advance of this we will provide you with further details of the impact of IFRS16 including fully restated financial statements.

So in summary, overall the Group made good progress this year in a challenging market. Underlying profits up 8% and ahead of consensus. Free cash flow up 7%. Net debt down £220 million, ahead of guidance. And today we are guiding to further net debt reduction of at least £600 million in the next three years while also allowing for robust dividend payments and of course increased investment in our core supermarket estate.

I would now like to hand you over to Mike.

Mike Coupe
Chief Executive
Thank you, thank you Kevin. Good morning everybody. Can I start by just first of all saying this will be the first and only time I will refer to the CMA during the course of this presentation. As far as I was concerned we drew a line under that with the preliminary findings in February and I am going to talk a lot about what the business has been doing during the course of the last year. Because in the end that has been the focus of the 180,000 colleagues running our business week in-week out. So I won't be talking specifically about the CMA firstly.

And secondly, there are a number of things that we will be talking about. We have talked about the Capital Markets Day in September that I won't talk about today. So we'll do two things in September, one is talk about some things we are currently looking at to do differently within our business. And secondly, to update you on progress of the plans we will be talking about during the course of this Presentation.

So it's worth just going back to the fundamentals of our market because sometimes it gets lost in the blood and guts of the day to day trading. There are two big dynamics driving the retail grocery industry and you could argue the retail industry more generally. The first is the growth of the discounters and we have said since I have been running the company that we would expect the discounters to grow and ultimately get to a market share of 15%. And that analysis is proving to be right and that means there will be further trajectory over the next period of time where the discounters will grow by opening roughly 100 stores a year for at least the next 3 years.

And secondly, if you took a medium to long-term view, the rise of digitalisation and online technology which means the shape of the market is changing and will continue to change way beyond the ultimate growth of the discounters. So those two big dynamics are driving our market and ultimately that is what led us to the strategy that we announced five years ago and we continue to execute against that strategy.

And when we think about how we need to develop the business going forward, although there are a number of elements that will evolve and need to change and some of the emphasis changes over time, the fundamentals of what we are doing with our business remain the same as they were five years ago. That is to create great quality products that our customers ultimately are prepared to pay for, so deliver great value, underpinned by a colleague base that do a brilliant job of serving our customers week in, week out, represented by a core set of values which I will come back to during the course of this presentation.

But two fundamental elements in terms of thinking about the future. One is to know our customers better than anyone else and we are almost uniquely placed to be able to do that. And secondly, to be there for our customers whenever and wherever they want because our customers shopping habits are changing and changing very rapidly. And we believe we are in a great position to develop our business against that consumer backdrop.

And on this slide shows you the critical assets that we have 608 supermarkets, 820 convenience shops. We serve 27 million customers a week. We are the second largest food retailer in the UK and we have a fantastic opportunity with Argos with now 1,200 points of presence and with sales which are approaching 60% online. So as we stand today, already 20% of our business is going through various online channels.

So in terms of the five priorities, these have been tweaked slightly from what you may have seen before. First and foremost we need to be successful in our grocery business. We need to drive quality, we need to drive value and we need to drive service.

Secondly we believe there's an opportunity within general merchandise and you don't need me to tell you, you can't open the newspapers or watch the TV without seeing yet another general merchandise or clothing retailer in distress. What does that mean? It means that the market will consolidate and we believe we are in a very strong position to benefit from that. And that continues to be an opportunity for growth in the future.

Now that we have been through the investment programme for the Bank and we have replatformed, we still believe there's an opportunity to grow our financial services, particularly within the digital space. But equally we need to generate efficiencies so that we can reinvest back in our core proposition. And again one of the things that we have put a lot of emphasis on over the last period of time is growing our digital capabilities and joining together our digital properties so that wherever you choose to shop with Sainsbury's, whether you want to shop with us in our physical real estate or our digital real estate, it is joined up and increasingly we see you as an individual and we can personalise our service as a result.

And Kevin has already talked about it, one of the key emphasises from a financial point of view is to make sure we have got a resilient balance sheet and to continue to generate cash so that we can pay down our debt and that is certainly part of the emphasis that we have focused on over the last year.

Again if you look back historically, it is worth reflecting on the fact that our business has been pretty resilient and all of our mainstream competitors have had a significantly challenging time at some point over the last five years and broadly speaking have returned back to something like the sales, the relative sales performance of five years ago. And during that period of time the Sainsbury's business has actually been remarkably robust.

What we would recognise and need to recognise that there are still some underlying challenges in our business and this chart shows you, well it shows you a couple of things. One is the direct interplay between the mainstream grocers and the discounters. So effectively there is a pretty straightforward trade-off in terms of the growth and share of the discounters and the underlying performance of the mainstream supermarkets.

Secondly, actually our relative performance is more robust than perhaps some people might think. On that chart retailers see as Tesco who have lost not an insignificant amount of market share in the last period of time. And thirdly, and this is a point that we keep reiterating, but quite often gets missed by the commentators, the market data, the Nielsen data does not fully take into account our overall sales. So the reality is that around 20% of our company sales are not picked up by Nielsen. And so we very deliberately today talked about our supermarket sales growth because that represents the transfer of sales into the supermarket business from repurposing space within our general merchandise business and bringing Argos stores into Sainsbury's stores which is part of the equation that is just not recognised in the Kantar or Nielsen data.

But if we distil that down further, and this is one of the critical things that we need to address over the next period of time, actually we have done a pretty good job of maintaining, if not growing our market share in premium own label products. Maintaining broadly speaking our share in our standard own label and indeed maintaining our share in branded goods, so our volume shares. The critical issue that we need to address over the next period of time is being more competitive on core commodities and I will talk about during the course of the Presentation.

We have talked to you before about the product quality framework that we use and broadly speaking if you look at that chart, the things on the right-hand side, we have actually done a pretty good job of growing or maintaining our market share. The challenge is the things in the bottom left hand corner and again if we think about the dynamics of the market, things that might have been in the top right-hand corner not that long ago are getting increasingly commoditised in some categories in some sectors and gives the basic sort of idea of something like fillet steak which not that long ago would have been an added value premium product but has been commoditised and therefore there is a dynamic shift in the kind of products that sit in the bottom left-hand corner and our job is to reinvent stuff in the top right whilst maintaining competitiveness on things in the bottom left.

Our customers still believe that we are ahead of the game in terms of our food quality and actually there is a significant gap between us and our mainstream competitors. And broadly speaking we have maintained that gap. And that is because we have invested a lot of time and effort in growing added value sales in the categories that we already overtrade in.

So if you look at this chart, we do have market shares which are ahead of our overall market share in a number of the value added categories, meat, fish and poultry, dairy, cereal, speciality and packages goods being examples. And we have continued to maintain our market share, but also grow in the added value parts of those categories. So for instance outperforming through the launch of Just Cook and Slow Cook, dairy alternatives being a big area of growth in the marketplace overall. FreeFrom products, muesli and granola.

So what this says is that we have done a pretty good job. Well first of all we start with a lead in those categories and secondly we have done a pretty good job of maintaining and growing those categories. And indeed if you look at Taste the Difference, a £1.2 billion brand, significant overtrade versus our competitors, we have seen volume and value growth in the last year. We continue to develop what we would call Owned Brands, so products that are unique to us that offer differentiation to our customers, but also offer us a margin opportunity and a good example of that would be Boutique cosmetics up 80% since the 2018 re-launch.

And then distinctive brands, brands that bring some kind of uniqueness to our business. We now have 126 products in our stores, that is about £130 million of added value sales and these products, these categories tend to be higher margin which of course helps our mix and helps our ability to invest in our underlying core business.

And if you look at the chart on the right-hand side you can see that actually we have been gaining from our mainstream upmarket competitors. So during the course of last year we have actually seen switching losses or switching gains coming back into our business from Waitrose and from M&S. And that again would imply that we have done a pretty good job in this area.

But we would recognise the fact that we need to do more work in our commodity categories and that is in the end fundamentally what has driven our underlying share loss in the last period of time. And over the next period of time we will be addressing this and there are a number of product areas we know we can do a better job in and we will be investing in making sure that we are more competitive. But it is not a one size fits all answer. You know every category has its own unique characteristics. We know through the work that we have been doing through the potential Asda transaction, there are opportunities in costs of goods. We know we can make our business more efficient.

So there are opportunities, further opportunities in the way that we bring our businesses together. And we know that there is work that we can do in the category hierarchies to make sure that we can compete and we have the right range structure in place to make sure that we can be more price competitive. And so over the next period of time you will see a lot of emphasis on bringing those products to market.

And a case study we have given is J.James which gives a good illustration of what we can do. So we have got a 30% increase in volume as a result of new customers to the category. We have got customers switching from existing products. But overall we have seen our breaded chicken sales up 9% and that is an example of something where the overall dynamics of the category have been managed quite carefully to make sure that we can afford to invest back into the underlying entry price points.

The second emphasis in the core grocery chain is to increase the investment in our supermarket business. We have had a big series of investment programmes over the last couple of years and Kevin has already referred to the fact that rolling out Argos stores in stores and the Bank programme to all intense and purposes have finished now. So that gives us the capacity to invest in our core supermarket estate. And we are planning to one way or another invest in around about 400 supermarkets over the course of the next year. And that can vary from somewhere like Hedge End which is one of our top five stores where we are doing a full refurbishment, quite a significant investment, through to perhaps putting more of the beauty range and therefore putting the beauty big bets back into some of our existing supermarkets. So as I say roughly two-thirds of our supermarkets will get some form of investment over the course of the next year.

And we have got lots of experimentation that has gone on. So if you go to our Selly Oak stores there is a lot of new ideas that we introduced. So we are challenging ourselves to get the ideas that have worked back into our business as quickly as possible. So if you take beauty as an example, we have had eight trial stores, we have seen sales grow by 40% and we believe we can roll that out into at least 90 stores in the course of this calendar year. We have got wellness aisles in a number of stores, that is working. So again relatively capital light to roll back into our shops. Making investment into food services.

One of the big wins from the Selly Oak trial is the integration between clothing and general merchandise, so making the shopping experience more seamless from a customer point of view and again we believe that is an opportunity that we can roll back into our core estate.

And again if you look at the middle chart, it just emphasises the point, one of the successes we have had over the last period of time is to drive the sales density in our supermarket chain and that doesn't come through in the headline Nielsen and Kantar numbers because it misses a very big part of the equation which is the benefit we get from repurposing our space to put an Argos back into our supermarket business. And we now have over 280 Argos stores in Sainsbury's stores and that is what is driving the 1% growth in the underlying supermarket sales.

One of the great success stories for us over the past period of time has been our convenience business and again that is a business which is very beneficial from a margin and profit point of view. We have a hugely advantaged set of real estate, we have only ever invested in quality assets and that is reflected in the underlying performance of the business. And you can see from the chart bottom right that our sales densities are market leading and actually significantly ahead of the competition and in the end the sales densities are what drives the profitability. And we have seen our market share step up over the last period of time.

Now why have we driven that growth? How have we driven that growth? As I have said already, investing in the quality underlying real estate. That means we are not driving at numbers we are only interested in opening high quality shops. And we have improved the shopping experience, so things like mobile scan and go are opportunities to drive the customer experience and make it easier for customers to get in and out of our shops. But perhaps most importantly we have tailored more and more our individual store by store ranges, and so now around about 85% of any given convenience stores range is bespoke to that store. So that gives you an idea of the level of tailoring and the level of focus we put on making sure we have got absolutely the right group of products in each individual convenience shop.

But a great story, and certainly again one of the drivers of the overall profitability of the organisation and underlying growth of 3.7% which mostly is underlying like-for-like growth.

And similarly in Groceries online. So our growth pretty much 7% groceries online. The currency of the online world is very much about speed, so a lot of focus in all of our business on how we get products to customers even more quickly and hence we now have same day delivery in about 60% of UK households. Our GOL app now accounts for 20% of our orders. And one of the things we have worked really hard on is to improve the productivity of our grocery online business. So over the last five years we have seen an improvement in pick rates of 32%. And when we look at some of our competition and particularly Ocado, actually our pick rates are pretty much not far off what they currently achieve through their fully automated warehouses. So the investments we are making in productivity have improved our efficiency and are certainly driving customer service availability, accuracy and timeliness, all of the things which are critical in this market. And underlying our costs per order, despite the significant increase in our wages have actually gone down by 9%.

And the last thing that we have been focusing on in the last year in our core supermarket business is how we adapt our colleague base to face into the ever changing customer needs. So we have been through a huge amount of restructuring in our organisation. We have effectively restructured all of our management teams and we have also re-contracted with all of our store colleagues. We have re-contracted on the basis that we want our colleagues to be more flexible so to be able to work across more departments, but also to be more tech savvy. So a contractual requirement as we look forward and make our business more efficient we will have more digital capability for both our customers and our colleagues. Our colleagues need to be able to adapt to that. But in return we are now paying our market leading pay rates, so £9.20 an hour is significantly ahead of our competition. And whilst that is a drag on the P&L in the short-term, it is an issue that our competition will have to face into over the next period of time. So we are ahead of the game, we are ahead of the game in terms of the restructuring of the organisation, getting our management team in place and getting our colleague flexibility in the right place. But also in our underlying rate of pay which is now significantly ahead of the market.

So we have a lower cost to lead in our organisation. We have much more customer focus in the way that our stores are organised. More flexible and simple structures and a much higher level of leadership and colleague engagement. And during the course of the last year we have introduced real time feedback to our colleagues through our Lettuce Know app which enables our customers literally as they walk out of the store to feedback about their shopping experience. And that data, that information is passed back to our colleagues instore literally the day after and we are able to then analyse centrally how well we are doing. So every store knows the areas that they need to address and equally as an organisation we get a macro picture of the areas we need to be investing in to improve our customer visits. So that replaces what we were doing this time last year which was effectively a monthly mystery shopper visit. So much more intense, much more real time, much more focused on the individual local stores.

And we would be the first to acknowledge that during the course of the last calendar year as we went through the colleague changes, we did see our underlying customer service metrics decline. And as an individual I get lots of emails from our customers and broadly speaking there is a direct correlation between our customer service scores and the number of emails that I get. So actually in reality you could have a very simple measure in this business as to what our customer service is, which is basically Mike’s inbox and how many emails am I getting from customers.

But you can see on the left hand chart as you look at it, where were at the bottom of the curve, so that is kind of on the downside, where are at our best. But also where we are now and even these stats are slightly out of date because we had our best Easter ever both in terms of our sales over the Easter weekend, but also our customer service stats. And broadly speaking since about autumn we have seen every week those stats step up week on week. And the good news is that there is still a load of headroom because we know that the range across our stores is pretty significant and even if we are to bring the below average stores up to the average we would make a significant improvement in our customer service scores. And there is certainly room right across our estate to significantly improve and we have demonstrated that and will continue to demonstrate that over the next period of time.

And last, but by no means least, the business is underpinned by a core set of values and it is our 150th birthday this year. We are encouraging our colleagues to go out and do something in the communities that we serve as part of that celebration. And it's amazing that around about to date 30,000 of our colleagues have actually volunteered to do that. So it shows that this business has a heart and we sit at the heart of the communities that we serve and ultimately we have a broader role to play in society overall.

So whilst there are a series of headlines, the summary is we have done a pretty good job of growing certain parts of our business, Groceries online, Convenience, making our Groceries online business more efficient which has been profit enhancing. Our Convenience business is definitely profit enhancing and growing the added value food ranges which is also definitely profit enhancing.

The three areas that we know we need to address, underlying commodity pricing, that is our challenge over the next period of time. Actually our customer service scores are broadly speaking back to if not slightly ahead of where they were, but then that is an opportunity for improvement. And we have committed to invest a reasonable amount of capital in improving around about 400 of our supermarkets over the next year and those are the three areas of focus for me and the team over the next period of time.

If we look at General Merchandise, strong performance within Argos, growing market share against the backdrop of what has been a pretty challenging market. And when you have retailers in distress you have a lot of distressed stock in the marketplace and that reflects in the underlying dynamics of the market. And the reality is if you look at the way our customers are behaving, they have more money in their pockets, disposable income generally speaking means that people spend more money in retail. But at the moment our customers are holding back because of the uncertain political environments as much as anything else and it feels a little bit like our customers are behaving as if we are in recession despite the fact that the macro economics, i.e. they have more money in their pocket, more disposable income would normally drive a different dynamic in the marketplace. But nevertheless Argos strong performance in a weak market, growing in electricals, toys, leisure, nursery. More challenging in home and furniture, but equally an area where there is an opportunity and again margin enhancing if we can get it right.

But there is a trade-off and again we have been pretty open as we open Argos stores in Sainsbury's stores, the overall net effect on individual supermarket sales is positive. The effect on the Sainsbury's clothing and general merchandise if profit enhancing because we generally speaking take out the sales of the core electrical business as an example and entertainment and give more space to home textiles and clothing. But it does have a drag on the overall general merchandise sales in the Sainsbury's business which of course is the part of the business that gets measured by Kantar and Nielsen. But it also gives us an opportunity of creating more range across our estate so as a customer you have more opportunity to shop a larger range in more Sainsbury's outlets than you would have had this time last year as a result of putting Argos stores in Sainsbury's stores.

And Argos does a brilliant job of serving customers. So already very high customer service stats, you know pushing 80%, above 80% in some of the channels to market within Argos and actually going up year-on-year. So you would have difficulty finding many, if any businesses that deliver that week in, week out in the retail sector. And that is reflected in some of the independent market analysis which would see Argos customer service as rated by customers going from 46th last year to 8th this year and we would anticipate that is going to get better in the next period of time.

So we continue to enhance the proposition, the master assortment has been reduced by 26% and that has reduced the level of duplication both within Argos, but also within both of our general merchandise businesses. And we have removed a lot of the low value items because in the end the Argos model is driven by the cash profit per item. So even relatively low margin, but high value products in the Argos business are more profitable than selling low value items with higher margins because the business model is driven by cost per item sold.

We are continuing to leverage our buying scale, remember again it is only in the last year we brought together the general merchandise and clothing buying teams within the organisation. And the buying cycles within clothing and general merchandise around about nine months. So we have already integrated and brought together around about 4,000 products within that. But nevertheless there are other opportunities and we look forward to continue to consolidate ranges to grow our market share, but also make our ranges simpler and to drive buying scale which will give us the opportunity of reinvesting back in underlying pricing and the core proposition.

We now have 476 digital stores so again the business is very rapidly moving from the old Fisher Price calculator format into a much more modern and much more up-to-date format. Pay@Browse is now in 162 stores which means that customers don't have to queue to pay. Again a massive improvement in the customer experience. And we now have visual search. So if you photograph a product we can tell you whether or not we have got it available to you. And voice search through Google home. So again dramatically improving the proposition and making it easier and easier for customers to shop with us within the Argos business.

And this just gives you a sort of shape of how the estate has changed in the last year. So Argos stores, standalone stores reduced from 823 to 602 partly driven by the closure of the stores within the Homebase stores, but also the transfer of stores from Argos standalone into Sainsbury's stores. And of course that has a dramatic affect on reducing rents, rates and the overall occupancy costs of the individual shops. Now at 281 Argos stores in Sainsbury's stores. We certainly believe that there is around about another 30-50 we can go for, but of course they get more complex as we go through them and it does rely on the local Argos store lease running out. So we are at the more challenging end of the spectrum. But it means that we now have around about 883 so roughly 6% more Argos stores whether they are standalone or within the Sainsbury's estate. And we have significantly increased the number of collection points. So again making it very convenient for customers around about 1,200 points of presence.

And the right-hand chart just shows the way that the shape that the business is changing and how we move towards a more online and pre-ordered and fast-track delivery model as customers move away from the traditional store shop.

Clothing, a challenging market again. We have actually grown our market share against that backdrop. But more importantly we have been focusing on driving full price sales. So we have reduced the number of promotional days during the course of the year, that would have certainly had a drag on the sales line. It would have been helpful to the overall profit line. And we have seen full price sales growth of around 12% and as I say that is driven by about 20% fewer promotional days year-on-year. Again if we look forward, we are doing a pretty good job within Tu online and also within Tu at Argos so as we stand today we are moving rapidly towards 10% of our sales being through the online channel. And again if you want to be in the clothing business in the foreseeable future you need to be investing in online which now accounts for well over 20% of sales within the entire market. So very much an area for growth for our future.

We'll talk more about our Financial Services in September but two points to make. One is we have been through the investment programme and whilst it has been painful and longer and more expensive, we can now broadly speaking draw a line under that. But it does mean we have got a very modern set of platforms on which we can build our Financial Services business in the future. Secondly we have a very strong set of commission based products, so insurance, ATMs, travel money, these are all businesses which we have seen reasonably significant amounts of growth over the last period of time.

And thirdly there is an opportunity, a very significant opportunity as the banking market changes to invest in how we show up in our digital real estate with our Financial Services offer. And a very good example of that is the Argos storecard app. Now we have 1.2 million registered customers so very high levels of market penetration. We now launch digital statements so over half of our customers are active with digital statements which of course means we are not sending out pieces of paper anymore so a substantial reduce in costs. And around about 45% of all of our repayments for the Argos business, the Argos Financial Services business is now made online. And that is very much the direction of travel, so not just within Argos but within our organisation more generally making sure that we have got the right financial services products enabled through digital and in the right point for the customer journey in a joined up way again is front and centre of what we are doing with our Bank.

We have continued to deliver substantial cost savings in the year and will continue to do so in the foreseeable future. So over £220 million of cost savings in the year through a number of areas, labour, marketing, digital and technology and logistics. But we know that there is more that we can be going for so we have integrated a lot of functions within Sainsbury's and Argos and indeed the Bank. But there are further benefits that we can drive from that as we look forward. So there are still many areas of duplications. So one of the big focuses over the next period of time is how we bring the businesses together closer, how we join our organisations together better, but also eliminate any forms of duplication across the two businesses. But we are committed to reducing our costs to make our business more efficient investing in technology to be able to do that because ultimately that is the primary way that we are going to be able to be more competitive in the marketplace overall.

And then there is the investment in digital and I personally think this is one of the most exciting things we are working on and one of the most sustainable sources of competitive advantage over the medium to long-term. So if you look at something like SmartShop, we now have it in 100 stores. There is a lot of investment involved in that both in terms of the infrastructure, so making sure you have got the right bandwidth going into your shops and making sure that you have got the right Wi-Fi connectivity. But once you've got it you have then got access to customers in real time as they are shopping. And in our most highly "penetrated" store we will see sales of maybe up to 20% going through SmartShop and that is important because it gives us a way of talking to customers not just in our physical real estate, but also more widely in our digital real estate. And as we join our properties together with things like single sign on wherever you are in the Sainsbury's ecosystem, whether it is shopping with Argos, shopping with the Bank, shopping in the supermarket or shopping online for groceries, you will have a similar customer experience. And so increasingly we will be able to anticipate and fulfil your needs because the vast majority of customers as of today shop with us in only one of our channels and that gives us a big opportunity in the future.

We are rolling our SmartShop as I said, we will have mobile already in 8 of our Convenience stores and across the road you can go and try mobile scan and go. So literally walk in, scan your groceries on your mobile phone and walk out. And again it is an experiment, interesting to see already the adoption rates are pretty high. But it again shows how the world of payments will adapt in our supermarket business and our Convenience business over the next period of time.

Argos we now have Pay@Browse in 168 stores and we will rollout digital shops into about another 200 Argos stores over the next period of time. So we will move from around about 450 to 650 by the end of 2020, by the end of this financial year.

I talked about single sign on, so gradually we are joining together our digital properties so you only need one way of getting into our ecosystem and just go back to the numbers. So people through Argos Financial Services, through the SmartShop app, through digital Nectar, all of these things gives us access to people on their mobile phones in a way that we can join together all of our digital properties.

And that brings me onto Nectar which is currently in trial in Wales. We have been pretty pleased with the results. So effectively Nectar goes from piece of plastic to something that is on your mobile phone that is delivering value to you in real time. And we will roll that out over the course of the rest of the calendar year. It is the largest loyalty scheme in the UK, it is 18.5 million users, it is the most recognised brand. And again we already have 1.2 million people who use the Nectar app for the way they interact with the Nectar business. So again a very large customer base that is existing. And part of the benefit of Nectar is it works across a broader ecosystem so not only does it deliver value within the Company overall, it also we have partnerships with a number of key providers. So we have resigned five of our major partners in the last year and we have added Esso, Lloyds, EE and Europcar during the course of this year. And again it provides more value across a wider customer base than other equivalent schemes.

And last but by no means least, we will continue to strengthen our Balance Sheet. We have been through a major investment cycle through the Bank programme and through Argos stores instores. We can maintain the level of capital investment, Kevin has talked about that, and focus that more over the next period of time on our core grocery real estate and the increasing digitisation of our business, whether that is through Argos or through the supermarket chain more generally. And pay a dividend and reduce our debt we believe over the next three years by around about £600 million. So we will significantly strengthen the Balance Sheet. We are very disciplined in the way that we invest capital and Kevin has showed you how that will play out over the next few years. And therefore we will be more than able to cover our dividend into the foreseeable future.

So in summary, we have done some things very well within our grocery business, so grown online, grown our convenience business, grown or maintained our share within added value food categories. Work to do in core commodities, we have improved our customer service but we can do better on that and invest in our core real estate. There is an opportunity within general merchandise, the market will continue to consolidate and we will be ultimately a net beneficiary of that. We have got work to do in giving our customers easy access to financial services, but big emphasis on digitising the products that we sell. Very exciting work going on within our digital future and as we join those properties together we believe that we will have a unique competitive advantage as we look forward, particularly as we join our data together. But we are also very cognisant of the fact that we need to have the financial capacity to invest in our business and therefore we are very thoughtful about how we invest our capital whilst maintaining the kind of levels that we spent over the last few years, managing our cash flow carefully and therefore paying down our debt.

Now with that I am going to play you one film whilst Kevin and I prepare ourselves for the onslaught that is going to follow. So thank you.

Eyes well up when we show that, so we don’t do it at the beginning we always do it at the end. Bruno why don’t you go first.

Question and Answer Session

Question 1

Bruno Monteyne, Bernstein
Thank you, good morning, Bruno Monteyne from Bernstein. My first question is around the grocery business. You talk about investing in commodities or anti-price points. Are you considering a similar redesign of the brand and the merchandising and the role of the products or is it just about pricing of basics, or are you rethinking bigger round of brand? And if you do can you really fund the price resets you need on those products within the existing margin structure of the business or does it take more to reset? That is my first question on grocery please.

Mike Coupe
So you have more questions for us?

Bruno Monteyne
Yes I have one on the pensions?

Answer: Mike Coupe
The short answer is it is product by product category by category approach so in some areas it might be appropriate to have an entry price point brand. So there are some core commodities which are traded and therefore you might choose to have a different approach, different brand at certain times of the year. And the other example I gave is the J.James brand which is specifically a tertiary brand created for a given category and given customer proposition. So there is no black and white answer because there are different ways of addressing the issue.

And that plays to your second point which is there are some areas where you would change the buying model in order to be able to fund the investment. But don't lose sight of the fact that there is still a lot of work to be done in making our business more efficient. So we have talked about the integration of the two businesses and that can certainly generate reasonable levels of cost efficiency. And there are other areas that we are focusing on, again if we manage to get penetration levels of SmartShop up to let's say even 10% then that would reduce some of our overheads in our shops pretty significantly.

And the last point, we have to be slightly careful, but clearly the CMA work does suggest, I said I wouldn't mention it but I will, does suggest that there are some opportunities within costs of goods and whilst I wouldn't for a moment claim that we could get half the total that was out there, we should be able to get a proportion of that and that again should give us the capacity to reinvest back in the offer.

It is also a dynamic. So it is changing literally by the minute and by the hour so we also have to be very cognisant about what some of our competitors have done. Some of the things they have done have been very good. Some things they might have lived to have regret and they may do less of in the future. So we also have to be mindful of that.

Further question
So you see no reason to reset the margins to afford those new commodity prices you are talking about?

Answer: Mike Coupe

It's very much on a pay to play basis. That is the approach we take and in the end we'd say there is a relative level of conservatism in the current outlook for the company as well which also should give us some headroom as we look forward.

Further question
On the pension you sort of highlighted on the pension exceptional costs that you have and exceptionals. You stressed in the Report that is a non cash, but I am sort of confused by that. Every provision is non cash when it starts but becomes cash when you pay it out. If you now have a commitment because of the legal claim that you have to pay women more in pensions, surely that additional provision you have taken means the cost of your future pension cash outlays will be higher. So it is only temporarily non cash, is that right to classify it as non cash?

Answer: Kevin O'Byrne
Yes you are right, we are talking about 50 years so over time that will come through, but it doesn't affect our commitment and our requirement for cash injections into the pension scheme at all in the short-term. We are in the middle of our triennial review with the trustees. We haven't quite completed that and that will set then the cash contributions going forward.

Further question
But it is clearly different if you do a right over an asset, there is no ongoing cost, this is a non cash charge, but it will become cash over time and I was a bit confused.

Answer: Kevin O'Byrne
It's not £100 million cash charge to the business this year or next year, or it is spread over 50 years.

Further answer: Mike Coupe
But it also depends on the investment returns from the pension fund, but again over 50 years you and I would be speculating pretty significantly if we were trying to double guess what might be happening and all pension schemes are funded and analysed on a relatively conservative basis. You would hope that you could deliver returns that were better than the current arrangement. So the reality is none of us really know but it is over such a long period of time as to be impossible to speculate as to whether or not it will be a cash drain or a cash benefit to the business.

Further question
And last, but not least, the Bank. On my estimates like more than a billion has gone in in different types of transition caps, equity. Despite all of that, if I look at your cost:income ratio it is still very high and getting worse. That would sort of suggest that you are still subscaling the Bank in your banking business. But if you subscale you are going to have to grow it a lot and that means more equity injections to keep it growing. So that sort of paints a picture of a cash drain for so long. Have you actually considered Plan B of actually ditching the Bank and see how much money you could be at for selling the whole banking business right now?

Answer: Kevin O'Byrne
No we are not actively looking at it Bruno. What we are focused on, we are very aware of the performance of the Bank and we are very aware and I would say share your frustration in how we get a return from the capital that has gone in. So what are we doing? We are being more disciplined about the capital that is going in and you have seen £190 million the year before that and £80 million next year. We are looking at ways we can do more capital like growth in the Bank and ways that we can limit the capital required. We are looking at growing the commission type business and in September we would probably like to share a few more of those thoughts in the capital market day.

Further question
But is the reasoning correct that the cost:income can only really get healthy if you have a much bigger bank, [both talking over each other].

Answer: Kevin O'Byrne
You grow as you say and then you reduce cost and we need to look at both.

Bruno Monteyne
Okay, thank you.

Question 2

Rob Joyce, Goldman Sachs
Thanks very much, Rob Joyce from Goldman Sachs. The first one just a simple one to Kevin I guess. In terms of PBT, I think on your website 652 for consensus for FY20, are you comfortable with that number?

Answer: Kevin O'Byrne
Yeah we don't normally Rob at this early stage comment on consensus, but clearly if we had something to say we would say it.

Further answer:
Second one is just, a lot of very helpful day-to-day provided in terms of customer perceptions. I noticed that I guess outside of just the under indexing on the entry level products the actual perception gap in terms of 'has good food' I think 'good quality food' or whatever, that gap has basically halved versus the peers over the last four years. Is that something you are looking to invest in as well?

And then just in terms of assessing when you might need to put more into the business, what level of market relative performance is an alarm bell for the business, if the current level isn't?

Further answer: Mike Coupe
Yeah, I mean the point I was making is that we have done a pretty good job of our added value foods. You know there's always work to be done and all of these things are like painting the forth road bridge, the constant iteration and our constant challenge about sure that you at the right point in the cycle. So you know meat reducers and meat free is a big area of growth. If you are too early you are going to waste a lot of money and if you are too late you miss the curve. We've pretty good at making those kind of calls. If you look at things like FreeFrom, allergen free products, we still maintain a relatively high market share because we are kind of at the right point of the cycle.

But you are right, in the end there is a narrowing of the gap and we need to keep challenging ourselves on that side of the business to continue to find ways of enhancing our proposition in added value fresh foods. But it is something that we are reasonably good at and we will challenge ourselves to be continuing to drive that change in the future.

The emphasis I wanted to put on the added value, sorry on the core commodities is just making sure that we and you recognise that we know that we need to do work in that area.

Further question
So just I guess relative, you did put up the market share slide. Is that something we would expect to see improve from here or is it something you are not focused on, you don't think is important?

Answer: Mike Coupe
Well we have to balance all of things off. I mean in the end we want to be maintaining if not growing our volume share, that would be a start point and certainly within the mainstream grocers that would be our aspiration. And we'd recognise that in some areas that we have seen our market share decline, but it is not quite as black and white as the world might paint it firstly.

And secondly there is a very straight forward harsh reality in the way that the Kantar data is published which is it just completely ignores 20% of the company's overall sales and at least a proportion of those are now going through our mainstream supermarkets. And if you disaggregate that it does make a reasonable amount of difference to the way that you might look at market shares. And we would look at it in the rounds not quite in the relatively single minded way that Kantar and Nielsen do.

So we always have to think about these things in the round and we always have to make sure that we are balancing the right approach to managing our cash, driving our sales, but also maintaining the right level of profitability in our core business.

Further question
Thank you. And then finally just on the 20%, on the Argos bit, you've had capacity exit in the industry which you foretold. You didn't play as heavily in Black Friday, yet I think the second year you flagged that margins are under pressure in that business. As you roll off the synergy programme that you alluded to coming to the end of some of the easier wins there, does that business move into being profit headwind?

Answer: Mike Coupe
It is some and some. And the areas that we have grown in tend to be at the lower margin end of the spectrum but I have already referred to the fact that the key driver of the Argos business model is the cash profit per item. And so selling relatively small things at relatively low margins but extremely valuable is actually better for the business than selling high margin products which are relatively low cash value.

So you always have to look at it through that lens and of course for a number of the more expensive products there is the financial services product attached to it which again over time is beneficial to the business.

But there are clearly opportunities in buying and we have only just literally in the last year bought the buying teams together so we can certainly integrate ranges which will drive out benefits in terms of cost of goods. And there are certainly some mixed benefits if you look at things like furniture. There is undoubtedly an opportunity to grow that. We have a pretty good two man delivery channel. And so over time we could see our way to growing some of the higher margin categories within the Argos business.

But we are not pulling any punches, the market is pretty difficult at the moment and unless and until we get some in my view settlement to the current political situation I suspect that is going to continue for the foreseeable future. So I think it would just be misleading to call up too much at this point in the cycle.

Further answer: Kevin O'Byrne
There's one other lever we can pull. Obviously you know there's premium ranges with what we are doing, there are new ranges at higher margin as Mike said and then there is the lease base and the rent base. But relatively short leases there. So there is either a renegotiation with landlords or there is a change closing stores. We have got a number of economic levers we could pull.

Further answer: Mike Coupe
And one data point we didn't put in, you know we have gone through the investment stage with Argos stores in store. So we have round about 280, many of those are still going through their maturity curve, in fact all of them are going through their maturity curve. So there is just a natural cycle of growth that will come through in a reasonable proportion of the sales overall just by virtue of the fact that we are seeing that maturity come through the estate. So on the balance of probabilities we should if nothing else changes, we should outperform the market simply because of that maturity curve.

Question 3

Andrew Gwynn, Exane
So it is Andrew Gwynn from Exane. I have got too many questions. So let's go for three. Is there a sense that you have taken a bit too much cost out of the business in places? Sainsbury's traditionally has been you know the nicer store environment versus the competition. So are there places perhaps where you perhaps look to roll back some of the cost saving that you have done?

The second one, obviously you have alluded to a couple of times on the COGS opportunity. Obviously it was understanding that the CMA process was relatively blind. So you didn't necessarily know where that COGS opportunity was so how can you now go out and get it?

And then the last one, let's go for capex. Capex running about 0.75 times underlying depreciation of the banking outlet intangible amortisation. Is that the right number? Again you talk quite a lot about digital investment within the Group. That to my mind sounds quite expensive. Is it right to spend 0.75 times depreciation or is depreciation just wrong?

Answer: Mike Coupe
Shall I take the first two and then Kevin can take the last one. So yeah actually I would argue it wasn't necessarily the cost ambitions, it was just the sheer physical reorganisation of the retail teams which ultimately led to some of the things we talked about during the course of the Presentation. The reality is we lost approximately a third of our managers, many long-serving managers and the great news is that we bought a whole bunch of very new, very dynamic talent into the organisation as a result of that and we have a much clearer and more streamlined way of running our shops. But there is no doubt it was disruptive particularly during the course of the summer last year.

So because we are seeing the metrics move forward, if we weren't seeing the metrics move forward I would agree with the underlying premise of your question, but actually every week, week in, week out we see that gradually stepping up and we've seen some of our best customer service metrics in the business over the Easter period. And we can literally read it real time. So it is something which is very, very front and centre of the organisation and you can talk to Simon after this just to get some further colour on that.

You are right, in the end the process is blind. So you are right in terms of your premise, but on the basis that you know that there is buying opportunities there, we should be at least asking the question. And there will be sense and this is, you have to be slightly careful in how you put it. But let's face it, the supply base might have been less forthcoming in the last period of time knowing that they might be being faced with a reasonably large bill and so the other opportunity is that within our supply base they may be let's say more willing to invest in our business now than they might have been whilst we were going through the process. So that's the other dynamic which I suspect will drive some of our cost of goods opportunity as we look forward.

Answer: Kevin O'Byrne
Just on the capital Andrew. I mean £550 million I think that is a reasonable amount of money. It's £2.5 million for every workday of the year. So we have got a lot of money to invest in the business. We are very disciplined about how we allocate it. We are looking for, when we look at growth capital, we would like to see a four year pay back. If it is cost saving capital we would like an eighteen month payback. If we found that more of the initiatives that Mike talked about and more of the initiatives that we are trying in stores was paying back quicker and was growing, we would come back and spend more. We are really returns constrained or maybe even in some cases, ideas constrained rather than cash constrained. And if the right thing to do for the business was to come back and say to investors, do you know what, we should be spending £600 million and here is why, we would do that.

Further answer: Mike Coupe
And if we could find 50 high quality convenience stores, as an example, tomorrow I would have absolutely no hesitation in writing the cheque to buy those because they are fantastic returning investments. So we are not limited by our cash as you have seen, we are limited by making sure that we are very disciplined in the way that we allocate capital and you know as well as I do that this industry is notorious for not making a return on the capital it spends and that is something that we are very aware of and very focused on making sure we don't fall into that trap.
.

Question 4

Dave McCarthy, HSBC
Thank you, its Dave McCarthy, HSBC. You didn't say much on pricing and price baskets today. Can you tell us where you are on pricing and how that has evolved over time the way you have given us other data and looking at the different price baskets you use i.e. not just one measure but your front basket, your back basket and so on?

And then related to that can you just remind us what the difference in the price list is between your convenience offer and the mainstream offer and has that changed over time as well?

Answer: Mike Coupe
Yeah, I'm not going to disaggregate the data in the way you have just described. So we obviously measure or we measure literally 14,000 products every week in a high level of detail which we would never make publically available. But broadly speaking we are comfortable with our start point for our price position, but we recognise as I have said already that there is a particular area in core commodities where we need to be more price competitive. So on the broader basket we are in reasonable shape. It is in the core commodities where we need to address not just pricing but also the positioning of the products.

So to Bruno's point earlier, the reality is if we look at our Basics ranges, they are quite often cheaper than our mainstream competitors and cheaper than the discounters. But that is not recognised by our customers. So we have to think carefully about how we re-engineer categories in order to be able to deliver an outcome that means that we are more price competitive in the way that customers view it, but equally we are doing it in a way that is affordable and manageable.

There is roughly a 5% gap between the Convenience business but I mean that covers a multitude of different dynamics because in the end the Convenience business is driven by making sure you have got absolutely the right range in each individual location. And so typically a category can be one or two products and the choice of that one or two products in any given store can make a huge difference to what you might view as the price basket. So overall it is a gap you know on a SKU for SKU basis of 5%. But the reality is that is a pretty superfluous way of looking at it because if you went to the one around the corner, heavily orientated towards fresh food, Taste the Difference, Added Value foods, a higher end wine range. If you went to one that is just down the road from me in York it would be a very different and you know different range and appealing to a different customer base.

Question 5

Sreedhar Mahamkali, Macquarie
Thank you. Sreedhar Mahamkali from Macquarie. Three questions as well please. First two probably are connected and I will ask them together. Just going back to the COGS opportunities you talked about, are these predicated on some sort of volume outperformance relative to where you are now or do you think some of these are actually there for the taking?

The second one is the £500 million cost savings target isn't being repeated today. Can you give us some thoughts on how we should think about it and what sort of level of cost savings you should expect this year relative to 220?

And a third question is, Mike you have talked about consolidation in general merchandising and you talked about you being in a strong position. What role do you think Sainsbury's plays in that consolidating market?

Answer: Mike Coupe
So if I go for the first, Kevin can talk about the second and then I will come back on the third. Yeah clearly if you have got volume growth it's an easier story to sell to suppliers, but equally many of the suppliers I am talking about have a vested interest in Sainsbury's growing. So in many cases they are prepared to invest in their supply chains and our business in order to generate volume growth as well.

And going back to again how we might look at this. In some categories you may well rationalise products which means the volume per skew increases making a more efficient supply chain and ultimately that would result in a lowering of cost to goods. But there isn't a kind of one size fits all approach. Again in answer to the question that Bruno posed, each category has its own unique characteristics, each category has its own competitive dynamics. So you have to look at these things literally SKU by SKU, category by category in order to get the right outcome and that is very much what we are focusing on.

Further question
So to that point, have you already got a reasonable sort of line of sight of where you are going in that sort of COGs bucket?

Further answer:
Yes we don't talk about that today. We have done a lot of work on looking at our value chains and actually reduced already in the previous year a cost of goods, our cost of goods by looking at all aspects of our value chains. But we know that there is more work that can be done. And I have used the Forth road bridge example on a number of occasions. The idea that you kind of start and you finish just doesn't work like that. You start and finish

certain things at certain times, but it is a continuous review of how we can do a better job of driving efficiencies on an end to end basis and how we engineer categories to deliver an outcome which both satisfies our customers and maintains the right level of profitability in the business overall. And it is literally SKU by SKU, category by category.

Answer: Kevin O'Byrne
While we haven't specifically talked about it today, we have continuing as you would expect, cost saving programmes in the business with the target that we would at least cover cost inflation every year as we go forward and we have detailed plans behind those.

Further question
Is there a number this year in terms of 220 last year?

Further answer
You can sort of work out our cost inflation is something in the order of £200 million a year you know so it is that scale. And anything that we would do above that we would invest in the offer.

Further question
And GM consolidation?

Answer: Mike Coupe
Yeah I mean clothing, GM, I mean that is just a general point I have made already which is there will be consolidation in this market. We had a go at that this year but life moves on. But the reality is that there are interesting businesses out there and there ultimately will be distressed assets out there and there is a range of possibilities. So at one extreme you know we are putting Specsavers concessions into our shops. That is a good use of space, it works for them and it works for us. We don't own the business we just get a rent-roll from that. At the other extreme we bought the Argos business because we believed that actually the best value generation would be by driving out the value synergies, the cost synergies, reducing rent-roll, bringing in the buying books together and making the back office functions more efficient. And of course having been through that process and having put the building blocks in place there may be opportunities to be able to do that in the future. But don't hold your breath, there is nothing particularly on the stocks, but you would always be you know mindful of what's going on in the marketplace and if opportunities arose then we would be in a position because we have got cash in the bank to be able to deal with that if those opportunities for the right assets came up. But there's a range and a spectrum of possibilities.

The other point I would make is that we have now an increasingly valuable set of digital assets and so if you think about it in the round, access to our customers and we talk about the fact that we have 35 million unique customer relationships in our business overall. That is something that could be valuable to other businesses. So there is no reason why over time we wouldn't consider not just a different relationship in our physical real estate, but also in our digital real estate as well. And I suspect over time that might be a bigger opportunity than the physical side.

Sreedhar Mahamkali
Thank you.

Question 6

Nick Coulter, Citi
Morning, Nick Coulter from Citi. Two questions if I may. Firstly, I think in the past you have referred to a higher margin rate for the Group. Is that aspiration still valid in the medium to long-term or is it more about sustainable volumes?

And then secondly, what gives you the confidence that discounters will peak at around 15% per market share? Thank you.

Mike Coupe
Well Kevin can do the first one.

Answer: Kevin O'Byrne
Well I think Nick the target, I think a margin target doesn't feel like the right thing for the business right now. I think what we have got to be focused on is having a very robust and dynamic retail business that delivers consistent profits.

Further question
Just directionally not as targets, just directionally?

Kevin O'Byrne
Sorry I didn't get the question?

Repeat question
In the past you have referred to a raise, but directionally do you think your margins can increase over time or is it more about driving volume?

Answer: Kevin O'Byrne
It's more about driving volumes than driving consistent cash returns.

Answer: Mike Coupe
And on the discount, I mean I have genuinely have no idea other than being able to look at analogists markets in Europe and around the world. And broadly speaking the average is around 15%. They continue to open roughly 100 stores a year between the two of them and at least in the line of sight that we have, that is likely to continue for the foreseeable future. At some point there has to come a point where if you are burying a lot of billions of pounds in the UK market and making less money no matter how long a term view you are taking, you ultimately would have to take a view as to whether or not that is a good use of your capital, as I say, no matter how long a view you are taking.

And when you unpick the figures you know the discounters were very heavily driven 4-5 years by underlying like-for-like growth and pretty impressive volume growth on an underlying like-for-like basis. Increasingly they are only being driven by additional space and ultimately I would suspect their owners would have to ask themselves a question as to whether or not they would continue to inject the amount of capital they are currently injecting.

But there is no sign on the horizon that we are looking at saying that they are slowing down their rate of expansion certainly for the next 2-3 years. And that would lead you to the conclusion that we introduced what now 3-4 years ago, that they will get to 15% roughly by 2022 and you know what, that looks like it is going to happen.

Further question
But there is no sign from your property teams that they will reach a certain penetration in terms of stores per town or catchment or what they might do with their formats in terms of evolution that gives you?

Answer: Mike Coupe
No there are some evolutionary formats we know from our own experience that getting a smaller format to work in a dense urban population is more challenging from an economic point of view, so we will see how that plays out over time. But there is no obvious line of sight that that 100 is going to be 50 or 20 or 10 over the next period of time and indeed in their public utterances they have broadly speaking confirmed that they will continue to open reasonable numbers of stores over the next three or so years.

Nick Coulter
Thank you, that's very helpful.

Question 7

Maria-Laura Adurno, Morgan Stanley
Thank you, Maria-Laura Adurno from Morgan Stanley. So one question coming back on the cost saving and the comment that you just made about your £100 million per annum of cost inflation which needs to be offset by the cost saving. So am I doing the maths right then to say that out of those 220 only £20 million was reinvested in prices or was there other levers that allowed you to actually increase the content that was reinvested in prices? And if we were to take then 2019 so the year ahead, how should we be thinking about those price investments? Is there something that is like going to be a continuation of what you've done or be on the side you are doing as SKU by SKU and category by category, are you actually thinking about it differently? So that is the first question.

Mike Coupe
Crikey that sounds like the entire business strategy in one question!

Further question
The second question is that over the last year and a half we have actually seen other players come out with alliances and new buying strategies and I was just wondering whether this is also something you currently have in mind and whether it would make sense for your business?

And the last question is around the banking profitability, I was just wondering what are your thoughts for the year ahead? Thank you.

Answer: Kevin O'Byrne
We've guided to £45 million just to be clear, there is £10 million of transfer pricing in there. So if you like it is like-for-like £35 million.

On the cost inflation, I think the broad picture you painted of where we are this year with costs largely covering inflation and not a lot more is I think a good working assumption. Clearly we think we could probably do more in some places, but I think that is a good working assumption for the time being.

Answer: Mike Coupe
I mean the bit of the equation we don't refer to and is quite important is underlying cost of goods which aren't in the cost savings that we talk about and we haven't given you a number and probably won't.

And secondly, there is a margin benefit. So the underlying premise is that we can do more to add value and have done a reasonable job of that and of course if you are adding value, it does give you a capacity to invest because it makes for a stronger margin mix. And one of the strengths of this business is we still continue to overtrade in broadly speaking the added value higher end categories. And that ultimately does give us a margin advantage overall.

As far as buying alliances, I mean there are undoubtedly opportunities for levels of co-operation. It would be very, very difficult to do in the UK market, but we do believe and in fact we already have things in place where we are effectively acting as the procurer for other people. So for instance we supply Booths with their grocery products as an example. And there may be other opportunities within the UK market which ultimately, to the point about volume, has potential in the future.

We are also supplying companies outside the UK, so a Dairy Farm in Hong Kong as an example buy Sainsbury's products and have done a pretty good job of selling them which again enhances our overall volumes and again should be beneficial to our suppliers.

But it is very difficult to do buying alliances because of the way that the competition rules are structured in the UK and I am not, personally I think that buying alliances with companies outside the UK are really, really difficult. You know I have tried this on a number of occasions. I give the example of the Margherita Pizza. You'd think the specification of Margherita pizzas were the same anywhere in the world, it is not. Having tried to do it between Germany and the UK, the German's like bits of oregano on the top of their Margareta pizzas and the Brits don't. So the reality is they are different products and so you can't combine the scale because either the Germans won't buy the one without the oregano or the Brits won't buy the one with the oregano. So that, so in some core commodities you can get benefits, but it is a relatively limited number of products where the specifications are pretty much fixed throughout the world.

Question 8

Dusan Milosavljevic, Berenberg
Hello this is Dusan from Berenberg. Just two questions from me. One, just before you announced the Asda bid last autumn we were talking about potentially partnerships in wholesale, the UK wholesale industry, that is where your peers have moved. What is your thinking about opportunities there for consolidation relative to maybe non food categories?

Answer: Mike Coupe
Yeah it might seem like it is about 5 minutes, it was actually a year ago when we announced the Asda deal, not the autumn, but anyway that is a small point. I mean in terms of wholesale I have said it already there are certainly. We have buying scale, we are the second largest purchaser of food in the UK and ultimately there is an arbitrage between the cost prices that other smaller players might be paying and us and we do think that is an opportunity and it is something that we would actively explore.

In the end it is quite a delicate negotiation in order to be able to make that happen and I have already talked about the fact that there are number of areas where we are already effectively acting as the procurer for other people in our marketplace. I can't perceive there is an opportunity, the route of the question is would you buy a wholesaler? The answer to that question is never say never, but I suspect that is not something that is obvious because the only wholesaler of any scale has already been bought. So you are left with in the overall scheme of things relatively small businesses, although in some cases extremely successful businesses.

Further question
Okay. And the second question just on the guidance for exceptional for next year when you take all of those categories together?

Answer: Kevin O'Byrne
Yeah what I said earlier was that we don't think it would be above £100 million next year from a cash point of view.

Further question
Okay and working capital for next year again, the last year was positive about £200 million, this year it was a little bit negative, being £50 million negative.

Answer: Kevin O'Byrne
Yeah I'd worked on the basis of working capital being broadly flat this year. There's a couple of factors going on there which isn't clear from the numbers. We had, we have done some good work in the last couple of years on working capital, so we had a benefit underlying roughly £150 million each of the last two years. That is something you can't just keep doing because when you take it out it is a onetime impact. It is disguised in the number for this year because we had some of the one-off costs we have talked about. We had some Brexit stock building etc. We changed timing of VAT payment which was about £60 million which went in the working capital number.

So for your models I would assume flat and then we will see where we get to during the year.

Dusan Milosavljevic
Thank you.

Question 9

James Anstead, Barclays
James Anstead from Barclays. Just a question probably for Kevin on the target for the £600 million net debt reduction in the next three years. The first thing was just to check that the £133 million that you are getting for the British land dissolution is included within that £600 million?

Kevin O'Byrne
It is.

Further Question
And then as a kind of follow-up to that I guess two quite significant variables, again cash flow forecast for the pension top-ups and the bank capital injections and those, well they haven't been variable because you have given us due guidance kind of historically but there is obviously potential of the top-ups possibly reduce and the capital injections you will talk about later in the year. But what are you assuming in that £600 million? Are you assuming they stay where they are or have you put different?

Answer: Kevin O'Byrne
I'm assuming the Bank stays around, we talked about the £100 million mark, we will see because that is the working assumption. And the assumption is that the pension stays broadly where it is as well.

We think the £600 million we front-end loaded, we have said it is at least £600 million. But I think the important thing today is to say we are very focused on free cash flow, we are focused and committed to reducing our net debt which we have been doing for the last couple of years, were making a commitment. And we have said at least that clearly we would like to beat it, but first of all we would like to deliver it and frankly if we have delivered £200 million every year, I don't think anybody would be too upset, but there is potential maybe to do more in time.

Closing Remarks
Mike Coupe
I don't see any other hands in the room. So thank you very much for coming this morning and look forward to seeing you all again. Thank you.

Kevin O'Byrne
Thanks very much.

End