J Sainsbury plc – Third Quarter Trading Statement 2019-20
Wednesday, 08 January 2020 – 9.00am

Mike Coupe
Chief Executive
Good morning everyone and Happy New Year and welcome to the Quarter 3 Sainsbury's Trading Update Call which covers the 15 weeks to January 4th. I am joined here today by our CFO Kevin O'Byrne and I am going to ask Kevin to run through some of our Quarter 3 highlights in a moment and then we will hand you over to you all for the Q&A. So Kevin over to you.

Kevin O'Byrne
Chief Financial Officer
Thanks Mike and welcome everyone. I will now take you through some of the key numbers, Looking at grocery first, sales grew by 0.4 per cent representing a continued outperformance of our key competitors in both value and volume over the Quarter reflecting the investments we have made in the customer offering in our stores over the last year and the ongoing improving in service and availability.

Behind the total sales growth of 0.4 per cent we saw lower inflation this Quarter versus last year, so this actually represents a slightly better volume performance in a slower market despite a reduced benefit from new space. And we continue to generate strong growth in our online grocery business, up 7.3 per cent in the period.

General merchandise sales fell by 3.9 per cent. Argos delivered a strong performance over the Black Friday period and outperformed a weak market in consumer electronics, but was heavily impacted by very weak toys and gaming markets where we have large positions, both of which saw double digit declines. The gaming market in particular was down more than 35 per cent impacted by an absence of new product launches. Argos customer service metrics remained strong over the period with more customers shopping online and taking advantage of our click-and-collect and delivery services, pre-paid click-and-collect sales for example grew by 16 per cent providing a great customer experience and of course reducing costs as people collected the products themselves.

Finally looking to clothing, sales grew 4.4 per cent. Full price sales grew by nearly 8 per cent with sales of seasonal products helped by the colder weather earlier in the Quarter. And sales were helped by very good performance from our Christmas, party and gifting ranges. Online clothing sales grew by more than 40 per cent and in the period total Group online sales accounted for more than 20 per cent of the business up 5 per cent year-on-year.

So overall a tough backdrop and some challenges in general merchandise, but a good performance from our grocery business in a weak market. Operationally we were in very good shape across the business with strong availability and service and we have exited the Quarter cleanly from a stock point of view.

We will now open up the call for your questions.

<u>Question and Answer Session</u>

<u>Question 1</u>

Andrew Gwynn, Exane
Morning all, Happy New Year. So two questions from me. So first off I will ask a consensus question because I am sure somebody else will, but your thoughts on this year's number, but perhaps also next year's forecast as well? Very early stages I know.

Second question, obviously some weak performance in the GM business, particularly as you mention in clothing, er in toys and gaming, but to what extent does that matter for profit? Is there a significant exposure from a profit point of view to those categories or is it really just a bit of top line?

Mike Coupe
I will ask Kevin to answer both of those I think.

Answer: Kevin O'Byrne
Andrew first on consensus, you know we don't traditionally comment on profit in a Trading Update, but as you will expect if we had something to say about consensus we would say it. So you can infer we are comfortable with consensus. Next year from memory, consensus is up 1-1.5% or something. We honestly haven't completed our budgeting for next year etc, but that doesn't seem unreasonable at this point.

On the General Merchandise, of course they all contribute. You are absolutely right, toys and gaming would be generally lower gross margin products in the mix. So they are less impactful than sales shortfall in some of our other categories like Home for example and General Merchandise. But of course they all contribute so we have had to do some good work on costs to manage the bottom line.

Further question
Okay and just come back to the food business, will we see any sort of standout areas there? I mean the performance for you is as you mentioned better than peers, it also nearly listed peers at least?

Answer: Mike Coupe
No it is reasonably sort of even in its performance. The Taste the Difference volumes grew so that was a big tick in the box. We continue with the programme of rolling out opening price points. So we are on track to deliver what we said we would deliver. And then there is a lot of store refurbishment that has gone on during the Quarter. So it is a very rounded sort of blended performance.

The operational stats is probably the other standout thing where year-on-year all of the metrics we measure on customer satisfaction, move forward, our availability was as good as it has ever been. And things like speed of checkout were significant improvements year-on-year which is testament to all of the work we have done in investing in self checkouts, but also SmartShop. And you know look at SmartShop of a factoring in of itself. Around 15 per cent of sales in the stores that have it. So round about 500 stores went through SmartShop over the entire Quarter which shows how much our business is changing and how rapidly it is changing.

Further answer: Kevin O'Byrne
Andrew just building on Mike's point, the Taste the Difference volumes grew, but Kantar data yesterday would also show that we were the only traditional retailer to show growth in value Own Label sales, so it was a very balanced performance.

Andrew Gwynne
Okay thanks guys.

<u>Question 2</u>

Maria-Laura Adurno, Morgan Stanley
Hello, thank you for taking my question. I just had a question with respect to space addition. Maybe if you can talk us through the different dynamics into this Quarter and how you see that evolving in 2020?

And then the second question is coming back to toys and gaming. There is definitely a bit of a structural element but also the shift due to people using more tablets and not necessarily playing with the games. But I was just wondering in terms of 2020 if there is any levers that you actually think could potentially reverse the trends seen in the Quarter? Thank you.

Answer: Kevin O'Byrne
Firstly Maria I will talk maybe to the property ones. We have seen space reduction in the, well broadly flat actually in food and reduction in general merchandise in Argos stores. The dynamic behind the scenes was we closed about 23 convenience stores which we announced at the Capital Markets Day, so we have just been getting on with doing that in the period. So we had a negative space drag on the convenience business in the period. Clearly that is beneficial from a contribution point of view. And you would expect that you would see in time, space being reduced in the business, particularly in Argos as we close existing standalone Argos stores and don't replace all of them with store in stores.

Further answer: Mike Coupe
Yeah and on the specifics around toys and gaming you can take it as read that we will do a big review post Christmas, because clearly in the case of toys it is now the second year running where there has been significant reductions year-on-year and we need to make sure that we are maintaining our market share and our competitiveness in that part of the market. On gaming it is clearly a structural change in the sense that more gaming is going online, but this year it was mainly driven by the absence of the sort of big console launch. And we expect cyclically that that would happen next year, this time next year. So probably a combination as you say of structural changes in the marketplace, but also we need to go back and make sure that we have got the right exposure to the right categories in those markets as we go into next Christmas.

Of course this time of year and beyond it becomes much less significant as for Argos's business, so it is really only in the key Christmas quarter that these categories come into their own and they pay a disproportionate part of the Argos general merchandise sales.

<u>Question 3</u>

Bruno Monteyne, Bernstein
Good morning everybody and Happy New Year. My first question is trying to read in your commentary on whether the market in the UK is really getting worse or not. I took note of what you were saying about your fifth price lockdown in 1,200 products. Phased out and seen big price cuts. I look at the Kantar data showing market growth at 0.2 per cent which is also much worse than before. So there will be a sense that today's top line market in the market will grow, the amount of private investments you assess within is making things worse again or is it the normal hum drum and usual promotional and trade planning announcement?

The second one is, is there anything more you can say about your new value oriented products that you are launching? When you had the Capital Markets Day you made it clear they weren't going to get prime position, you thought that was not necessary. Any changes in the way you are approaching the merchandising, the rollout, any successes or failures that you think are worth discussing? Thank you.

Answer: Mike Coupe
Yeah I mean if you look at the market, I mean I showed a chart last night at our Leaders Group which basically says the growth in the grocery market has stepped down from around 1 per cent to as you have already rightly pointed out, virtually zero. That is partly a function of value falling out of the market and I guess if there is a structural decline in volume it is probably too early to call it, but clearly the Christmas quarter would suggest that there has been a decline in grocery volumes over the quarter. Whether that is specific and uniquely to the last quarter I don't think we will really know until this time next year when we have got the sort of full extent of the overall trends. But probably the biggest headline driver of the market has been the reduction in inflation which by implication is a result of the market being more price competitive.

We are pleased in the sense that our relative volume growth is higher than our value growth, so from that perspective we are seeing the actions that we are taking coming through in the stuff that we sell.

There is not a lot we can add to the opening price points in the sense that we don't do a lot of stuff in that area, but a lot of categories we were engineering over the Christmas period we kind of get back into the full flow of that in the last quarter. So I suspect we won't talk more extensively about this until we get to our Prelims Update in May. So there is not a lot more other than what we have already said, and certainly not any significant changes in our approach.

Bruno Monteyne
Thank you.

Question 4

Clive Black, Shore Capital Markets
Good morning gentleman and a very Happy New Year to you all. Questions post the General Election, everybody in the north is full of the beans of joy. And I just wondered in that respect Mike, given you are an experienced player in this industry.

Mike Coupe
You always say that to me, thank you.

Clive Black
Do you see the potential, given greater, well given less uncertainty and perhaps stimulation by the Government through a variety of levers for household expenditure to improve? And in that respect do you think it is reasonable that the grocery industry should capture some of that?

Answer: Mike Coupe
Now internally post the General Election we saw no difference in the trading pattern in our business and I talked on the Media Call about the fact that you characterise ours as almost twin peaks. We had a very strong month end in November, it then got really flat in the first few weeks of December and then peaked very strongly around the weekend before Christmas and Christmas week itself. So nothing obviously, directly out in the General Election. And when it comes to how our customers are feeling, I suspect your analysis is right, it will largely come down to the sentiment out of the Budget, probably the next most significant event in March.

In theory at least, the customer trend should work in favour of retail in the sense that customers have more disposable income, inflation is comparatively low and therefore that should reflect itself in trading up in grocery and in people buying non consumables. I think the story of Christmas will be that that is not actually reflected in what customers have really done.

And of course another significant announcement in the last few weeks has been the 6 per cent increase in national living wage which again you would have to believe should ultimately flow through in customers having more money in their pockets and using that money to buy stuff that we sell.

But to be quite honest Clive, we are planning on the basis that it is not going to get any better in the next year and that we will structure ourselves accordingly. If there are fiscal stimulus put into the market as a result of the Budget or anything else that the Government chooses to do, then we will benefit from that as and when that happens, but I am not holding my breath.

Further question
And you comment on the national living wage, is that ahead of what you would have been expecting prior to the Election?

Answer: Mike Coupe

Yes for sure. I mean if you take the sort of general trend, it is of the order of 4-4.5 per cent. So absolutely, but we are in a great position in the sense we made a big move to £9.20 an hour. So we have got plenty of headroom between where the national living wage will go and where we are currently. And we have reflected on the fact that having made that big year-on-year increase, we effectively have no wage inflation in the second half of this year. And as we look forward in next year we will obviously take the view on where we need to pitch ourselves in the light of the national living wage for the next wage round.

Further question
And just as a second and final question you should have from me. The 20 per cent participation online across the Group, where do you see that progressing you know just in terms of a general expectation over the next few years?

Answer: Mike Coupe
I think you could probably attribute 5-10 per cent growth year on year on year. So that will gradually move towards 25-30 per cent on that kind of basis. You know, plus or minus a bit.

And you know to the question around space, you would expect us to have less retail space in five years time. So the way that the shape of the business in five years will realistically be probably 25-30 per cent online. 75-70 per cent through core physical real estate. And that is very much in line with the way that customers are choosing to shop. And we will hand on the tiller, steer the ship in that broad direction assuming that nothing changes in the way that customers are behaving.

Further answer: Kevin O'Byrne
And you have seen quite a dramatic change in Argos, if you look at year-on-year we have gone from about 35 per cent of the sales in stores last year people came in, we didn't know they were coming before they hadn't reserved or anything. This year it has dropped down to about 31 per cent. So we have seen quite a move. We have still got lots of people coming in to collect things in store, but that is also reducing slightly so the overall store mix is reducing. The nice thing is our leases are on four years, average leases, so we can change the shape of the estate as customer habits change.

Clive Black
Well look, thanks very much for the comprehensive answers and all the best guys.

<u>Question 5</u>

Nick Coulter, Citi
Thank you, good morning and a Happy New Year, good morning. Just if I may follow up on your grocery volume comments, I am not sure about the last four weeks, but I think Kantar has your like-for-like inflation as incrementally positive and as you say, below the market. Would you broadly agree with that observation?

And secondly, still on grocery, on your promotions, could you comment on the shape of your promotions and your like-for-like promotions in or through the quarter? I guess that is with regard to the usual levels of fuel, BWS and I guess twist wraps given the season?

And then lastly on general merchandise, could you give a sense of the negative space impact in the minus 3.9. My understanding is that there is a small positive contribution in grocery. So presumably there is at least a few tens of bps in the minus 3.9.

One supplementary if I may on Kevin's inventory comment and clearly not a problem in clothing whatsoever, but presumably you successfully cleared the general merchandise inventory in the period? Thank you.

Answer: Mike Coupe
I will ask Kevin to comment on the second two and I will have a go at the first two. I think I will defer to James to sort of explain behind the scenes exactly what the shape is, but broadly speaking our volumes, we are inflating less than our competitors. That is the best way of summarising it.

Further question
Do you have a negative mix as well, presumably?

Answer: Mike Coupe
Yeah, so the realised value per item is less than it was, if that makes sense, but it is probably better to have a more detailed conversation with James behind the scenes to sort of unpack the Kantar data because it probably hides a multitude of sins. But by definition if we are putting more opening price points into the business and that part of our business is growing, it has an effect on the average price per unit sold. And as we have described at the Capital Markets Day, our measure of success is that we grow our volumes and our cash profitability which broadly speaking is in line, if not, we are actually achieving probably slightly ahead of that ambition.

As far as promotions in the round, lots of noise, as usual pretty intense trading period. But if you look at fuel and wine, we didn't really do a lot in twist wraps, but fuel and wine we did more. But then all our competitors did more and if you look at fuel stunts, the number of days on promotion then Tesco were almost twice where we were and Morrison's were about 60 per cent higher than where we were. And both of them basically added more days and we added about the same number of days year-on-year. Similarly on wine. But on the other side of the equation, if you look at Kantar it will show that our ongoing promotional participation actually dropped year-on-year.

And so in the round we would take the view and we'll need to do the analysis, so this is very much sort of first cut, but we take the view that broadly speaking the business is about the same promotional weighting year-on-year. So we think broadly speaking it plays a draw against a backdrop where the level of promotional intensity probably went up. And probably the most significant number is the fact that people like Aldi were actually more promotional year-on-year, significantly more promotional year-on-year which would suggest they were also driving at keeping that.

Further question
And Lidl I guess as well, okay, thank you.

Further answer: Mike Coupe
Well Lidl ran a big Daily Mirror promotion which year-on-year is quite significant for them.

And then on space and inventory, Kevin.

Further answer: Kevin O'Byrne
Yeah Nick on space, the impact of space reduction in the Argos estate would impact sales by about 0.4 of a per cent. And then if you look across stock, the areas we would worry more about in general merchandise, if you think about electronics just because they have a shorter shelf life with technologies, than fashion items. So we don't really have an issue there. We clearly have a little bit more with toys, with the stock that we can trade through in the coming period.

Nick Coulter
Okay super. Thank you so much, thank you.

<u>Question 6</u>

Rob Joyce, Goldman Sachs
Good morning guys and Happy New Year. Three from me. First one, on the food inflation, can you just give us an idea in absolute terms what that inflation number is now running at and how that compares to the previous quarter? Maybe the size of the move Mike?

Answer: Kevin O'Byrne
A bit of colour Rob, it is less than 1 per cent and as you would expect, the deflation in kind of grocery, meat, fish, poultry produce etc in the period and a little bit of inflation in other areas, not fresh areas and broadly less than 1 per cent across the piece.

Further question
Okay and that is down what, maybe 100 bps since the previous quarter, is that right?

Answer: Kevin O'Byrne
Yeah it will be because, and particularly with the mix of fresh and produce in the Christmas quarter will impact that.

Further question
Okay, thanks very much. And then a couple more on the GM side of things. You mentioned that Black Friday was very strong. I think this time last year you were saying you didn't play in Black Friday. Should we read that as saying you decided this year you needed to get involved in Black Friday?

And then the second one on the GM side, just give us an idea if you could what percentage of sales the gaming category represents? Thanks very much.

Answer: Mike Coupe
Yeah on Black Friday, we didn't say we didn't participate last year, we just said we down rated some of the activity particularly in the Sainsbury's channel. So we did a lot less in the supermarket chain. Black Friday this year was mostly helped by the fact that it moved back by a week year-on-year and therefore it coincided with pay day which meant for the market generally and for us in particular it was incredibly strong. But it probably on balance brought forward sales from the subsequent few weeks. And I have referred to the fact that you could argue you have seen the Argos business, it was basically a story of two peaks, one to coincide with Black Friday fuelled by the fact it coincided with the pay day. And then Christmas week itself or the weekend before Christmas was incredibly strong as well. But the bit in the middle was challenging and I suspect that will be reflected across the market.

Further question
Does that pull forward mean you sell more on discount?

Answer: Mike Coupe
We basically buy the stock to sell and you know we will sell it as and when our customers want to buy it, but basically they have money in their pocket to buy it over the Black Friday weekend and that was reflected in our sales and probably the market more widely if you look at the BRC data.

Answer: Kevin O'Byrne
And Rob on the size of what we have talked about before is the gaming and toys markets over Christmas period would be just over 20 per cent of the GM business and we have got big shares in these markets, you know we have got about 18 per cent of the gaming market in the UK. We have got over 30 per cent of the toy market in the UK. So they are very important to us in this quarter.

Further question
And would they roughly split half-half gaming and toys within that 20 per cent?

Answer: Kevin O'Byrne
Toys would be bigger.

Rob Joyce
Thank you very much.

Question 7

Xavier Le Mené, Bank of America Securities
Good morning and a Happy New Year. One quick one actually from me. You have been better value in recent months, against year-on-year, you have been developing the entry price you know products. Where you are currently on that journey do you think that you met half of that or you are almost at the end just to go towards what is left you know for 2020/2021?

Answer: Mike Coupe
Yeah we said we would be effectively 90 per cent complete by the end of this financial year so that is about eight weeks to go. And I think we are 160 down and counting. So there is still work to be done, as we have already referenced sort of the 6-8 weeks before Christmas we don't do any significant category re-engineering because it is not a good time to be doing it. But we will clearly get back into the flow of things in the final quarter. So work to be done, but just doing the arithmetic, we are probably two-thirds of the way through the range development as we stand today.

Further question
Right and may I add actually in terms of pricing where do you stand today? Are you happy with your price positioning today or do you think you need to do more going forward, especially given the volume improvement you had?

Answer: Mike Coupe
Yeah I mean we are happy with our price position in the sense that it is sort of a measure of today. Who knows what the competitive dynamics will be in the future. And we will you know arrive with the cut and thrust of a very competitive grocery market and our ambition continues to be that we would want to grow our business across all of the category tiers, not just one category tier. So we would judge success not just by growing that new price point, but also by growing Taste the Difference, distinctive brands and our standard branded and Own Label ranges. So to fill the bath evenly rather than at one particular end or the other.

Xavier Le Mené
Okay, thank you.

<u>Question 8</u>

Andrew Porteous, HSBC
Hi guys and Happy New Year. A few from me if I could do, all on the GM side. Just thinking about the mix of sales particularly on the online business, you flagged that click-and-collect was growing a lot quicker than the fast track delivery. And I was just wondering whether you have got one eye on running Argos a little bit more from a focus on cash profit rather than sort of driving the growth in things like their fast track delivery?

Second question just on the toy and gaming category again. It just seems like a category where you seem to have struggled a bit more than some of the other players in the market over the past couple of years and I am just wondering is it a category where you underperform the market and is it one where you feel the competitors are perhaps targeting you guys a bit given you have got such a big market share in things like toys?

And then the last one was on the consumer electronics side of things where you have clearly outperformed. But there is no comment on sort of a market. I mean have you outperformed a good market there or given the overall like-for-like is it fair to assume that all categories across GM were a bit challenging?

Mike Coupe
I will let Kevin have a go first.

Answer: Kevin O'Byrne
On the consumer electronic market, you last question Andrew, the market is down a bit and we outperformed it as you said. So it is down a few percentage points. Now we have only got detailed measure on the market up to the end of November so we don't get the full December measure but we did think that trend continued.

Toys and gaming, I disagree, I think we have held our share well over the recent period. We have had a bit of share pressure recently in toys in some of the infant and some of the pre-school areas in a competitive market, but over a longer period of time we have held our share there. We will need to revisit that after Christmas as we always would and see is there more that we can do.

Gaming, we are comfortable with our share of position in gaming.

Further question
Just a follow-up on toys if I could do very quickly. It is one where people are perhaps a little bit more optimistic this year because it seems to be a few more events around Frozen II, did that just come a bit late and it just didn't come through?

Answer: Mike Coupe
Yeah Kevin has already said, it is too early to have done the complete post-mortem, but for the second year running the toy business was down double digit. So broadly speaking toy volumes have dropped by around 20 per cent over two years. And as a big player in that market we have clearly taken our share of that impact. The question that was asked earlier is what extent is that structure as in people just fundamentally changing their habits, how much of it is cyclical because of the sort of release schedule. And that is a piece of analysis we will have to do once we have seen all the market data. We don't see ourselves losing share in the way you have described. And clearly it is a market that people would look at or our market share people would look at avariciously. But nevertheless we think we have done a pretty good job of broadly speaking maintaining our share.

And the other point to make which is pretty obvious is that those categories are disproportionately large in the run-up to Christmas and therefore have less impact in the sort of normal, such as they are, normal trading periods post Christmas and for the rest of the year.

Further question
Thanks, that is really helpful. And just on the profitability within Argos, have you been a bit more profit focused?

Answer: Mike Coupe
We are always profit focused, but you know we always started a balance between offering fantastic value to our customers, maintaining high levels of service throughout our business and generating profit and cash. But you can take it as read and certainly in the analysis we gave at the Capital Markets Day, one of the key

measures of our ongoing investor sell is the fact that we are a cash generative business and we would look to reduce our debts significantly over time. And you know we are in line to do that this year and would expect to do it in the subsequent years on the back of the work that we have done. And clearly Argos plays a part in that.

Andrew Porteous
Thanks a lot for the answers guys, really helpful.

Closing Remarks
Mike Coupe
Okay, thank you everybody. I wish you all a Happy New Year. I am sure we will see you over the next few weeks and months and wish us luck in the last quarter. Thank you.

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