J Sainsbury plc
Interim Results 2021/22
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Presentation

Simon Roberts
Chief Executive Officer

Good morning and welcome to our 2021/22 Interim Results Presentation. Thank you everyone for joining us today. Last November I set out a clear plan and strategy to transform our business over the next three years. One year on, I'm pleased with the momentum we've built in all areas, and right across the Company.

As you know, fundamental to the plan was putting food back at the heart of Sainsbury's. Reflecting this Food First focus, we've gained market share as customers have responded to the improvements we've made across value, innovation, and service. We've made switching gains from almost all of our competitors over one and two years, and key to this has been our strong operating performance, where we've been delivering on the cost-saving programme that provides the fuel for us to reinvest in the customer offer. And this has not been at the expense of customer service, as our customer satisfaction scores have remained ahead of competitors across our supermarkets as a result of our focus in driving value, innovation, and availability, particularly in fresh food.

I'm really proud of the sustained strength of our digital business, where we've made a conscious choice to invest in areas like online grocery, and we've grown faster than our competitors, and we've been delivering on other priorities alongside Food First. The Argos transformation is on track, and we are pleased with the benefits we are already seeing. Argos is now a significantly more profitable business as a consequence.

Our Financial Services business has returned to profit in the first half, and we have built on the growing Nectar digital customer base with the launch of personalised pricing through Nectar Prices. Our Plan for Better is really picking up pace and is becoming fully integrated as part of our overall plan, both in terms of how we're showing up for customers and the work going on across our business to meet our Plan for Better targets.

As you know, it's not been an easy period for the industry with a number of well publicised challenges generally, impacting global supply chains, and particularly the UK food supply chain. So, more than anything else, I'm hugely proud of the way that all of my colleagues across the business, and every one of our suppliers have worked tirelessly to deal with these challenges, whilst at the same time delivering the best possible service and availability for our customers throughout this period.

Importantly too, we have maintained the pace and agility that we learnt through dealing with COVID and lockdowns and that has served us really well. Of course, these supply chain challenges will continue as we look ahead to Christmas. As I said in my letter to customers last week, we are working flat out across the business to ensure we make this a Christmas to remember.

My thanks and appreciation goes to all of our suppliers and all of my colleagues for everything I know they are continuing to do so brilliantly, and especially in the weeks leading up to Christmas.

I will now hand over to Kevin for him to share the financial highlights.

Kevin O'Byrne
Chief Financial Officer

Good morning, everyone. Thank you, Simon. As Simon said I will now cover the financial highlights for the 28 weeks to September 18th.

I'm going to start with sales. You will see in a number of areas through the presentation that we've given sales comparisons versus two years ago, as well as the prior year. First, because it provides a useful context against a '19/'20 base year, uninterrupted by COVID, and second, because some of our P&L guidance has been set against that base removing some of the distortions of the last financial year.

Grocery sales were up 0.8% in the half, with in-home food consumption still strong, but growing off a less elevated base in the second quarter as you can see in the two-year numbers, as COVID restrictions eased, and customers started spending more time working and socialising outside their homes.

General merchandise sales were down year on year in both Argos and Sainsbury's. This was in line with our guidance, as we annualised very strong lockdown driven comparatives at Argos. These comparatives reflected exceptionally strong demand in categories relating to home working, and home entertainment, and very supportive seasonal weather while many competitor stores were closed.

The biggest driver of the Sainsbury's decline was our decision to exit entertainment categories, particularly DVDs and CDs. Clothing sales grew reflecting weak comparatives, but we're also up 9% versus two years ago, despite reduced promotional activity. In total, retail sales, excluding fuel were up slightly year on year, and up over 7% versus the pre-COVID year to March 2020. Including the impact of fuel sales up 63%, headline first half sales growth was 6%.

Retail operating profits were down 6% year on year, but up 49% if you exclude the impact of business rates relief that we later chose to forego. Here we think a two-year comparison is more meaningful with profits up 20% driven by higher grocery sales, relatively limited direct COVID costs, and the benefits of our cost saving programmes, particularly at Argos. As we stated at Q1, we invested some of the profit benefit from higher sales and lower cost to improve our price position over the period.

Financial services made a profit of £19 million in the half, with the main difference year on year being the absence of the COVID-related bad debt provisions charge taken last year. Alongside the benefit of lower interest costs, this drives a UPBT increase year on year of 23%, up 56% on a two-year basis.

At a statutory pre-tax level, we reported a profit of £541 million as we booked £181 million of income relating to legal disputes which more than offset reduced restructuring charges. I'll explain these in more detail later.

Free cash flow was very strong reflecting strong trading and a seasonal working capital inflow. In the prior year the seasonal working capital inflow was magnified by the COVID impact on sales patterns and stock purchases.

Net debt, excluding leases reduced by more than £600 million, driven in part by the conversion of the £242 million of the convertible bond to equity. As you know, net debt is

always lower at the half year versus the year end due to the favourable working capital position at this time of year.

We will pay a dividend of 3.2p per share in line with last year and in line with our practice of paying an interim dividend of 30% of the prior year's full dividend.

This waterfall summarises the UPBT movement versus the pre-COVID year to March 2020, illustrating the benefit from higher retail profits, but also lower interest costs. These reflect the material progress we have made on paying down debt over the last three years, as well as lower IFRS 16 lease interest, due to new leases being written on lower interest rates.

Looking now at our financial services year-on-year profit movement. The impact from last year's reduced lending activity flowed through to this year, offset by modest improvement in travel money and ATM revenues, the absence of last year's big one-off COVID-related provisions, lower funding cost and cost base savings. We therefore reported underlying profits of £19 million in the period. If we exclude a small £5 million release of COVID bad debt provision, underlying profit would have been £14 million.

Going back now to the Group P&L. In order to provide a clearer view of our underlying performance, as usual we exclude P&L items which by virtue of their size and/or nature do not reflect the Group's underlying performance. These are outlined on this slide.

Restructuring costs were significantly lower this half year than in the equivalent period last year, when restructuring and impairments reflected the announcement of our Food First strategy. Our guidance for total restructuring charges for the three years to March 2024 is unchanged at £900 million to £1billion. We're expecting a current total of £75 million to £100 million in the current financial year.

More than offsetting this, we booked income from settling legal disputes, two of these relating to overcharges from payment card processing fees. The cash impact of these settlements is detailed in this slide. We have already received £75 million of the cash in 2016 relating to this. We received £27 million in this half, £13 million is a non-cash provision release, and we will receive the remaining £67 million cash in the second half.

The net cash impact in the half of restructuring charges were £52 million and the total net impact of one-offs was an outflow of just £4 million.

This was another period of strong underlying cash generation. The year-on-year comparisons are complicated by COVID. Last year benefitted from rates being paid in the second half and exceptional working capital inflows.

As noted earlier, this year's cashflow benefitted from some working capital inflows versus year end, and we always see in the first half.

After paying the prior year final dividend of £165 million and reflecting the conversion of the convertible bond, net debt excluding lease liabilities reduced by around £600 million versus year end.

Net debt including lease liabilities also reduced, reflecting an increase in lease liabilities to £6.3 billion, an increase of around £500 million versus the year end.

Now, let me explain this. We hold a nearly 50% interest in an investment vehicle set up in 2000 that owns 26 of our stores. We lease these stores from the vehicle. In the half we gave notice to purchase 13 of these stores at the end of their lease. As a result of this decision,

we've recognised a substantial increase in our lease obligation based on the estimated value of these properties.

In the second half there are a further 10 properties where we have a similar decision to make.

Between now and 2023 we'll be deciding whether to permanently retain the sites we acquire or resell and lease them back. In addition, on completion of the transactions the property investment vehicle will be unwound meaning, we will get back some of the cash we paid for the sites we retain. Therefore, the adverse non-cash net debt movement we see this year will reduce once all of the transactions are fully completed in 2023.

This is a really positive step overall as these transactions will, in time, monetise our investment in the property vehicle and secure some of our top sites for the long time, either as free holds or on lease terms that we want.

We are on track with our balance sheet target to reduce ex-lease net debt by at least £950 million by March 2023, excluding the benefit of the bond conversion. Likewise, we continue to forecast average free cashflow of at least £500 million per year over the three years to March 2025.

So, in summary, a very strong first half of the year, reflecting the investments we have made in the food offer driving market share gains, and strong cost saving progress, particularly at Argos. As a result, underlying cash generation is strong, and we are well on track with our leverage and free cashflow targets.

We flagged supply chain challenges earlier in the year and alongside some of the other well-known challenges relating to labour shortages. It makes for a more uncertain environment heading into peak, but we are well placed with strong supplier relationships, well developed and accelerating cost savings, and strong operation platforms.

Hence, our guidance remains unchanged with the expectation that we will deliver UPBT of at least £660 million versus a pre-COVID 2019/20 base of £586 million.

Thank you very much for your time. I'll now hand you over to Simon to take you through some of the operational highlights of the period and provide an update on progress against the plan we set out a year ago.

Simon Roberts
Chief Executive Officer

Thank you, Kevin. Before I move on, just a quick recap here of the highlights of the first half. I'm encouraged, both with the strong momentum we've built over the last 12 months and the leadership team we have assembled to lead the transformation of this business. As a result, we have achieved a strong and robust operating performance, and delivered for our customers while significantly reducing our costs. We're delivering across all of the priorities we've set out last November. At same time, we've learnt to work with a greater pace and agility than ever before.

So, in turning now to review our strategic progress, firstly, I think it's important to continue to give some context on what's changing in the grocery business, so we've updated this chart that you will have seen before. It continues to show a very gradual, but very clear normalisation of in-store transaction and basket spend levels. This is something that we expect to continue as customers spend more time shopping, eating, working, socialising,

and having holidays outside their homes, and increasingly outside the UK. As a result, we're not expecting the very high level of grocery sales we have seen in H1, to be sustained into the second half or into the next financial year.

Now, alongside some of the things about how our customers choose to shop, which we expect to trend back to normal, some things have been transformed for good if we look at the role that digital now plays across our business.

We had a well-invested digital real estate, heading into the pandemic, and this has enabled us to scale our digital businesses and to do that efficiently. We consistently raise the bar in challenging ourselves to be able to serve our customers whenever, wherever and however they want to shop. And we're really delivering on this, across online grocery, as you can see on this chart, and across Argos, where online penetration has remained high despite the opening of our standalone stores, and in stores too through Smart Shop participation. Digital is also giving us the opportunity to engage differently and more personally with our customers, as we set out in our Nectar Deep Dive investor day a couple of weeks ago.

Turning back to our grocery performance, this is the same measure we have shown you across our reporting periods, volume market share, which we think is the most meaningful way of measuring our performance relative to the market and our competitors. The first bar shows performance over the half on a two-year view, the second, the same on a one-year view. In both cases we have performed ahead of the market, and ahead of our big box competitors.

On both periods, our volume market share has been stronger than value market share, reflecting our high level of price investment, and hence relative deflation and better value against competitors.

We're consistently focused on delivering leading customer service, and customers tell us that this is continuing to set us apart from our competitors. We set our expectations high, because our customers do.

It's been vital to listen and respond daily, throughout the pandemic, and this has been even more the case as restrictions have eased. For example, on safety, we learned quickly that not all customers and colleagues were happy moving at the pace that government had suggested. As a result, we responded accordingly, in stepping up safety messaging and measures. Customers have told us consistently throughout the pandemic that they see us lead in the industry on this, and that they feel safer in our stores than in any others.

Now, as I've said previously, we're committed to sharing consistently the metrics that we monitor internally. A key example would be customer satisfaction in our supermarkets. We're proud of the lead we've built here, versus competitors. As you can see on this chart, we've maintained this lead through the first half and beyond, but the absolute level, and the gap versus competitors did step back considerably, in the second quarter.

There's a pretty simple explanation to this, which lies in the availability challenges the wider industry have been having, particularly from the end of the summer, the end of our Quarter 2.

Through this period overall product availability served as a leveller across the industry. Quite simply, it is too important a factor to see beyond, "can I get what I want", in rating their experience in store, as a good one. Especially if essential products like milk and bread are in short supply.

Now, we have made bold decisions, given the supply chain challenges, to improve our product availability, and as a result, we're now seeing significant improvements in customer satisfaction, as we build into peak trading. You can see the gap versus our competitors is starting to open up again.

Now, I said earlier in the year that we still have more to do, to improve our customer satisfaction in grocery online. We're growing share faster than competitors, but coupled with the availability challenges, this remains a continued focus for us, to ensure we deliver the most consistent customer experience. I'm confident we're taking steps to further improve our performance, as we head into the second half.

So, overall, a good operating performance, and growing momentum across the business. But one year into our plan, it's worth taking stock a little, and going back to the key principles.

We have a clear, galvanising purpose at the heart of our plan to be a bolder, better Sainsbury's, "*driven by our passion for food, together, we serve and help every customer*".

So, now to reflect on our plan, and the value creation priorities we set out last November. I know you will now be really familiar with these, and particularly the top three. What I'm most encouraged by is the fact that we have a strong and growing momentum across all five of our priorities. Very importantly, we're using them to drive and deliver better prioritisation, and resource allocation across the business. We can also clearly see where they are driving improved performance, and we're measuring that performance consistently against the metrics we outlined. As committed, we are sharing our half one progress today, against those metrics with you.

You will see a new line here, on our "plan on a page", highlighting our value behaviours, something that we've only talked about internally, to date. These are three simple but important principles for how we will lead and work across our Company, to put the customer, our efficiency and our agility and pace at the heart of transforming culture and performance.

"Own it, make it better, and be human", are our value behaviours being rolled out throughout the business. Our leadership team are passionate about the changes we are making to how we work, and we've had a great response and high levels of engagement from our colleagues already.

We're well under way with this bold cultural change to be a better Sainsbury's for our customers, our colleagues, our suppliers, and of course, our shareholders. This is at the very heart of the transformation we have set course to achieve.

So, reflecting on the essence of our plan, and what we've said will be different as we make progress, we're putting food back at the heart of our business. We know we can do better on value, on the product offer and on service. We're starting to deliver against that, and our customers are recognising this.

Our key portfolio brands Argos, Tu, Habitat, Financial Services and Nectar, are all more clearly focused on supporting the core food business and are all delivering improved standalone performances.

We're making real progress on structural cost reductions, which will permanently reduce our cost to serve, freeing up more resource for us to invest back into the customer offer, and flow through to the bottom line.

This will put us in a really good position versus our competitors, as we face into an environment of rising cost challenges.

We remain clear about our commitments to shareholders, in the form of profit delivery and cash generation, underpinned by the consistent metrics we are targeting.

So, how have we done against these eight metrics? Well, as you know, we're in the first year of our plan, and so, whilst we have strong momentum in some areas, I believe we still have much in front of us to deliver. We're setting the bar high, and so the amber arrows here mean that we are on track at the halfway point of this year but expect to push further forward over the balance of the year to go.

We are pleased with our progress and improvement across a number of the key metrics, grocery performance, profit growth, cost reduction and free cash flow. And overall, we are delivering to plan at the halfway point this year, across all our measures, but some plans, such as our Plan for Better commitments and improving our return on capital, will take time to deliver.

Now, specifically on return on capital, this was down year-on-year in the first half, but there's a bit of a technicality here, because ROCE is a 52-week measure, and the second half of last year was impacted by the decision to forego business rates relief. Adjusted for that phasing impact, ROCE would have been 8%, so well on track.

We will continue to consistently report against these eight measures as we implement our plan, and as I've said, we will share how we're doing every time we report, to enable you to assess our progress along the way.

Let's now look at progress against each of our priorities, starting with putting Food First.

We've delivered consistent improvement in value for customers across the range, but particularly on the items that really matter most for them in the basket, and we are seeing some encouraging signs that customers are shopping differently with us, as a result.

The pace is building across product innovation, with some powerful coordinated new range launches, and our commitment to online capacity and performance has delivered strong market share gains.

We're also fully integrating how we will deliver sustainability at the heart of our Food First plan, reducing food waste, plastics, and at the same time, improving healthy diets. You will hopefully have seen how that's increasingly integrated into our *Helping Everyone Eat Better* customer messaging and our advertising.

This switching data is one of the clearest indicators that we've been winning spend from most of our key superstore competitors, when looking at the position versus the pre-COVID base two years ago, and against last year too. Again, this is looking at volumes, the most relevant indicator of how customer share is changing.

Now, we're delivering better value through three distinct value programmes. First, we're building Price Lock, as our broadest value programme, reassuring on stable pricing day in, day out, across thousands of lines. Second, we're investing in core, high volume lines, particularly focused on the centre of the plate. Third is our commitment now, across around 300 products that deliver Sainsbury's Quality at Aldi prices.

I told you earlier that we had focused our efforts on protecting availability on fresh, above all other areas. This is because we know it's these products that matter most to customers, and where, particularly in meat, fish and poultry, customers buying these products will generate the greatest associated halo spend, as they buy into other categories to complete the meal. So, this is where we are focusing our price investment too.

You can see the results here. We have outperformed the market on these two really important categories; meat, fish and poultry, and produce.

Likewise, when we created Sainsbury's Quality, Aldi Price Match, we know that Sainsbury's have always been famous for the quality of its fresh food, and so this is where we have focused our Aldi Price Match, with now nearly 90% of the volume sold through Sainsbury's Quality, Aldi Price Match in fresh categories, like meat, fish, poultry, produce and dairy.

You can see here the impact this is having to our price position relative to competitors. Across the whole of the range, but particularly on those centre of plate items, with the improvement continuing through the half.

We're encouraged with the performance we're seeing, and our consistency here will be fundamental in permanently improving customer value perception - and we know it's working. Again, it's generating halo spend, as customers buy into these everyday essentials, and shop other products too, as you can see in this updated version of the chart we showed you in April.

But vitally, we also know that we're growing volumes from secondary cuts faster than our competitors are. Secondary customers are those who do some of their grocery shopping with us, but who spend more of their grocery spend elsewhere. We knew secondary customers were an opportunity for us, as this is where we have been under indexing, relative to competitors.

What we're seeing, as we deliver more consistent value across the range, is that these customers have more confidence in our value position and are putting more items in the basket, as a result.

Stepping up product innovation is a key pillar of our plan to put Food First. We changed the way our commercial teams work about a year ago, and as a result, we're now building some great momentum here. We're on track to triple the number of new products we bring to customers this year. We launched 650 products in the first half, and over 300 products will be new for this Christmas.

This is delivering results, driving trade up, and contributing disproportionately to the halo spend we're seeing from secondary customers buying into our price match products.

It's also not just about the what, it's also about how. You can see here a number of products from our first ever Autumn Range, tapping into the change in the customer mood as the season changes, with warming winter products. These latest products are performing really well, and together they highlight the substantial opportunity we are seeing to lead in food innovation again.

Coordinated range launches like this really deliver an impact for customers. I would thoroughly recommend these products - some really fantastic new lines.

Now, new products have to deliver a difference for customers, whether that's giving an opportunity to trade up, improve value, reduce waste and packaging, or offer a healthier,

more sustainable option. What this shows is not just innovation, but really, a coordinated programme across *Helping Everyone to Eat Better*, with recipe suggestions, really sharp prices across fresh fruit, innovation in meat alternatives, and talking to customers about how we're reducing our impact on the environment.

So now, turning to online grocery. One of the key Food First commitments we outlined last year was to grow online capacity and extend our routes to market. We've made this a real point of difference, with the capacity that we added last year, and we've been fully committed to keeping those online customers that we gained.

Order numbers have slowed as more customers have returned to stores, but our online sales have continued to be stronger than the market and we've been pleased with customer retention rates. This is showing through in continued market share momentum. We've just stepped on again, recently reintroducing our same-day offer. We dropped this offer when online demand was at its peak. It's back now, and available in many more stores than before.

This chart shows the breadth and scale of our online grocery proposition that we now offer customers, having continued to grow our immediacy business both in-house and with delivery partner, collecting orders from our convenience stores. It's important to recognise that this isn't just a London business, with around 40% of our immediacy sales now coming outside of London.

We called out the significant online market share gain we made last year as our biggest online competitors lost share. We have built on that this year, as the only one of the major online grocers to gain share. We're now the second biggest online grocer in the UK, having been number four two years ago.

Now, quite fairly I think many of you asked us what would happen to the productivity gains we made as online order volumes drop back from the lockdown-driven peaks. The answer is that the margin and contribution gain we're showing here, versus the pre-COVID base, is pretty much the same as that we were showing last year, with contribution margin doubling and profit contribution up around four times.

We have had headwinds against these COVID peaks with lower basket sizes and drop densities, but these are still comfortably ahead of pre-COVID levels and we've continued to optimise the operating model as well as making strong progress on pick rates and drop densities against pre-pandemic levels, both big drivers of improved productivity.

Now, I'm in Glasgow this week with Kevin where Sainsbury's is the Supermarket Partner of COP26, the United Nations Climate Change Conference. There's a real focus here on driving for partnership and collaboration. We all know that no individual or organisation is going to deliver the scale of progress we need to see without deep collaboration and commitment at an industry and global level.

I hope many of you were able to attend our ESG event in June or view it on our website. We laid out our Plan for Better with stretching targets across our three pillars of Better for you, Better for the planet, and Better for everyone. I'm encouraged by our progress and pleased to say that we are ahead of our trajectory to become Net Zero in our own operations no later than 2040, and as a result, last week we confirmed we are accelerating that commitment to 2035 across scope 1 and 2 carbon reduction.

Now, our second priority focuses on our portfolio of brands outside of food, our Brands that Deliver and how they support our ability to deliver in food. We've really changed the way we

think about each of these brands and the role they play in the business with a much tighter focus on how they support the core food business while delivering for their customers and in making a return in their own right.

Let's talk first about Nectar. Hopefully, many of you were able to attend our recent Nectar Deep Dive event and if not, you will find all of the materials and video recording on our website. I think it gave a great sense of the opportunities that this part of the business gives us. We're continuing to grow our digital Nectar base and I've talked previously about our drive to hit 10 million registered digital Nectar collectors. We're well on track to hit that next year with over 8.2 million customers currently registered.

Now, why does this matter so much? It matters because it enables us to talk to our customers in a much more effective, engaging and highly personal way. We were really pleased to launch Nectar Prices at the end of September. Based on a customer's potential value to Sainsbury's, their price sensitivity and the types of products and offers we know will appeal to them, we can offer each and every digital Nectar customer a completely personalised set of prices on up to 10 products each and every week, and the opportunity to save up to £200 a year.

Now, we believe that this approach to truly personalise pricing is unique within grocery retail in Europe. It's early days but we're really encouraged that we're already starting to see some uplift in our SmartShop usage and penetration and also in digital Nectar.

Nectar360 is the B2B side of Nectar, which works with hundreds of our suppliers to build their marketing plans across our store and digital assets. Nectar360 uses our unique coalition loyalty offering and first party data set to offer shopper marketing services, data insights and digital media capability to more than 700 FMCG and GM brands.

In particular, we've made significant investment in our digital media capability and we believe we are now industry-leading in this space, giving brands the opportunity to engage effectively with customers and deliver really strong returns on their advertising spend.

Digital media is driving our growth plans for Nectar. On the left-hand chart here, you can see that we plan to grow our gross billings by 25% over five years, driven predominantly by our data and digital capability growing to 10% and 30% respectively. As a result, over the course of the next four years Nectar's Group profit contribution will grow by an additional £60 million to £70 million as you can see on the right-hand chart, with the key driver being significant growth in billings from our digital media network at high incremental margins.

So, moving to Argos, which has become a fundamentally different business in the last two years with digital really at its core now. Over 80% of sales started online in the half versus a little over 60% two years ago. Alongside the changes we've made to the store estate and are making to the fulfilment platform, this has made Argos a more efficient and structurally more profitable business.

We said earlier in the year that we expected Argos sales this year to be broadly in line with those of two years ago, implying sales declines this year. We're tracking a little ahead of that at H1 but clearly with a weaker Q2 than Q1.

So, what was driving that guidance and the sales declines we've seen? We've been clear before that Argos was in something of a sweet spot last year, given heavy exposure to the types of product categories that saw disproportionate growth as customers focused time and spending on living, eating and entertainment at home. Categories such as electronics,

technology and electrical were real winners through this period and at a time when so many competitor stores were closed.

Second, the weather last summer combined with lockdown was also conducive to strong seasonal category performance and the summer weather certainly did not show up in the same way this year.

Lastly, as we take a more disciplined approach to trading, we have voluntarily stepped away from some promotionally fuelled sales in categories like toys.

Looking to the second half, we flagged in July that we expected general merchandise supply chain challenges to persist through the year. This will impact stock levels and hence top line performance through peak trading over Quarter 3. However, given gross margin and cost progress, we remain confident of a strong Argos profit outcome.

We are making really good headway with the Argos transformation plan which will simultaneously reduce the structural cost base of Argos and improve the customer offer. We're on track to open around 70 Argos stores in Sainsbury's stores this year, closing a similar number of standalone stores, and we've now opened our first two local fulfilment centres in Bristol and Leeds.

As we build this network out, they will become the core fulfilment network for Argos and will give shoppers quicker access to a wider range as we move more stock closer to customers with improved and more consistent and visible availability and at the same time, the benefits of reduced working capital.

Now, thinking back to that Argos home and furniture performance chart. We've moved at pace to make Habitat our main home and furnishing brand with a significant increase in the proportion of this season's ranges that are Habitat branded. This has elevated the quality and credibility of our ranges and driven a strong market performance. We see the launch of Habitat as a great opportunity across Argos, Sainsbury's and Habitat online, given that customers are increasingly looking to refresh their homes post the pandemic.

We recently launched a new Habitat brand commitment, *"make your home a happy habitat",* to help reposition the brand as affordable and accessible for all. You may have seen our latest TV campaign which boldly relaunches the brand. In September, we also launched Habitat's first furniture range for kids, which offers some really great new products.

We see the continued strong recovery in our clothing sales this half, but again, this isn't really the story. It's a business that is again fundamentally stronger than it was pre-COVID, having built scale online and transformed the commercial model. Full price sales now account for nearly 90% of sales, a huge step up from around 60% pre-pandemic and a real testimony to the quality of the Tu clothing offer.

Turning to Financial Services. We announced last week that we'd ended discussions with third parties on a potential disposal of Sainsbury's Bank. Importantly, the bank has not stood still while those discussions have been taking place. We continue to simplify and strengthen the business in line with the strategy that we set out two years ago, the key points of which are summarised here.

We said two years ago that we would not inject any more capital into the bank and that capital self-sufficiency is still an absolutely vital pillar, alongside generating higher returns and reducing the cost base.

The remainder of this slide highlights the last of these key strategic points, with the focus of the financial services business on Sainsbury's customers, be that through its role in supporting Argos sales or the very close link to Nectar. And as we also said last week, we are comfortable with consensus profit forecasts for the financial services division.

So, to our third priority: Save to Invest. We've been a bolder business over the last 12 months. We've made clear decisions on prioritisation on what really matters to customers and on where we can permanently reduce the structural cost base of the Company and reduce our cost to serve. This in turn has helped us to be bold in investing back into the customer offer. We are well on track to reduce operating costs of sales by more than 200 basis points over three years.

You will have seen a version of this chart before. The numbers have changed, but the headline target is the same in terms of the reduction in cost to serve. So, why have the numbers changed? Well, first the sales line has been stronger and second, we're facing into higher operating cost inflation in some areas than anticipated, which has meant we've brought forward some of the cost savings but with the same net result. I take a lot of confidence from the fact that 75% of the cost savings we have delivered are structural cost savings, fixed costs that won't return.

This is reflected in the updated chart here. Looking at the biggest block of savings here, it's easy to think of operating model projects as areas in retail which are easy to target, with a high level of variable cost, but when you look at the detail here, we're delivering real transformation to the way we work, be that in Argos or in the changes we've made to the online operating model. These are bold changes that have fundamentally transformed the cost base on a structural basis.

Now, we're gradually filling in more detail here on the breakdown of the three-year cost saving programme. You will see in particular that the supply chain and logistics number has stepped up, rising to meet some of the greater headwinds we have in this area. We've already closed five depots with another due to close next spring, and the key integrated transport planning system is rolling out at pace.

So, to summarise. Well, in food we've been absolutely true to the strategy we laid out a year ago on value, on innovation, and on service. Despite some big macro challenges, we've delivered great momentum in market share over the first half.

Argos is normalising after an extraordinary year last year, but it's a new normal for Argos which is a fundamentally more profitable business with a lower cost to serve. The same goes for our clothing business and Financial Services is delivering on its COVID recovery plan.

We're on track to transform our cost base across the Group with bold programmes that are driving structural change. We will deliver strong profit improvement this year on a normalised base with underlying profit before tax of at least £660 million.

Looking into peak trading over the next few weeks; we've talked already about some of the challenges, particularly on general merchandise stock, but in food we're building good momentum on customer satisfaction metrics and we're well set operationally to build on last year's very strong Christmas performance with a really fantastic customer proposition.

We've been very clear on how our plans will deliver for shareholders through an inflection in profit, through high returning transformation projects helping to deliver real structural change in our cost base, and through strong free cashflow generation supporting a strong balance sheet and a consistent dividend. We're on track on all of these measures.

So, returning to our three core priorities, these are the pillars of the strategy we set out a year ago. They are informing everything that we're doing and they are delivering results, and the momentum, I hope you will agree, is very clear.

We're not doing this in isolation, of course, and there are clearly some challenges that we've had to deal with and will continue to deal with, but the strategy has made us a stronger, more agile and leaner business and I'm confident that we're really well placed to deal with those challenges.

Thank you for listening and for joining us this morning. I really appreciate your time.

Question and Answer Session

Operator

Good morning and welcome to your Sainsbury's Interim Results 2021/22 Analyst Q&A call with your host Simon Roberts. Simon, please go ahead.

Simon Roberts

Thank you. Good morning, everybody and thank you for joining us this morning for our Interim results call. I'm in sunny Glasgow this morning with Kevin and we're really pleased that you've joined us for the call. I hope you've had a chance to see the presentation that we posted on our website earlier this morning.

Three things really to take away from that just to headline the call. First bit would be that one year in from setting our Food First plan, we've built strong momentum across the business and our first half results really are a great demonstration of this with the strong operating performance, continued market share gains in grocery and robust delivery from our cost-saving programme.

Now there are a lot of well-publicised challenges clearly out there right now across supply chains and costs that are making life more challenging. But we've carried the momentum from the first half over into the start of the second half and we're confident that we're well placed to deal with those challenges.

So, with that in mind as well as the fact that we still have peak trading ahead of us, a really key six or seven weeks ahead, we've reiterated our outlook today and continue to expect to report underlying PBT of at least £660 million for this year.

So, with that, let's now get into the questions. Thank you.

Operator

Thank you. The first question then is from William Woods from Bernstein. Please go ahead.

Simon Roberts

William, good morning.

William Woods, Bernstein

Good morning.

Kevin O'Byrne

Good morning, William.

William Woods, Bernstein

A couple of questions from me. So the first question on your retail operating profit and the Save to Invest programme. I'm trying to understand the bridge from last year to this year. The first question is what percentage of the COVID costs have come off versus last year? Then I suppose building on that, if you took a - if you take the normalised view of operating profit for last year around £350 million. You strip off some of those COVID costs and add on the fuel profits and look at what savings are coming out of the Save to Invest programme, it doesn't like much of that is hitting the bottom line. Could you give some clarity on how much of that is actually hitting the bottom line?

Simon Roberts

William, thank you. Kevin, do you want to pick up on the costs?

Kevin O'Byrne

William, just on the COVID costs, we guided to COVID costs of being 10% to 15% of the £485 million that we saw last year and that guidance still stands. It's first half loaded so in the first half we saw something in the region of about £50 million of COVID related costs and that was versus £291 million that we saw this time last year. So clearly a material reduction in the COVID costs.

William Woods, Bernstein

Understood and I suppose if you flow that through it looks like Save to Invest in terms of the bridge isn't necessarily delivering to the bottom line. Is that…

Kevin O'Byrne

Well last year we didn't have rates bill in the first half. So there's £204 million that we incurred in the second half that related to the first half. So that makes it - it's quite confusing I appreciate when you're doing the year on year.

William Woods, Bernstein

Understood okay.

Simon Roberts

William, maybe just more broadly on the cost saving programmes. So as you'll remember we laid out a plan over three years to deliver a 200-basis-point reduction in cost. We're actually seeing the progress we expected in the first year. A number of key programmes there and 75% of the costs coming out of the business are structural costs. So the programme is on track and it's both enabling us to improve the offer but also improve our performance as we do that too.

Kevin O'Byrne

Yes and [slightly]. If you took 20/21 and 21/22 together we're up actually overall on the costs. So we've pulled some of the costs saving forward. I think it's the rates within this probably making the comparisons a bit confusing.

William Woods, Bernstein

Got you, thank you.

Simon Roberts

Thanks William.

Operator

Thank you. The next question then is from Fabienne Caron from Kepler Cheuvreux. Please go ahead.

Simon Roberts

Morning Fabienne.

Fabienne Caron, Kepler Cheuvreux

Morning, good morning, everyone. Two quick questions from me. The first one, can you share with us the level of food price inflation that you see in the UK market and how high do you think it is behaving in this environment? The second question would be as well on inflation but more on the wage, energy side and logistic side. Is there a way for you to give us a kind of quantification of the cost inflation you had in H1 and how much you expect in H2 please?

Simon Roberts

Fabienne thank you. Okay let's just reflect first of all on the broader inflation in the market and then maybe I'll ask Kevin just on cost inflation. So when we look at inflation across our business in the first half of the year, it was broadly flat in grocery. A bit up in grocery products, long life ambient. We were actually deflationary in the half on Fresh.

As you'll know, core to our strategy was absolutely to become more competitive. So as we've travelled through the last 12 months and particularly in the last six months, we've been working really hard to improve our value for customers. That's one of the things that's really come through in our results as we see the momentum improving.

So clearly cost inflation pressures are building, we can all see that. As we sit here today, we clearly expect inflation to build into the second half of the year from where it's been. Our strategy is to be really competitive on price, to continue to drive the cost saving programmes that we are. To clearly work closely with our suppliers to ensure we mitigate headwinds as far as possible. But in the end, some prices will go up whilst we retain value and the pass through will be inevitable. We expect that to happen over the second half of the year.

I think last thing to say on that is that of course our scale and our ability to build volume in food means that we can negotiate, improve terms with our suppliers too and that's obviously key to offsetting some of this pressure. Kevin, do you want to talk about cost inflation?

Kevin O'Byrne

Yes, just on some of the cost inflation Fabienne. I mean things like energy we're protected because we hedge in advance and our hedge actually rolls into the next financial year as well. So we're well protected on energy. Freight as well, about 90% of our freight is on fixed terms that we had negotiated pre the current spikes. So we're protected again, at the moment on freight costs.

In salary costs, it's largely in logistics and there's two things happening there. There's some one-off payments that are for Christmas that are retention payments. Then there are some base salary negotiations that are going on. But overall as a - the majority of our employees across the retail business for example, we set the wage rates back in first quarter calendar quarter last year and those rates we haven't changed.

Fabienne Caron, Kepler Cheuvreux

Okay can you just come back on the behaviour of Aldi? Is Aldi passing some food price inflation on commodities, for example like milk or butter?

Simon Roberts

Yes, well I think, as you'll have seen, there is some upward movement of prices in some areas. Milk has been an example of that in recent weeks where you've seen the industry begin to move prices up. I think coming back to the outlook, we clearly should expect food inflation to increase over the second half and as a result of that some prices will go up.

I would expect the industry to behave rationally in this regard. There's higher input prices. There's higher operating costs. That will inevitably lead to some price increases. As I say we’re going into that environment with a much stronger relative price position than we’ve been in before. You can see when you look at the presentation particularly in the areas of comparison against Tesco and Aldi for example how much more competitive we are year on year. Aldi for example around 400 basis points improvement.

So clear inflation pressures. They will feed through, holding onto our value position strategically absolutely key for us.

Fabienne Caron, Kepler Cheuvreux

Okay thanks you, very clear.

Simon Roberts

Thank you Fabienne.

Operator

Thank you. The next question then is from Rob Joyce from Goldman Sachs. Please go ahead.

Simon Roberts

Hello Rob, good morning.

Kevin O'Byrne

Morning Rob.

Rob Joyce, Goldman Sachs

Morning, thanks for taking the questions. So I've got three. So firstly, just on the guidance, I'm wondering if you can help us understand the decision to keep the guidance where it was. As far as I can see your interest costs have fallen by around £20 million since you last guided us on that for the full year.

It looks like you've pulled forward cost savings of maybe £50 million to £100 million on that and I think on Argos et cetera it sounds like you think is in a structurally more profitable position. So I was just wondering why there wasn't the opportunity here to maybe increase that guidance, would be the first question.

Second one just on food inflation, I wonder if you could give us an idea of where your basket inflation is currently running at. That would be very helpful. Then the third one just in terms of exit rates. Obviously the Argos 2Q, I think two-year declaration has got a bit of attention there. Just wondering if you could help us understand what the exit rates are looking like in Argos into the third quarter maybe on a two-year basis. Thank you.

Simon Roberts

Rob thank you. Okay let's take each of those in turn. So starting with guidance. So as you say, I mean first thing I just want to be absolutely clear on as we started the call that we've reiterated our guidance of at least £660 million. As you've seen in our results, we've had a strong first half of the year. I'm really encouraged with the momentum in the business. We've got good momentum against our strategy and we're taking that momentum into the beginning of the second half. So I think that's important to say.

That being said of course, there's six to seven weeks to Christmas. I think just about 50 days to Christmas and there are some uncertainties. So you'd understand that we're applying some caution given the timing of where we are, given some of the uncertainties that are out there. That's the reason why when we look at where we are, good momentum, some uncertainties. Time just to take a cautious view of that period of time until we get to the other side of Christmas. I reiterate again at least £660 million.

On your second question on food inflation, just to come back to a couple of the points we were just covering. So I think, as I say, in the first half, we were broadly flat. A bit up on long life grocery and a bit deflationary in fresh. As we've said, we expect that environment to change as we look ahead.

But in terms of where we are now, we're going to absolutely hold on to our competitive position in those product areas that are most important to customers. We're working very hard on the cost saving programme to make sure that we can absorb some of the pressure and inevitably there will be some pass on as prices in some areas increase.

Then specifically on your third question on Argos, so just standing back from the Argos business, we guided to flat sales in Argos on 19/20. As you've seen we had a strong first quarter, a softer second quarter. I think when we look at the second quarter particularly, two

or three elements in there that would be important to highlight. The first was clearly we've had a non-comparative position in Argos, given the fact the number of stores that were closed the year before.

Secondly, with the softer summer, so just all of the seasonal products in the Argos business didn't benefit from the very warm weather that we've had before. Thirdly, there are some supply challenges coming through. They're well trailed. Consumer electronics would be a good example, where there was less availability than would be optimum, and those are starting to play through.

I come back to the key strategic choice in Argos, which is we've laid a plan to significantly improve the profitability, to transforming the cost base and taking a less promotional stance. So, when we look at the period ahead, clearly, we're encouraged we've got that plan in place, because that is supporting profit delivery in Argos, and therefore, whatever the challenges are, from a supply chain point of view, we believe we can deliver a strong profit performance, underpinned by cost transformation, and as I say, an improved margin position. I hope that helps, Rob.

Rob Joyce, Goldman Sachs

Thank you, yes. Just one quick one, do we - the cost savings pulled forward in the programme, where's that mainly falling? Is that in the first half or the second half?

Kevin O'Byrne

It's spread across - pretty evenly across the - and bear in mind, Rob, we have higher sales, and so hence, we need extra cost savings to offset some of the additional costs of driving through the higher sales.

Rob Joyce, Goldman Sachs

Okay. Thank you.

Simon Roberts

Thanks, Rob.

Operator

Thank you then. The next question is from Andrew Gwynn, from Exane BNP Paribas. Please go ahead.

Simon Roberts

Hello, Andrew.

Andrew Gwynn, Exane BNP Paribas

Hey, morning, how we're doing? Just coming back to the property transaction, I think, Kevin, you talked about that during your part of the preamble. Just wondered if you could explain it a bit more. I guess it fits into a broader use of cash question, how you're making these sorts of decisions as the business de-gears. That's kind of the first question. Sorry, two questions. So, firstly, just explain the transaction a bit more, and then slot into a broader use of cash.

Then the final question, on availability of grocery. Clearly some challenges kicking around. You alluded on that, but just to flag, presumably, we're not expecting a significant impact in the second half. Thanks very much.

Kevin O'Byrne

Shall I just do? We have a structure, which has 26 stores in it. It was set up in 2000. We've got about a 50% interest in it, and we put these 26 stores in, and we leased them back. The leases come to an end in 2023, but under the structure, we have the option to either we can sign up new 20-year leases in the structure, we can exit stores, or we can buy them. We've taken the decision in the half, as you saw, to exercise the option to buy 13 of those stores.

That gives us great flexibility, because we can either retain the stores as freeholds, or we can lease them back on terms that we like. Clearly, it has an impact on net debt, as we've talked about, because, as you effectively take short leases and move them to longer leases, you increase your lease debt, as you'll know. But overall - and there's another decision to be made in the second half, on a further 10 stores, but really, what we're doing here is taking control of the stores, and then we'll keep the ones we want to keep, either on freehold terms, or on lease terms that suit us.

Overall, very positive, because we will get cash from the structure, we'll get control over key stores that we want to have in the estate, and we'll get leases that we want. Does that help?

Andrew Gwynn, Exane BNP Paribas

Yes, I think so. I can work through the numbers a bit later. Just into a broader use of cash question, obviously, you’ve decided to repay in the convertible, rather than reissue, and so forth, so just a broader question.

Kevin O'Byrne

Yes, I mean, our position, our high hope on cash flow is clear. It's been a big focus for us, as you know, in a very disciplined way, turning profit to free cash flow. We've taken some real structural decisions on our pensions scheme. We've reduced our debt and reduced our interest.

The Bank is self-sufficient, from a capital point of view, so we've pulled lots of levers to make sure that the cash flow flows through - the profit flows through to free cash flow, and then we - to date, our view has been we want to pay a dividend and have it well covered, and we want to reduce net debt. Why do we want to do that? Improve the financial flexibility of the Group and of course, it should increase the equity value for shareholders, as well.

In the last three years, we're very pleased that we've - sorry - three years to March this year, we'll deliver on average, about 500 million a year. So, that meant that the focus continues. I think our track record on this is, hopefully, clear. We've raised the target a couple of times, and clearly, we will be ahead of target now, because of the convertible, and we'll achieve the target without the convertible, that'll pull the target forward, and obviously, the legal cases that we've negotiated.

So, we're in a good position. Once we get to the point where we've achieved our leverage targets, the net debt to EBITDA less than three times, et cetera, then we'll come back and talk about what's next, from a capital allocation point of view. But we're very clear. Free cash flow is for shareholders. We remain very focused on it, and we'll continue to be very disciplined in that.

Simon Roberts

Thanks, Kevin. To the second question, and just in terms of availability in grocery. I think, we've all seen it's been a challenging few months. It's been tricky on a combination of supply, clearly, labour, HGV drivers, the challenges upwards in the supply chain, too. So, I think when we look ahead, over the second half, two or three things just to highlight that we've done.

The first thing is that I think that we've seen some stabilisation in availability. The team have been working flat out to make sure that we really deliver the best availability to customers we can. It's an absolute primary focus for us, because in the end, supply security is key in delivering customers certainty of what they can buy, and I think we've improved our position over recent weeks. As is shown, actually, in the presentation. You can see our customer satisfaction over the first part of Q3 has really ticked up again.

It's tough at the end of the summer, particularly in areas like milk and bread, some of the grocery lines, but we've seen that improve.

I wouldn't describe it as all solved, but I'd describe it as improving, and we're confident we're doing everything we can there, in that regard.

When we look over the second half of the year, I think, clearly, our scale, all of the relationships with suppliers that we're working really close with. We're doing a lot of work on recruitment, to make sure we can move product through the supply chain.

Interesting, in the last few weeks, we've actually begun to pick up product from suppliers, to make sure we can guarantee availability back in the business. That's been one of the enabling factors to improving the situation.

It's clearly really challenging out there, but I think we're going into what we expect to be a really big Christmas. I think for all the obvious reasons, we're expecting customers to really want to celebrate this year, given the events of last year, and so a bigger Christmas, a bigger demand curve, more at home grocery consumption. A lot of work going into get the supply we need, the wheels on the road we need, and the resilience we need to deliver the availability that customers expect.

I hope that gives some colour on what's going on behind the scenes.

Andrew Gwynn, Exane BNP Paribas

Thanks, that's excellent. Thanks very much. Thanks, Kevin, Simon. Thank you.

Operator

Thank you. The next question then is from Andrew Porteous, from HSBC. Please go ahead.

Simon Roberts

Morning, Andrew.

Kevin O'Byrne

Morning, Andrew.

Andrew Porteous, HSBC

Morning, team. A couple from me. First, on the inflation side of things - appreciate you're expecting to see inflation start to come through. Wondering on what sort of quantum you're seeing in the supply chain? Is it - I mean, clearly, pressures have increased, but is it at the point yet where you're worried about the knock-on impact on volumes, as you start to pass that on to consumers?

Then, a second one, can you talk to where Argos is, trading into peak? Appreciate there are some supply chain issues there. You referenced consumer electronics. Where's your availability versus the broader industry on some of the key peak end categories?

Simon Roberts

Yes, thank you. On your first point on inflation, I think, as we look ahead, clearly, we can't predict the scale at which inflation is going to pass through, but the pressures are clearly building from the supply base in a number of areas, and, as I say, we would expect the market to pass that on. Whilst, as I said previously, we're going to clearly be very focused on our own price competitiveness within that.

I think in terms of what we're doing, clearly, we're putting more volume through the business. More volumes mean that in the conversations we're having with suppliers, that's helpful, but of course, the pressures are clearly there. So, inevitably that will flow through.

At this point in time, we're seeing some of our competitors begin to move on price. We're clearly moving where we need to, whilst retaining that competitive position.

In terms of Argos, going into the very important peak six, seven weeks of the year, I think, as I say, there are some challenges in the supply chain. A specific example I would give you is that we normally, in our general merchandise business, run a toy promotion, a pretty significant toy promotion this time of year. We put that back a couple of weeks, because the product wasn't in the UK. We were pleased when it landed at the weekend. It's on its way to our stores now. It will happen next week.

So, I think consumer electronics would be an area where there is just a global shortage of products. In some other areas, we are moving the phasing of key activity, to reflect when stock will land. In that regard, I wrote to a significant portion of our customers last week, just to help them plan, so that they know when the key events and activities are happening, because they're not necessarily happening in the same sequences as they would have expected from previous years.

So, I think all of that's in place in terms of getting stock through. We've launched our Christmas ranges across GM. We go live tomorrow with our Argos marketing for Christmas. There's a lot of activity going in to make sure we can give customers what they want - recognising that 80% of our customers also are now shopping digitally in Argos, so, as stock arrives, we can be pretty agile, in terms of making sure we serve up to customers in the moment, as it were.

I think, when we look at the trading picture, there are clearly some uncertainties in the GM&C supply chain, and so that's the reason why, when I stand back, and look at the Argos performance, when we look at the second half of the year, the cost transformation programmes, the work we've done on margin, and I think, importantly, it will be a less

promotional environment, won't it? There's likely to be less activity around Black Friday. We expect to sell more products at full price, rather than at discount.

So, in the round, that's one of the reasons why we're confident on the underlying improvement in the Argos profitability, whilst there will be some challenges, driven by supply chain, in the top line.

Andrew Porteous, HSBC

Okay, thank you, guys.

Operator

Thank you. Your next question then is from Clive Black from Shore Capital. Please go ahead.

Simon Roberts

Morning, Clive.

Kevin O'Byrne

Morning, Clive.

Clive Black, Shore Capital

Morning, gentlemen. I hope Glasgow is kind to you.

A question around costs and stock and lost sales at the moment. In terms of some clarity around the magnitude of things. Year-on-year, particularly within Argos, or in non-food in general. What sort of costs are you facing into that would have been unplanned this time last year, if you get my drift?

Then, secondly, do you have a feel for the sort of magnitude of lost sales as a result of supply disruptions? Linked to that, should we be concerned about H2 working capital? Is a load of Christmas gear going to turn up in February, for example, that you'll have to hold, or do whatever you will with?

Because I guess what you're saying is, without these challenges, Simon, you probably would be announcing an upgrade to guidance today, is that right?

Simon Roberts

Thanks, Clive. Let me take your last question first, and then we'll go to each of the specifics you've raised.

Just coming back on our guidance for the year. As we've said, at least 660, on the basis of all of the momentum that we see in the business, in the first half, and I, and we can see clearly going into the second half. I just reiterate, the strength of the momentum in the food business, I'm really encouraged by the fact that our improved value position means that we're growing share on a one- and two-year basis, we think is really important. that's been underpinned by the strength of the cost-saving programme.

So, as you'll understand, I'm sure, with six to seven weeks from Christmas, there's a lot to play out in that period of time, but with that momentum, and with all that's in front of us, time for a bit of caution at this point in time, as we get to the other side of Christmas, but we're pleased with the momentum, and at least 660. So, just in terms of your last question.

In terms of the specific elements of that, maybe just in terms of some of the costs, Kevin, that Clive is asking about?

Kevin O'Byrne

Probably, Clive, the two areas that I'd point to that we wouldn't have expected to be quite where they are is freight and logistics. As I say, 90% of the freight is hedged, so we do have that 10%, which we will largely pass on to consumers. Then in logistics, we have the one-off elements, around Christmas retention and some of the negotiations that are going on right now, which we'll see coming through in the second half, but I guess that's well-publicised.

Your working capital point, there could be a little bit at the year end, you're right, because we're seeing normal freight would be 24 days from Asia, it can be up to 40 days. So there will be some potential there but in the grand scheme of things, we'll still deliver our free cashflow commitments this year.

Simon Roberts

Yes, and then just in terms of impact of sales on stock and I guess links to working capital and I think in the main, as Kevin said Clive, delays in shipping are around two weeks and so clearly we bring all of our Christmas stock in for around this time of year. So two- to three-week delays are the main order of the day, which means that rather than launching, for example, all of our Christmas products on the weekend just gone, a proportion of them will arrive the weekend after next, so still in plenty of time for Christmas.

In terms of the impact on lost sales, what I would say is in the categories where there was more pressure on the supply chains and GM, they are the categories, clearly, which are inherently lower margin, so consumer electronics, I talked about toys. So again, I wouldn't want to underplay the significance of the challenges in supply in some areas, but when we look broadly at the P&L in general merchandise, what we see is that cost is really delivering and we're on track as to where we expected to be on the Argos plan.

As I say, I think Black Friday will be a smaller event for all the obvious reasons. There'll be a lot less promotion in the market and in the areas which are higher margin for us, clearly those products are less of an issue, so in the round, that's one of the reasons why we can be confident in the second half profit outlook for Argos, albeit with some impacts on the top line for the reasons that we're describing.

Clive Black, Shore Capital

Thank you for that. Then just finally, could you just give us a few words on the fuel market and what that's doing for Sainsbury's P&L?

Simon Roberts

Thanks, Clive. So, I think a couple of things to say here. Clearly, putting the events of a couple or three weekends to one side, two things I would say to you. First of all, we've grown share in fuel and we're pleased with that and I think there's a correlation between our

improved performance in grocery, more customers visiting our supermarkets, and our improved share in fuel, so we're encouraged by that.

Clearly, we continue with our strategy of pricing locally and competitively, and that's working well for us. We've got a strong network of PFS – petrol filling stations – in good locations which are working for customers and working for us. Of course - you'd expect me to say this - our colleagues have done an incredible job in the fuel business over recent weeks.

It was a really challenging number of days, as we'll all remember, and so we've learnt a lot through that period. I think we delivered well for customers, we're encouraged with the financial performance and as I say, the combination of being better value in grocery and gaining share in fuel is one of the things that we're encouraged by.

Clive Black, Shore Capital

Well done guys, thank you very much.

Multiple speakers

Thanks, Clive.

Operator

Thank you. Your next question then is from Sreedhar Mahamkali from UBS. Please go ahead.

Simon Roberts

Hello, Sreedhar.

Kevin O'Byrne

Morning, Sreedhar.

Sreedhar Mahamkali, UBS

Good morning, guys, thank you for taking my questions. A couple of quick ones just to follow up on some of the discussion on Argos. The first one is I guess a concern for investors is that Argos slowed down a little earlier than expected and trying to extrapolate that into next year is clearly a bit of a concern.

Maybe from that point of view, if you can talk a little bit about how you're strengthening the underlying Argos customer proposition, looking beyond the short-term supply chain or tough comp issues. Is there anything that you're seeing there in terms of customer proposition, any data points that you can share in terms of what's happening with the Argos customers and the feedback you're getting and what you're doing there? That'll be helpful.

Secondly, specifically on the supply chain issues we've been talking about, are they getting better or worse over the past few weeks, if you can just give us an idea. The delays that you talked about, Simon, two weeks, is it getting better? Do you have any visibility on that?

The last one is instant groceries, so the rapid grocery delivery. I know you're active in this 60-minute grocery area, you've got partners with Deliveroo and Uber Eats for this and you've got your own Chop Chop. How are you thinking about the 10-minute grocery delivery

opportunity? Is that something that you could see yourself participating in through Chop Chop or any other partnerships? Thank you.

Simon Roberts

Okay Sreedhar, thank you. Well, let's take each of those in turn, so let's start with your questions on Argos. So, I think a couple of important things to say. I think clearly when we look at the second half, I hope we've given some good context in terms of the broad supply chain challenges, so underneath that what are we doing to strengthen the Argos proposition?

Well, you'll remember when we launched our strategy, three really key elements of that in terms of Argos. The first was that we are now partway through rewiring the Argos fulfilment network with the launch of around 30 local fulfilment centres. The advantage of this as we roll this out will be to improve availability for customers.

So, in a business that is now 80% digital, our ability to serve up availability to customers and enable them to access products at speed is clearly going to be a key source of advantage. So, we've opened the first two local fulfilment centres in Leeds and Bristol. We're really pleased with how that's going and clearly, that program will roll out in terms of improving both stock availability and also financially reducing working capital.

Secondly, in terms of the proposition, we put Nectar into Argos around a year ago now and we're really encouraged with the number of Argos customers that are now accessing Nectar. That gives us a way of personalising the content when we talk to those customers.

Thirdly, as part of the Argos platform clearly, you've seen the relaunch of Habitat with customers actually increasingly post-pandemic and post-lockdown are looking to refresh their homes. We're really excited about the potential for Habitat at this point in time and actually, the point about the margin accretive categories in the general merchandise model, the strength of home and furniture for us is one of the things we really want to push on.

We think it comes at a time when there's a high level of customer interest and appetite for those products and as we roll Habitat out, we've been really encouraged with the response we've had from customers. Then underlining all of that, of course, it's about making sure that we're competitive, what we need to be in Argos, but also as I said earlier, recognising the fact we're not going to overpromote in Argos.

So, we're making some very conscious choices about improving availability as we roll out the LFC network, as I say, both digitally and in product terms improving the offer, but also being selective as we look ahead about the extent to which we promote. So, that's where we are on Argos.

I would just finish the point by saying when we look at the second quarter, there are some important points on the comparatives that I think explain some of the performance. Just to reiterate a couple of those, as I say the first is in the lockdown. Clearly, last year we were pretty much on our own and so as everyone else has opened, that's clearly now changed the comparative position.

Secondly, of course, we've seen a much softer summer and that had an impact in the Argos business. Thirdly, just to say that were clearly some supply chain impacts starting to come through, which we would expect to continue as we look ahead. So, that's where we are on Argos, Sreedhar. If we just then extend and look more broadly in terms of availability overall, I think as I said in grocery, situation's stabilising.

Still plenty of challenges but I think the size and scale of what we're doing gives us confidence as we go into a big Christmas we can deliver customers what they want, and if they can't get the exact product, then something very close to it. Then I think just thinking about inflation more broadly, I think was your other question?

Kevin O'Byrne

Rapid delivery.

Simon Roberts

Yes, so just on inflation before I finish that and then rapid delivery. As I said a number of times, we are expecting to pass on as the pressure builds whilst keeping really competitive.

Then on your point on grocery online, clearly the momentum's been really strong. We're twice the level we were pre-pandemic. You can see our presence now in on-demand, so in Chop Chop we're now – you're seeing a significant scale there - in just under 50 stores and through Deliveroo and Uber Eats, just under 400 stores, and a lot of that volume coming from outside of London. Look, we're listening and learning here all the time. So, as you'd expect, we're looking very closely at how customers are shopping, we're learning a lot about what they're putting in the basket.

We're actually pretty encouraged by the basket levels here, up over £30 in Chop Chop and towards £25 in Uber Eats and Deliveroo. As you'd expect me to say, online fulfilment, productivity of online, responding to how customers are changing the way they shop is a very key focus for us.

Kevin O'Byrne

Sreedhar, I might just add a point there. We probably at this stage see that sort of 15-minute-type delivery as being something we'd work with partners. We have Chop Chop but that wouldn't be – we wouldn't see that expanding enormously and our business focused on the same day, next day of the market.

Sreedhar Mahamkali, UBS

Yes, got it. Just on that supply chain point, I think some of what I was trying to get to is you've talked about two, three-week delays in shipments coming through. Is that a pattern that's getting progressively better or you still see that sort of delays persisting into next year is what I was trying to understand.

Simon Roberts

Okay, thanks Sreedhar. So, let me just try and clarify on that. I think inevitably the global supply chain situation we don't think is going to rectify itself in a short period of time. These issues are with us for a while so I think what we're doing is, we've learnt a lot through the pandemic in terms of adapting how we work, planning early, booking capacity early as Kevin said, and we're doing that in the context of an environment that we think will continue to be challenging for a while yet.

Sreedhar Mahamkali, UBS

Thank you.

Simon Roberts

Thank you, Sreedhar.

Operator

Thank you. The next question then is from James Grzinic from Jefferies. Please go ahead.

Simon Roberts

Hello, James.

Kevin O'Byrne

Morning, James.

James Grzinic, Jefferies

Good morning, Simon and Kevin. I have two, really. The first one, I presume all of the hedges on freight and energy roll over next year.

Simon Roberts

James, the line is quite difficult to hear you. Can you get nearer the phone, maybe?

James Grzinic, Jefferies

Can you hear me better now?

Kevin O'Byrne

A little bit, that's better, thanks.

James Grzinic, Jefferies

All right, okay. My first question was around the impact of the hedges on freight and energy rolling over I presume next year. Can you give us a feel for the magnitude of the incremental costs you'll get as that happens? The second one – I understand your point on ultra-convenience. Is that independent of how big that market turns out to be? Will you always do it via third party logistics providers or if it turns out to be a big market, will you look to internalise all of that?

Kevin O'Byrne

James, I won't be able to give you detailed numbers on freight or energy. Our energy hedge runs well into next year, so we've got quite a bit of protection there. As it rolls off, clearly we have rolling programs and it will depend on where the market's at, at the time.

Likewise with freight, I could give you some direction and clearly, we're in negotiations ongoing on freight. We would be able to do long-term contracts with people at rates that are reasonably materially lower than the spot rates that you're seeing in the market right now, but they will be more than we contracted the last time because of the changes in the world.

I think the comfort I would take there is I think relatively we will get good freight prices relative to the market and we will – I think the market will have to pass those freight costs on, so it's not something – we're clearly fighting to keep them as low as possible because that's good for customers, but we'd expect that to pass through.

Simon Roberts

Thanks, Kevin, and then just on the second question on immediacy ultra-convenience, as you say. I think a couple of points just to reiterate here. The first, I would just talk about the proportion of our online business in grocery today. So, when we look at where we are in total volumes, we're doing somewhere around 640,000 or a bit more home delivery, 75,000 – around that – a week on click and collect and around 70,000 on immediacy.

So, just in terms of proportion terms of the total volumes we're putting through, it's clearly growing at a rapid rate but the overall level – we're confident that the platform we have in place enables us to learn fast, to scale in locations where customers are looking to access this service, but also to clearly look at how this is going to play out over the longer term.

As Kevin said just now, the key focus here really is what timeframe customers really do value and what size of basket and range they want to access. So, it's an important and fast-growing part of the business, but it's a very small element of the total online at this point in time. If you sort of think about what's the size of our immediacy sales today, it will be equivalent to one and a half or two of our supermarkets in total for the year and we run 620 supermarkets. So it's growing but we need to keep into context its relative size, and as I say, understanding how customers want to shop this and how our Chop Chop platform particularly can respond is very front of mind.

The other thing I would just say is we've just recently relaunched again our same-day service. It's one of the things we had to stop in the pandemic for obvious reasons, but we're back out with that now in more stores and again, customers are responding to that well. I hope that gives some more colour to the question, thank you.

James Grzinic, Jefferies

Can I follow up on that, Simon? I take the point that it's very, very small now. I guess more broadly, the debate is does the offering shape the scale of demand? If it does and it becomes a much bigger part of the market, would you be looking to internalise that, rather than have third party logistics providers?

Simon Roberts

I'm trying to give as much context as I can in the context of, you can see our strategy, which is we invested ahead of the curve digitally and we have a strong online food business, we're growing market share faster than others. You've seen how we've adapted through the pandemic, as we've scaled online capacity to more than double our volume. I think we've learnt a lot as a business about (1) the speed and pace we can move at and (2) how customers are shopping online.

Not to repeat the point, but I think it's really important we focus on home delivery and click and collect, because that's where the vast majority of the volume will continue to be. And let's remember, customers value freshness, speed, quality and value and that's the key focus of our work in those areas. We'll keep listening and learning and watching. I would just stress the point again, we're very present and active in immediacy through Chop Chop and Deliveroo and we'll continue to learn and develop our thinking as that grows.

Operator

Thank you. Just before we move to the next question, as a reminder, if you do have a question, it's just star then one on your telephone keypad. The next question is from Victoria Petrova from Credit Suisse. Please go ahead.

Victoria Petrova, Credit Suisse

Good morning, Simon, good morning, Kevin. Thank you very much for taking my questions, I have two small outstanding ones. First, still on food price inflation, just to be clear, do you think you have already seen a peak? And are you more focused on some spot contracts or forward-looking contracts? For example, for proteins, where we're seeing such a strong price inflation.

And my second question is on real estate. Obviously with the reshaping of the industry, which you just talked about a lot, you probably have some excess real estate. How do you think about it? Obviously during your capital markets day a couple of years ago you talked about subleases and various complementary opportunities for your stores. Do you have anything to add to that? Maybe provide some colour or maybe there are any sort of financial engineering changes in approach, thank you very much.

Simon Roberts

Victoria, thank you. So I'll talk on food inflation. I heard the second point really clearly in terms of you were particularly referencing proteins there. So let's just talk about that and then Kevin maybe on the property question. So I think let's just take a step back here on food inflation. I think we can all see the pressures that are there on a combination of supply chain input pricing on commodities, costs in the supply chain of production and labour, the supply chain challenges that are there in terms of moving products. So they're clear and we can all see them.

I think in terms of where we are, as you'd expect we're working really closely with our suppliers. There are going to be some inevitable price increases flowing through. We are entering into that context in a very different value position to we were before and so it's a combination of these two things, which is improve value for customers, so on day in, day out products we can deliver what customers expect of us. And then clearly in areas where there is significant headwind building on commodity prices, raw material costs, costs of production, that will lead to, I think, the industry rationally moving prices up. And in the second half, I think we all expect that to happen. We will do that as the market moves and as I say, with a strong value position to start with.

On the specifics on proteins, as you say, there are some value chains where the pressures are more significant. I'd just contrast that in our own business with the strength of the change we've made in meat, fish and poultry. So one of the key elements of our strategy was to really win the secondary customers back who weren't shopping centre of the plate with us. And you'll see in our presentation, Victoria, particularly in meat, fish and poultry, how much the volumes have moved forward as we've improved prices. And of course, if I'm a meat, fish and poultry producer, one of the things I'm looking for is volume. And so as we improve volume - and you can see on slide 27 of our presentation that our volumes have grown 10% against the market 7% and that provides some mitigation to the inflation pressures that are there. So I hope that gives some background on that question. Kevin, do you want to pick up on property?

Kevin O'Byrne

Yes, Victoria, it's been an area of focus for us for some time as part of our cash agenda. So firstly, I'd say we've sold off over the last number of years assets we didn't want, sites we didn't trade from where we were sort of a landlord for someone else and we've sold off our land bank, where we've built up land, as everyone else had, in previous times for future developments which we concluded we didn't want to use for stores. So we've been doing that. So if you look back, you'll see cash coming in every year for that number of years as we've done that. That's largely complete.

The second thing you'll see us doing is closing underperforming stores and you'll see that even in this half. If you look at the detail in the accounts you can see the number of both supermarkets and convenience stores that we've closed and we'll continue to do that. Then the other thing I'd point to is the mixed-use developments, which we have talked about before and we're probably overdue, we must give you an update at the year-end. But we've got one site in development, we've got a number of sites in planning and we continue to push that through so that we create strong cash flow from particularly assets we have inside - in the London area, which are very valuable to put homes on them and then we get a new store at the same time and we generate cash flow from that. So that continues to be a focus from our property team.

Operator

Thank you, we have no further questions at this point. I'll pass back now to Simon for closing remarks.

Simon Roberts

Well, thank you again, everyone, for joining us this morning. Just to close by saying of course, really key period as we head into Christmas. We're in good shape. Some challenges out there but I think there's some good momentum in the business and as we look out over the second half, we're very confident in the plans and the actions we're taking. You can see the strategy starting to deliver. We're in one year of three, so there's a lot in front of us to do. But I feel we've got all the right focus in place to really drive it forward.

As you know, we're very focused on delivering for customers and we're very focused on delivering free cash flow to shareholders. There's some good momentum and we're very focused on the second half, so at least £660 million and look forward to talking to you soon and thank you again for your time. Thanks for this morning.

End