J Sainsbury plc

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Preliminary Results Announcement 2020-21
Wednesday, 28 April 2021 - 9:30 am

Simon Roberts
Chief Executive Officer

Good morning. Welcome to our 2020/2021 results presentation. Thank you everyone for joining us today.

It’s been an exceptional year for the business, for our people and in everything we've delivered for our customers.

First and foremost, I want to recognise the outstanding contribution of my colleagues, of our entire team. They have risen to the huge challenges and have been heroic in how they have looked after our customers, and each other, every day. I’m really proud of the business and the part we played within the wider industry response, as food supply chains really stepped up to feed the nation.

My thanks also to our suppliers for all their support and partnership. They have done a fantastic job throughout the last 12 months.

Every day in every part of what we do, we cared about what mattered most for our customers, our colleagues and the communities we serve. Safety first, prioritising the elderly, disabled and vulnerable from day one, protecting availability, supporting shielding colleagues, supporting communities with food donation. Our values really came to the fore.

And it’s been a time of extraordinary change, learning and agility for the business too. We have responded and adapted well throughout the pandemic. We have delivered at pace, every step of the way and as a result, we’re stronger & fitter for the future.

I set out a clear plan and strategy in November to transform our busines over the next three years. We are clear on our priorities. We are putting food back at the heart of Sainsbury’s.

I'm encouraged by early progress and I will update you on where we are, once we've heard the detail behind the financials from Kevin. Kevin over to you

Kevin O’Byrne
Chief Financial Officer

Thank you, Simon. Good morning and thank you for listening into this presentation.

I will now cover the financial highlights for the 52 weeks to March 6th, before handing back to Simon to cover our operational performance and update on progress against the plan we set out last November.

I’m going to start with the sales line. Grocery sales were up nearly 8%, driven by higher spending on food for in home consumption as a result of the pandemic. The main influence on the movement in grocery growth through the year was the timing of lockdowns.

In stores, general merchandise and clothing sales gradually recovered over the year while Argos sales were consistently strong through the whole year, driving the strong general merchandise number. Simon will cover the strength of the fourth quarter in particular later on.

In total, retail sales excluding fuel, were up just over 7%. Fuel sales were down 39% in the period so retail sales including fuel were broadly flat year on year.

Retail operating profits fell 22%, reflecting very strong execution and efficiency across the business and a good level of operational gearing in both our grocery business and Argos, offset by nearly £500m of COVID costs.

Financial services made a loss of £21m, returning to profit in the second half of the year. With some offset from interest costs down £48m year on year, that resulted in a group underlying profit before tax decline of 39%.

At a statutory pre-tax level, we recorded a loss before tax of £261m, as we booked £617m of predominantly non-cash charges relating to restructuring and impairments. This was in line with the guidance we gave in November. I'll cover these in more detail later on.

Free cash flow was very strong, growing £173m year on year, with a working capital inflow of more than £450m, driven in particular by strong trading in the fourth quarter. Net debt reduced by almost £540m.

I am pleased that we were able to deliver on our commitment of protecting shareholders from the full impact of COVID, effectively paying a flat full year dividend year on year.

This waterfall summarises the UPBT movement year on year, with retail profit down £208m after the £485m of direct COVID costs. That £485m is higher than the estimate we gave in November, having gone through a third lockdown and having paid a third thank you payment to front line and distribution centre colleagues, recognising the amazing job they have done for our customers.

The table on the right shows the breakdown of retail COVID costs in the year, with higher colleague costs the largest part of these, as we paid the wages of vulnerable colleagues who isolating and unable to work, covered higher than normal absence levels and made three thank you payments that I mentioned to front line colleagues.

Looking now at financial services. The waterfall on this slide shows the main moving parts of the financial services underlying profit for the year. We booked £43m under IFRS9 in the year for estimated future bad debts on our loan book. As expected in the year we earned less commission income from ATMs and Travel Money, and reduced interest income due to lower lending activity. This was partially offset by reduced funding costs.

The bank's management team have done a great job in a difficult market, taking timely and decisive actions and have delivered a good performance relative to peers.

The right hand chart shows the contrast between the H1 loss and the H2 profit. In the first half, we made a significant provision in anticipation of future credit losses which has remained sufficient to cover our current predictions. Therefore, in H2 we did not book additional IFRS9 COVID provisions, and the bad debt charge was lower than in a typical half as we had some impairment benefits from a one-off debt sale and a reduction in customer balances.

Looking to next year, profits will rebuild slowly as we cautiously grow the lending book while still facing commission headwinds. We are comfortable with consensus forecasts for the Bank returning to profit, subject to the economy recovering as expected.

These charts summarise some of the most important performance drivers for the financial services division. Firstly, the reduction in the lending book, driven by lower personal loans and credit card lending, earlier customer loan repayments, and the runoff of the mortgage book.

Second, we have talked many times about the quality of our lending book and everything we have seen to date reinforces that. We have conservatively provided against losses, as you can see from the step up in the coverage ratio.

And the bank's balance sheet has continued to strengthen. We are in a stronger position than at the prior year end in terms of capital, bad debt coverage and liquidity.

Going back now to the group P&L.

In order to provide a clear view of our underlying performance, items which by virtue of their size and/or nature which do not reflect the Group's underlying performance are excluded, and these are outlined on this slide.

In the period we incurred a total exceptional cost of £617m, in line with the guidance we gave in November. Our guidance for exceptional costs over the three years to March 2024 is unchanged at £900m-£1bn and we expect to incur the remaining costs of £250m-£350m evenly over the next 3 years.

The two biggest drivers of the restructuring charge are the Argos store closure programme that we announced in November and the reorganisation of our logistics network as we combine our Argos and Sainsbury's networks and reduce our number of depots and stock locations. The costs include asset impairments, as well as closure provisions such as dilapidations and redundancies. These programmes are progressing at pace and Simon will talk more about this in a few minutes.

In the year, COVID-19 and the accelerated structural change led to a full impairment review of all the Group's assets. These were almost entirely booked in the first half. As a reminder, for Retail this reflects changes in future channel mix and the impact on asset values while £105m of the impairment number relates to the write down of intangible assets in the Bank.
The cash impact in the year of the restructuring charges was £54m.

As I noted earlier we generated very strong cash flow in the year. Most notable is the working capital swing, with a significant reduction in stock at Argos and strong trading in quarter 4 driving higher payables balances at Argos and Sainsbury's. In the simplest terms we sold more stock than usual ahead of the year end and didn't pay for that stock until the new financial year. This more than offset the impact of higher Sainsbury's stock and reduced fuel payables.

Disposal proceeds reduced versus last year when we were unwinding the British Land joint venture. We therefore generated free cash flow of £784m, an increase of £173m year on year, or closer to a £350m increase when you exclude the reduced asset disposals, reflecting the net impact of lower profits and the working capital movement.

Obviously as trading normalises over the course of this year we expect around half of this working capital benefit to reverse. We therefore, expect materially lower free cash flow generation this year as this chart shows.

So, we need to look at the cash generation over a three-year period to March 2022 to see the underlying performance. As you can see the underlying average rate of free cash flow generation is expected to be in line with what we have committed to deliver over time. Looking to the outer years, it's worth remembering that this projection is after we pay increased capex and one-off costs relating to the key transformation projects.

Alongside the cash benefit of strong trading, this year we continue to see ongoing benefits from the structural changes we've made in the last few years, no bank capital injections, lower interest costs and lower cash pension contributions. Therefore, in addition to the commitment to the dividend this year, we are also able to increase our net debt reduction forecast.

We are now expecting to reduce non lease net debt by at least £950m over the four years to March 2023, £200m more than our guidance in December, largely due to tight working capital management.

In the shorter term, as you can see from this chart, we expect net debt to increase slightly this year as the working capital benefit I discussed reduces. But clearly very good progress over the two years, particularly in the light of this year's lower profit.

Looking to this year's P&L, we continue as you might expect to take a prudent view on the year ahead, but in line with our commitment to deliver profit inflection we also continue to expect UPBT to be higher than the £586m reported in the pre-COVID year to March 2020, and we have stated that we are comfortable with consensus forecasts of £620m.

Looking at the detail versus that pre-COVID comparison year of 2019/20, we expect underlying retail profits at Sainsbury's and Argos to be higher and we are guiding to interest costs of around £50m lower over two years.

Against that, we will have some ongoing COVID costs, we're expecting Bank profits to be lower than pre-COVID levels and we face a colleague cost headwind against a year when variable compensation was unusually low.

So, a year of significant COVID costs and of significant one-off costs associated with the big and bold decisions we've made this year. But underlying this we've delivered strong profitable sales growth and a very strong cash performance. We've paid a stable dividend and we're more confident on the pace of deleverage, reflecting stronger underlying cash generation.

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

Simon Roberts
Chief Executive Officer

Thank you, Kevin.

So, turning to our operational and strategic delivery. I will cover the following in the next 40 minutes.

First, a reflection on the full year of trading through COVID and our strong operating performance. And second to highlight the strong start we've made towards delivering the priorities we set out in November, Food First, Brands that Deliver and Save to Invest, and the bold decisions and good momentum that are driving that

You're familiar with how we looked after our customers through this pandemic and kept customers and colleagues safe. This was our top priority. And we were proud to be recognised as the safest supermarket by the UK's leading consumer champion.

But what I think is key is the momentum we built through the year. We've grown online capacity two and a half times, compared to what we were delivering before the pandemic. Our technology and digital capabilities have rapidly scaled, enabling us to serve customers whenever, wherever and however they want to shop. And we redeployed and reskilled 15,000 colleagues whose roles were impacted by COVID.

Ultimately, making the right choices for customers and colleagues has meant the business thrived and has become stronger through the pandemic

We've spoken before about the rapid shift to digital. There is no better illustration of the agility of our platform over the last year, than the growth we've delivered across our digital businesses. Online grocery sales have more than doubled to £3.6bn. Growth went further and faster than we achieved in the first half.

We were the fastest growing of the scale online grocers. We added 3 percentage points of share over 12 months. Argos grew digital participation to over 90%. Smartshop remained a critical part of customers shopping safely and more quickly, with sustained momentum at over 30% of sales in handset stores and over 50 million transactions over the year.

Linked to this is a really strong move on in Digital Nectar, where we have a clear market leading position with 7.4m users. The digital platform has been such a fundamental differential for us in serving customers better, faster and more safely through the pandemic.

And as a result, delivering leading customer satisfaction is what has and will continue to set us apart. We listened and responded to customers at a level we've never achieved before. We invested in the areas that really matter to customers, like safety, store standards and availability.

You may remember this chart showing customer satisfaction measures compared to our key competitors, in stores and online. We've achieved record levels of customer satisfaction. Availability in our supermarkets went up 3%, colleague friendliness up 7%, easier and faster to checkout up 13%. We also made progress on quality and value for money.

The increase in online capacity brought challenges too, as exceptional volumes put unprecedented pressure on product availability and timing of slots. We know where we didn't fully meet customer expectations at points in time, and we are very clear on what needs to be done and how we can improve on this.

Looking at our performance compared to the market, this chart reflects for a second year running our grocery volume growth has been ahead of the market and of most of our key competitors, through the whole of the year. And we have a strong story too across our general merchandise & clothing businesses which have performed well benefitting from the sustained shift to online.

Argos has clearly been the standout over the last year, sustaining very high levels of digital sales. An exceptional fourth quarter, in particular, with very strong contributions from gaming and some pull forward on seasonal spend in particular as customers prepared for Easter and outdoor socialising.

We've also seen a really strong recovery from the Sainsbury's general merchandise and clothing business through the year.

So overall a good operating performance and growing momentum across the business, but as we look ahead, it's early days and we've much more to do.

I was clear when I set out our new plan 6 months ago, that we can and will do better as a business, for all of our stakeholders. And in the rest of my presentation I will focus on where we are today and our plans for the year ahead.

A new, clear, galvanising purpose is 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.

Our team feel proud of what they have achieved throughout the last year and what has been delivered for all our stakeholders. And as a result there is a strong and growing belief and conviction about what we can now deliver as we look ahead.

So, turning to our plan and the three value creation priorities we set out in November. These are now driving resource prioritisation and will drive improvement in our performance over the next three years. They are centred on putting food back at the heart of our business and making sure that we make the right choices with our other brands, and our cost savings programmes to cut complexity and support investment in our customer offer.

So what's changing? We're putting food back at the heart of our business, to do a better job for our customers. We have significantly changed the way we look at costs, the way they are managed and governed in the business, and we are targeting a significant 200bps reduction in the cost to sales ratio.

We are clear about our commitments to shareholders, in the form of profit delivery and cash generation, underpinned by consistent metrics we are targeting. And very importantly, I know this is not visible on the outside, but as we set course to deliver against our plan, this is underpinned by necessary change we're making in our culture and in how we work.

This means more focus on the customer, clearer accountabilities, bold choices and a more responsive, faster, lower cost organisation.

I have made a number of leadership team changes in our business over the last 9 months. These changes have importantly brought new focus and energy in a number of key areas across the business. And I'm really encouraged by how our new team are already working together in leading the change we need to make and in driving our momentum forward.

As a reminder, we said we would have 7 consistent key metrics to assess performance, we have now added ROCE to this framework. So 4 operational and measures 4 financial ones We will consistently report against these 8 measures as we implement our plans to share how we are doing and enable you to assess our progress along the way.

So, to our first priority, putting food first. We're seeing early progress in improving customers' real and perceived value perception, the pace is building across product innovation and in online capacity and performance. 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.

Value for money has never mattered more for our customers and we are committed to being better value, with more consistent prices across the year, being more competitive in the key categories and on everyday products that matter most to customers. We're doing this through three distinct value programmes.

First, we're building on Price Lock as our broadest value programme. This targets primary customers, giving reassurance on good value and stable pricing day in day out.
As of January, we have delivered this across more than 2500 products, a clear and strong value commitment across the store and online

Second, we talked in November about the investment we had made in core, high volume lines, particularly focused on the centre of the plate. Meat, Fish and Poultry are critical, halo driving categories. When we win the centre of the plate, we see additional spend and volume that comes with those items. And we've seen customers continue to react positively with higher purchase volumes in these invested areas and growing baskets as a result.

Our third value programme is Sainsbury's Quality Aldi Price Match which we launched in February. This is aimed at winning more spend from secondary customers who are Sainsbury's customers, but spend less of their grocery budget with us. Over 50% of the products and 80% of the volume included in this are in fresh categories, like Meat, fish and poultry and Dairy. And this focus on fresh is quite different from similar competitor activity.

Families can shop with confidence for everyday essentials like Milk, Cheese, Yoghurt and Mince and core Grocery products too like Pasta, Flour and Jam. Sainsbury's Quality Aldi Price Match is already removing price as a barrier to choosing Sainsbury's and driving real and perceived value, particularly with our secondary shoppers. We are pleased with customer reactions, here's the latest TV adverts going out from later today

(Video)

I think both ads are really compelling, I hope you agree.

The charts here show the impact this has had on our year end price position this year versus last year. It's encouraging to see such early positive results; with a near 300 basis point improvement across the total basket versus Aldi, and a near 900 basis point improvement in those key focus categories I talked about earlier. If we look specifically at one of the main areas of focus, the centre of the plate with meat fish and poultry, we've seen a 15% uplift in volume

But this is the really important chart, which shows exactly what we wanted to see. It shows the depth of the price investment we're making in those key categories. And it shows that, as expected, the volume response in simple terms is not enough to make back that investment. But using Nectar data we can track and measure the total spend from customers buying into these key invested areas and we are seeing exactly what we wanted to see, which is an uplift in the 'rest of the basket' spend or what we call the halo benefit.

The sum of the parts is still a net investment but clearly a far smaller one and we benefit from putting higher volumes through the business.

Innovation is absolutely central to our plan to put Food first and there are two key elements to this programme as we step up our plan in the year ahead. We will launch 1,900 brand new food products this year, three times level of last year. In addition, about the same number of what we call 'renovated' products where we will improve product specification, customer appeal and packaging.

New products have to deliver a difference for customers whether that's giving customers an opportunity to trade up, for improved value, or meeting a need to reduce waste, packaging or offer a healthier or more sustainable option. We've significantly changed our ways of working across the commercial teams to deliver this outcome

We know that newness is important to customers and our product plan this year marks a real step change in our commitment to accelerating the pace of innovation.

You can see here our extensive range of tasty and delicious products to enjoy at all those BBQs and picnics this year. We're all set for a summer of celebration with a bold pipeline of new innovation launching just as customers prepare to get together with family and friends

Now we talked in November about the feedback we had heard from our suppliers. Put simply, they were telling us to prioritise better, innovate, and move faster to unlock value from working in partnership together. I'm encouraged that we're already working differently together, and our suppliers are recognising this. We're encouraged by the feedback we are starting to hear which demonstrates that change we're putting in place is now delivering benefits.

And that's through stronger partnership which is increasing supplier investment behind Sainsbury's. In return, our suppliers are seeing higher volumes. And through improved joint responsiveness we're driving innovation and sustainability

So now turning to Online. The rapid acceleration we have seen as you can see has driven our market share. We've been the only top 3 grocer to gain share over the year and we have seen the biggest share gain of the big 5 over the last two years.

We've been there for our customers when they needed us, and we think this puts us in a good place to retain more of that new online share than our competitors as we look forward. 58% of grocery online customers were new to online grocery shopping with us last year. As well as growing capacity, we have grown profitability with a pipeline of initiatives to support this

We have changed how we operate across our channels, to serve more customers, in more ways, more efficiently. This shows the online grocery proposition we now offer to customers. We've expanded the conventional home delivery model from our existing store base, but we have also substantially ramped up our Click & Collect presence, rolled out Chop Chop to another 16 cities beyond London and now partner with Deliveroo and UberEATS in 200 stores.

To help and serve our customers we introduced extended delivery times and saver slots, and delivery pass customer numbers hit a record of nearly 250,000. Our Click & Collect sales are up nearly 10 fold and grew to record levels, peaking at 27% of total digital sales, as we rapidly expanded our capacity to meet demand.

And we continue the expansion of Chop Chop & our unique dual partnership with Deliveroo & UberEATS enabling customers to buy over 1,000 products and get delivery within 30 mins. Now scaled to a £50m business, these on demand propositions are a great example of us responding to rapidly changing customer habits for these immediate missions and partnering to accelerate our plans.

You can see quite clearly in these charts the accelerating online momentum and as we said in November, this has been profitable growth for us, with our online profit contribution growing by a factor of 4, and the contribution margin doubling.

Looking at the drivers of that, our biggest online cost has been a headwind, with average pick rates down 12% for the year, due to COVID restrictions. This has recovered over the course of the year and is now back above pre COVID levels. The item pick rate drag was offset by bigger basket sizes and scale benefits. Importantly, these were not just COVID-driven. We continue to refine the operating model and have delivered some big wins on drop density and van utilisation in particular.

When we look to online economics over this next year, we know we will face some headwinds. But we've already started in a much stronger place on IPH having recovered to pre-pandemic levels. This is continuing to step up and we know we have a lot of cost efficiency benefits to come through.

Looking beyond the short-term store pick economics, we are taking a good look at the evolution of the online market, and as you can see we have already gained a better understanding than most of the immediacy market. The economics of the model will change as the balance between automation and labour costs change and as customer expectations around immediacy change too.

So to summarise here, we're confident in the continued profitable evolution of our store pick model but, given the pace of change and as you would expect, we are bound to be looking at these things across the industry like other grocers.

With food at the heart of Sainsbury's and our mission to help and serve every customer, we will soon launch a new brand promise. Later this year, you will see us switch from Live well for Less to help everyone eat better. This bold new commitment as a brand captures a far wider number of ways in which we can and will help our customers eat better. Affordable, easy, delicious food cooked at home, enjoyed together.

'Help everyone eat better' is our promise that commits to healthier, tastier, more sustainable food, available to all our customers, no matter how much time or money they have. And it will also fully integrate our sustainability ambition boldly and clearly within our commercial and customer objectives. This is very important to us, and something we will talk more about at our ESG event in June and through our role as supermarket sponsor of COP26 in Glasgow later this year.

We set out our net zero targets last year and promised to update on progress, not just on the Scope 1 and 2 net zero targets but on our wider sustainability goals. Customers continue to tell us they care and expect us to drive positive change to reduce the impact of their shopping on the planet.

We outlined our four key priorities in November, reducing our carbon footprint, helping customers make healthier and more sustainable choices, reducing food waste and reduce packaging.

We've made progress against three of these four. On plastics, there is lots we are doing; for example, we have removed 255 tonnes of plastic from our beef and lamb steaks by replacing our plastic trays with film lined boards. We've also removed over 6 tonnes by moving to paper straws on our juice cartons. As well as announcing our Scope 1 and 2 targets, we have committed to reduce our Scope 3 emissions. We've also continued to focus on everyday progress by implementing environmental measures in our new stores, ranging from installing EV charging points to Bee hotels to help boost the biodiversity of our sites.

Our 2nd priority relates to our brands outside of food, and how they support our ability to deliver in food. We've made material changes in how we run these brands. We have three very clear objectives. For each will deliver for their customers, making a return in their own right and supporting our Food business.

Let's talk first about Nectar. As a unique platform, Nectar is powering our ability to connect with customers through hyper personalisation of offers linked to individual shopping habits. It's a profitable business and we are accelerating performance. Not only do we have 18m active Nectar collectors, we continue to grow our Digital Nectar base, now with more than 7m app users. This is market-leading by some distance.

We have made significant investment in our digital media capability and we believe, we are now industry-leading in this space. Our suppliers recognise the value of being able to effectively communicate with these engaged customers, attracted by the strong and measurable ROIs we can deliver, by converting customer reach, relevance and engagement into sales.

We're showing just one example here of driving conversion through personalised content, but there are many more across all categories and the possibilities for collaborating much more on this platform with suppliers are significant.

We know there's a lot of interest in this area, particularly given the increasing size of our digital customer base, so we will share more on Nectar and particularly Nectar360 later in the year at a deep dive event we will plan.

The Nectar coalition gives us scale and is a powerful draw for new brand partnerships with earning and redemption opportunities at over 300 retailers. Last year we bought Argos onto the Nectar platform. We are already linking more Argos customers with Nectar than expected, giving new and better insights into these customers, their link to our other brands and a new more efficient way to talk to and incentivise them.

As expected, we see even higher levels of Argos customers using Nectar where they are collecting from an Argos store inside Sainsbury's. We announced our partnership with British Airways. The launch of our two-way Nectar Avios partnership is a great demonstration of the power of Nectar. It's a meaningful currency for customers and one they're increasingly engaged with through the Nectar App. You only needed to take a look at social media in the days after this partnership was announced to realise quite how engaged customers are here.

Argos has really come of age as a digital business. We are the third most visited retail website in the UK, with online sales up 69%. Over 3m customers were new to Argos in the year and they have used us across our ranges with strong performances in categories like furniture where we have really stepped up our offer.

We've been there for customers when plenty of businesses haven't been able to and they have experienced our market leading click and collect and home delivery propositions, with nearly 40% of sales delivered to home. We've made great progress in our customer propositions by launching the power of Nectar in Argos with over 2.7m linked accounts and strong sales participation.

We are well underway with the transformation plans we laid out in November to make the Argos model more competitive and more profitable. The Argos we start this year with is a very different business to the one we started last year. It is already delivering a significant reduction in cost to serve and this will build as you can see in these charts.

This year we will open around 70 Argos store in stores inside Sainsbury's. We will open our first new local fulfilment centre this summer and at least seven will be open by the end of the year giving shoppers quicker access to a wider range and with improved and more consistent availability. In addition, as we build out our network of fulfilment centres over the next three years, customers will also see a progressive improvement in availability as we move more stock closer to customers for rapid delivery rather than as is currently the case, availability being dictated by the range in their immediate store network.

Of course, this also comes with significant working capital benefits as we become more efficient with our stockholding across Argos.

So when we look to the Argos profits this year and the changing macro context we are being cautious on our sales forecast, given the uncertain consumer spending backdrop and the prospect of forgoing some unprofitable sales as we take a more disciplined promotional stance.

So, we're forecasting sales to be broadly in line with pre-COVID 2019/20 levels, but with a better gross margin rate and significantly lower costs. As a result, we are expecting higher profits than in the pre-COVID 19/20 base year.

There's been something of a quiet revolution happening at Habitat, as we have been making it our main home and furnishing brand and maximising its potential for the first time. Significantly increasing its distribution and the quality of our offer across homewares and furniture. At the back end of the business, we've now effectively brought all of the infrastructure in house to Argos, reducing cost and delivering a huge upgrade to the Habitat website. The relaunch of Habitat has made a strong start, with home and furniture sales up over 30% in February which was the first month of the launch.

We shouldn't ignore the contribution our clothing business has made this year. We've significantly outperformed the market, with a really stellar outperformance in womenswear in particular and our top line performance in stores has recovered over the course of the year. Customer feedback on our ranges has continued to improve. But importantly alongside this, we've learned a huge amount about how customers will trade online, how to manage promotional participation with tighter management of stock levels. We are now a significantly more profitable and capital efficient business as a result

In Financial Services, Jim and Mike have done a great job managing the impact of COVID, with a good performance relative to peers. Costs are lower, risk has been well managed and the balance sheet is strong, so we are well set to deliver the strategic commitments we set out at the Capital Markets Day in September 2019.

We said in November that we had received some expressions of interest in our financial services business. We continue to evaluate these and will update the market if and when appropriate. At this moment in time, our clear priority is to continue to deliver our core strategy. With a return to profitability in the second half, we are on track and expect to continue to deliver progress.

In doing so, as you can see here, we're delivering a strong and compelling financial services platform and the link to other Sainsbury's businesses is developing well across Argos, Habitat and Nectar.

So now to our third main priority, Save to Invest. As I've already said, We're making some really significant investments in our customer proposition. These are being funded by cost savings elsewhere in the business and we have the very significant ambition to reduce operating costs to sales by more than 200 basis points over the next three years.

The change in our cost ambition is clearly set out here. We've completely changed the way we govern cost management in the business, and this is giving us real confidence that we can deliver the step up in savings that we are targeting this year and beyond. We have created new programme management, new ways of working and built a muscle in the business that is stronger than we've seen before with a refreshed ambition for delivering our plan

Looking in some detail at that step up, you can see where these savings are targeted, with a number of the programmes that we talked about last year such as supply chain and logistics now well underway in delivering benefits.

Within the retail projects here this is not just headcount reduction, these are key change programmes where we've made big choices about things like our counters and the Argos store network as well as addressing some big opportunity areas like waste and shrink.

Overall, we've mobilised a significant cost change effort and we are making big choices, from resourcing our business more effectively to fundamental reorganisation of our supply chains.

This slide provides more information on some of the big-ticket areas over the three-year programme. Now that we have announced a significant reorganisation, we can share some more of the detail on the central costs target of up to £100m, which was part of the cost savings target that we gave you last year. We've also shown some of the staging posts on the supply chain and logistics journey, where we will see a large amount of change this year. So, these aren't just ambitions. These are very significant changes to our ways of working

So, in summarising where we are. We've taken the momentum that we've gained this year and used it to move at pace to change the business. There is no doubt that we have started to put food back to being front and centre in our business. But we've only just begun to deliver what we think is possible here.

We're transforming Argos and Habitat, and the Bank is on track to deliver its targeted return improvement. And we will deliver profit improvement this year on a normalised base and with a stronger net debt reduction target.

Our commitment in delivering for shareholders I hope is clear. Through an inflection in profit, through high returning transformation projects, and through strong free cash flow supporting a consistent dividend and a strong balance sheet. We have reconfirmed our guidance for the year. We remain prudent about top line expectations given the tough comparables, but we have a clear plan to achieve profit growth.

Finally, I promised that I will always return to what are now 8 key metrics as we move forward with our plans. We will therefore next share progress when we get together for the interims.

But for now let me say, I am pleased with the way we are shaping up with our operational measures having done particularly well in FY 20/21. We expect to push forward too with Net Zero as we launch our integrated plan with "Helping everyone eat better".

In the reported numbers this year, the financial measure have significant distortions from COVID. As confirmed, we expect profit growth this year over pre-COVID levels and we are getting on with delivering our cost savings programme. Last year was clearly exceptional as regards cash generation while lower profits reduced our return on capital employed.

Let me finish by coming back to our three core priorities. You can hopefully see how this is beginning to fit together in driving our performance and momentum.
We've made some bold choices to drive forward our priorities and we're working hard to reduce our operating costs and our cost of goods. We're reinvesting that money in the core areas of the food proposition that matter most to customers, particularly in value, and our customers are noticing. The retail market is so dramatically different to where it was a year ago. We've adapted at pace and we will continue to do so to be really well placed in a post COVID world.

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

<u>Question and Answer Session</u>

Simon Roberts,
Chief Executive Officer

Thank you. Well, good morning, everybody, and thank you for joining us on our Results Call this morning, I'm joined by Kevin O'Byrne, our CFO.

I hope you've had a chance to read the statement and see the presentation that we posted on our website earlier this morning. These cover what has been an exceptional year for the business and for our customers, and I'm very proud of all of my colleagues, they've done an amazing job looking after our customers, their colleagues and the communities we trade in. As we said in our statement, you can see we recognised this with a number of thank you payments through the year totalling around £100 million.

The third lockdown was particularly tough for everybody. And so just ahead of our financial year end, we made our third and largest payment to our frontline colleagues, amounting to around £50 million. Clearly, that's the number we include in our underlying costs. And so it reduced the retail profit that we reported, but we are very clear that it was the right thing to do.

I set out a clear plan and strategy in November to transform our business over the next three years. We are putting food back at the heart of Sainsbury's and it's early days, of course, but I'm encouraged by the early progress we've made. As a business, we've moved at pace to meet the challenges of the last year, and we're stronger and more agile as a result.

I will now hand over to the operator to take your questions. Thank you

<u>Question 1</u>

Nick Coulter, Citi

Morning Gents, I hope you are well, I have three. I'll go one by one, if I may. Firstly, can I ask about your medium-term free cash flow guidance? That seems to be a little more assertive in terms of the £500 million plus per annum. I think Kevin talked to tighter working capital in the prepared presentation, but is there anything else that's driving that change please? Thank you.

Kevin O'Byrne

It's in every line, but working capital is clearly one of these that is contributing to us. But we also have highlighted this morning, an unusually low free cash flow in the year we've started, because of the unwind of working capital from last year. And in very simple terms, what's happened there is, we had higher sales in quarter 4 where we got cash from customers and we paid for those products in quarter 1 of the new financial year. So, you get a swing.

So this year you'll need to really look at two years, which, again, you've seen in the presentation where if you look at the average over the two years to '22, March '22, you see strong average free cash flow, and the three years. And then as you've pointed to, we're very comfortable with the forecast to March '25 as we continue to focus on converting profit into strong free cash flow for shareholders.

Nick Coulter

I guess my question is, is your confidence in those outer years, is that purely working capital or are there other elements? Are you more comfortable about your operational plans? It seems like there's a small but important inflexion in terms of what you're saying on free cash flow.

Kevin O'Byrne

It's all of the above, but working capital is contributing a little bit more.

Nick Coulter

Okay, super, then on cost savings, which I guess are a key enabler, could you talk a little bit more about the supply chain transformation? I guess the principles and strategy behind that and how that differs from your legacy structure please. Thank you.

Simon Roberts

Yes, thanks, Nick. So I'll just recap on the key points we made in November, then we will bring you up to speed with where we are now.

So, as you say, we laid out a cost saving plan in November to reduce our cost of sales by 200 basis points over three years. And as you say, the supply chain and logistics transformation is a key foundation of that plan. And really, there are three things happening here. The first is that we are bringing together the Sainsbury's and Argos network to create an integrated transport and depot network, which means that we can operate more efficiently.

And we can also, to your first question, be more efficient in the stock that we have in the system to do that. That's the first thing we do. We're well on with that. So we've announced the closure of four depots already. We're bringing together the way in which our integrated transport network delivers across both Argos and Sainsbury's. And that plan is in delivery and it will continue this year.

The second component then is that, as part of what we're doing in the Argos transformation, we are moving to 30 local fulfilment centres, and that will mean that we'll be able to improve availability to customers over three years. That's a progressive transformation. We'll do a third this year, a third next year, and the third the year after, so the benefits flow year by year. And again, that that underpins a key aspect of the £105 million of cost saving in the Argos model that we'll deliver.

And then the third element here is really about how the combination of our supply chain and logistics activities together power a really efficient operation, end to end in the business and mean that we can improve the availability for customers with more efficient working capital, and in a way that really leverages the scale and size of the business and getting product to customers more efficiently.

So, it's a key element of the plan. We're well on with it, and we're confident of the commitments we've made on the cost savings it will deliver.

Nick Coulter

How much is actually changing in the core grocery supply chain, or is it just a case of, say, seeing some huge effort integrating Argos? What's actually changing in the grocery side, please?

Simon Roberts

Yes, so I think there are a couple of key elements there. The first is that we're looking at our depot network and we've announced the rationalisation of some of our depots. In two of our specific larger depots, in fact, in the year just finished, we've completed a reconfiguration. So, in Hams Hall and Waltham Point, which are two of our largest facilities in the U.K., we've reconfigured those which have meant we're able to put more capacity through them more efficiently. And we're closing a couple of depots too as we enlarge the capacity in a smaller number of locations.

Of course, as you would expect me to say, our number one priority here is to make sure that we deliver on the fundamental of good availability in grocery day in, day out. And so, as we have this cost saving programme, we're too very focussed on making sure availability remains strong, and you'll have seen in our customer satisfaction performance over the year, we're watching that closely and availability improved year on year. So, delivering the cost savings whilst making sure the operational performance is strong.

Nick Coulter

OK, great. One last one, if I may, just on Nectar 360. I appreciate you're going to do a deep dive at some point, but if you'd be able to add a little colour, while we wait for that detail, how many suppliers are you engaging with? What sort of growth are you seeing in that area? Is this nascent or is this more established? It would be great to get a sense of your relative positioning versus others on that on Nectar 360, as you alluded to in the presentation. There's a lot of interest and a lot of noise around this area. Thank you.

Simon Roberts

Yeah, thanks, Nick. So just to recap on a couple of the key headlines, The first key point I would make, is it’s all about having customers within the Nectar ecosystem. And the team have worked really hard over the course of the last year to accelerate the number of digital Nectar users. And we've moved, as you've seen in the presentation, up to 7.4 million now. And the ambition is to get to 10. And we're pushing hard to do that.

And the reason we're so focussed on that, of course, is because it means we can engage with a broader group of customers. Exactly in the way that you've described them both in our thinking about how we personalise our offer towards those customers, how we work with our supply base in the broadest terms, to be able to tailor and personalise the impression, and the offer we put in front of those customers.

And of course, as we grow online so substantially, the combination of 7.5 million plus on the way to 10 million digital users, is the ability to work with our suppliers through Nectar 360. And as you describe, this is an extensive and developed platform that we've been building and continue to accelerate and in so doing I think particularly online has grown so much, we can just reach so many more customers, so it's an area we're very focussed on.

We've clearly grown the number of customers substantially, and we think that being part of a coalition is a key enabler of that, because now there are 300 other brands that the Nectar coalition works across that enables us to accelerate quickly the number of customers within Nectar. And exactly to your point, we'll do a deep dive later this year, and we'll show you in different categories, different products, how we're building this media platform and how and working with suppliers and the bigger online business. We think this has got significant potential.

Nick Coulter

Okay, look forward to that. Thank you so much.

Thank you

Question 2

Sreedhar Mahamkali, UBS

Good morning, good morning, thank you for taking my questions.

Really a couple of quick ones perhaps that are connected. And the first one is you're talking to strong underlying momentum in the release, but it seems like net finance costs are coming in a bit lower than consensus expectations as well as you talking about accelerating cost savings. So all of that, at least to us, seems to suggest an upside to where consensus is rather than this sort of £620 million?

So perhaps if you can help us reconcile why you're not upgrading the PBT outlook for this year, please? That's the first one and second perhaps is connected, as I say, and that's the phasing of the cost savings in terms of the two percentage points, structural cost savings as well as Argos. How should we be thinking about it over the next two or three years? This year included. Thank you.

Simon Roberts

Sreedhar, thank you. So maybe Kevin and I will take the guidance for the year ahead between now and then. I'll come back and talk about the cost savings further. So in terms of where we are with guidance, we're comfortable with guidance. And I think we would say we're seven weeks into a new year, clearly. And there is uncertainty more than usual in the year ahead.

We don't know how covid is going to build from this point. And of course, there is unpredictability in the customer and economic environment. So we're very encouraged by the momentum we're seeing in the business, both in the food business and in general merchandise and Argos. But of course, that macro consumer environment is one that we're prudent about.

When we look at the positives driving improvements against the base years, the Argos profitability is underpinned by both the improvements in margin we're expecting, and also the cost savings in the Argos business they'll come to in a second.

As you seen in the presentation, we're encouraged by the momentum in food. We think investment in value is growing volumes. We're encouraged by the improvement in the online economics, you know, and we're expecting the continuing momentum in food to grow. And as you've seen, we've got lower interest costs, too. So there's a number of positives there. But also, we've got the uncertainty of Covid costs this year. We've got the Bank performance in the year ahead and we've got some differences in the variable comp. as well, that maybe Kevin, we should just share some of the perspectives in terms of the headwinds we're facing in Q2?

Kevin O'Byrne

Yes, just building on that, Sreedhar. And, if you put the numbers together, the interest benefit, the headwind from financial services, Covid costs etc, you're looking at retail profit growing a little, which I guess is behind your challenge to all Simon’s points. It's early. You know, it's an uncertain year, as far as budgeting at this stage.

But a big element which we talk to in the presentation is the variable compensation, which is unusually low in the year to March 2020. That creates a headwind of around £50-60 million if we hit performance targets this year. And so, if you exclude that element of UPBT, if we deliver the £620m, it actually represents underlying growth in mid-teens versus the pre-COVID level, which is a strong performance against all of the backdrop we've talked about.

Simon Roberts

Yeah, maybe just one last point on that Sreedhar I would make is, I think, we're very much seeing the year ahead as a year of really putting the key foundations in place in the transformation of the business that we expect to see. And doing that whilst we deliver a headline improvement in profitability of around six percent.

So, I think delivering those foundations on the momentum in the business, driving the cost saving programme that we're very committed to delivering, raising our profitability. And as Kevin has just described, there are a number of underlying aspects in the comparison that we also want to make sure we take into account in that.

Kevin O'Byrne

So just adding some colour. Simon talked in his presentation about 1,900 new products arriving, and there's a cost to that. There’s packaging, there's waste, there’s the price investment. So it really is a case of investing in the infrastructure and the foundation of the business this year and delivering profit growth reported sort of in the order of six percent versus 19/20.

Simon Roberts

I think just for building on your second question, Sreedhar, about the cost element, and I think if we take just half a step back in terms of how we're seeing the landscape ahead, I think the team have done a fantastic job getting momentum moving in the food business.

No doubt we'll talk about value this morning. But the delta we're seeing in terms of customer perception on price in a few months only is encouraging with a long way to go. But now we're seeing an improvement in our price index, particularly against Aldi and others, which is clearly key in our strategy. And the cost saving programme at its heart is about fuelling investment in the offer, creating the self-help we need to become more competitive on price and I think in the landscape ahead, that's absolutely critical for us.

And so, when we look at all of the activities on cost saving, the teams across the business have worked very hard over the last six months to build the plans for this year. And we're on with delivering them. And I think the two elements I would highlight; one is the key components of it, and then two, how we're organising ourselves to make sure we stay on track.

So as we set course on the year, we talked about supply chain logistics transformation, a very significant piece of transformation across the business that we're well on with, the Argos change over three years. And the benefits will flow pretty quickly in each of the three years. So we will close one hundred and seventy stores this year in Argos. We will open a number of store in stores and collection points. We will open our first seven local fulfilment centres, and we'll begin the journey of embedding that new platform for Argos. We've announced a number of changes in the centre of the organisation in early March as we look to become more efficient there and we are well on with those plans.

And then, as you saw, we announced the closure of our counters in November. So the cost saving programme is well on. And then we've organised ourselves with, you know, a very disciplined level of governance and focus to make sure we deliver the targets that we've committed to.

Kevin O'Byrne

And my only build on that would be if you look at slide 54, you can see that illustrates that the savings are pretty evenly spread over the next three years so it's not back end loaded. It's kind of pretty well a third, a third, a third.

Sreedhar Mahamkali

My apologies if I missed it, one last question on the Covid costs. I know you're talking about retaining some of those costs into this year. Any sense you could share with us in terms of what level of cost we should be thinking about, please?

Simon Roberts

Yes, I can. Thank you, Sreedhar. And I think just to just to recap, for £485 million of the covid cost in the year just finished, as you say, it's unpredictable in terms of the exact level of costs that we would see this year. We don't know the impact of a lock down potentially in the autumn yet, if that was to happen. But I think in the range of 10 to 15 percent of the way we're thinking about it of last year's covid cost, at this stage, we're continuing to make sure we prioritise safety first.

Our colleagues in stores are doing a brilliant job every day at the front door, making sure we continue to encourage customers wherever possible to shop alone. We're continuing to focus on delivering leading standards of social distancing in store and in our logistics operation, and that comes with costs. And that would be the view we have at this stage in terms of the amount we should plan and factor in for the first half of this year.

Sreedhar Mahamkali

Thank you very much for the detailed answers. Appreciate it.

<u>Question 3</u>

Andrew Gwynn, Exane BNP

Yeah, morning, how are we doing?

Three questions if I can, I'll try and keep them quick. First, on the Aldi Price Match, obviously an interesting chart that you put in the pack, but still a net investment. And I suppose the obvious question then is why do it? I suppose the obvious answer is counterfactual, but it just would help there. On online cannibalisation, I think you gave some good detail at the half year results so I'm wondering if there has been any change to that as the business has got a bit bigger. And then the last one, which is perhaps optimistic, sorry, variable contribution margin, it's doubled. I was traditionally taught that around about 12 percent is the figure we should expect for variable contribution in the store. If online is doubled, should we be thinking something in the range of maybe six to eight percent?

Thank you very much

Simon Roberts

Andrew, thank you, so I'll take now Aldi Price Match and online, and perhaps Kevin online or variable contribution margin.

So the answer to your question on Sainsbury's Quality, Aldi Price Match. And just to recap on the three core value programmes that are in place now. So, Price Lock is well established in the business over 2,500 SKUs targeting primary customers and ensuring that we've got broad value across the basket.

You'll remember in November we laid out a plan to win the centre of the plate and that was about establishing the fact that price perception wasn't good enough there. We've lowered the price of around 400 products and we've seen 15 per cent volume increases as we've done that.

And then to your question on Sainsbury's Quality, Aldi Price Match. We're pleased with how this has started. We've spent time listening to thousands of customers. And as you'd expect, this platform on Sainsbury's Quality, Aldi Price Match is deeply rooted in hearing that customer feedback. Customers wanted two things: they wanted really great value, of course, on these everyday essentials, but they wanted it with Sainsbury's quality. And that's the important distinguishing feature about what we set out to do here.

Eighty percent of the volume is in fresh products in meat and fish and poultry and dairy and produce. And we think that's really differentiated in terms of what we're doing there. And it's giving strong cut through in terms of our secondary customers buying into it.

We go live today, and I hope you had a chance to see the new ad this morning, Eton Mess. Definitely worth trying, but you can see that our £1.10 fantastic Sainsbury's quality strawberries, price matched to Aldi.

And in terms of the results, just to the point you make, I think we were very focussed as we launched this strategic value platform that we wanted to ensure the volume came through. So the chart highlights both the growth and net price investment and the halo benefit we're seeing. We wanted to win and we expected to win higher volume in the basket, more items in the basket, breadth across the rest of the store.

It's, of course, early days as we launched in February, but it's what we're seeing. And so when we go back to the plan we laid out: driving cost savings, creating the fuel to put into value investment, that's the way this is playing out. I would also add, of course, that our teams are working really hard with our suppliers at the moment to make sure, as well as driving in great volumes in the business, that we're also improving our cost of goods as well.

And so the combination of operating cost savings, along with becoming more efficient in our cost of goods, is giving us the firepower in the offer to make sure that we can both improve value and drive volume.

If we then talk about online, I can give you the sense of the latest picture on this, I think obviously we're in in a few weeks now where we're starting to see the impacts of the lockdown release.

We're still seeing online participation in the high teens. It's come off a bit and the majority of what we're seeing come off has resulted in those customers going back into stores. So, I think we're seeing the novelty of returning to the physical store for a number of customers being positive, but still in the high teens and we expect to see that continue.

As you've seen our in our update online this morning, the store pick model, we've continued to drive the efficiency of it and we think there's more headroom to go there. So we'll continue to improve item pick rate and there's more room to travel as we recover from the impacts of Covid.

You've seen the drop densities that are coming through there and the combination of maintaining a leading online position for customers whilst driving the economics whilst ensuring that we keep hold of customers in the physical channel if they come out of online, is the way we're thinking about it.

One last data point, which might be helpful. We've seen a quarter of a million customers sign up for Delivery Pass in the year. So those customers, by implication, wanting to use the groceries online service over the longer term. And we think that's important in terms of maintaining online loyalty as the customer behaviour picture changes with the customer motivation.

Kevin O'Byrne

I am going to disappoint you and not give you the number as I think you might have expected. But just a couple of words on the contribution. We look at all our channels down to contribution, whether it's convenience, whether it's Groceries online etc., because they obviously share resources, they share assets, they share infrastructure. The way we calculate the contribution from groceries online, which has increased fourfold, is that we look at all the direct costs that we charge in all the pickers, the vans, the drivers, the marketing, all related to that business.

And it carries all its costs and has increased its profitability materially year on year. If we were to fairly allocate fixed costs of that business, it's still profitable. So if it were to carry, for example, 18 percent of all our occupancy and property costs, 18 percent of our fixed supply chain costs, depots, etc. it would still be a profitable business. We do, and I think we've mentioned before, tend to look at the box or the network economics of a particular area. And obviously, if you allocate more fixed costs to groceries online, you get less fixed costs in other areas of the other channels and you'd adjust.

But we're very encouraged by what we can see in sales. For example, across the supermarkets, sales increased, if you include groceries online in stores and retail walk-in customers, up 11 percent in the year. Where we have grocery online and a [Argos] store in store in supermarkets, they were up about 18 percent so clearly we've got more sales through each of the boxes. We get more margin in the box of a largely fixed cost base. And that's obviously beneficial from a profit point of view.

Andrew Gwynn

When you then overlay the kind of lost profit almost within a store, when you think that online is coming from a lower margin, but you're losing a higher margin store sale - net net, are we looking at a growth in absolute profit from growth in online?

Kevin O'Byrne

Well, net net, clearly, you know, behind your point you're absolutely right. It is less profitable if we do an online delivery than if someone drives to the store and shops for themselves. So then we're looking at all of the levers that we need to manage in that box. So clearly all of the Groceries Online levers around van utilisation, pickrates, etc. So we manage that. And the front of store costs. So, for example, SmartShop in handset stores with 30 per cent of sales going through SmartShop; that saves us a lot of labour on the front of the store.

So there's more to go for, we believe, in improving the box economics, but we need to do that because as you've got a greater mix of online, that clearly puts some challenge where customers who were coming into the store have gone online and hence the actions we're taking on the overall box economics

Simon Roberts

The last point I would add, Andrew, is on the average basket. You know, I think you've seen in the presentation we're north of £100. We're holding on to high teens percentage online. And, we'd expect still to see a differentiated average basket compared to the wider industry.

That's helpful in terms of the economics. And as Kevin said, now we do still see significant headroom to continue to improve the store pick model and the team are all over that. And when you look at how pick rates are moving now, how drop density continues to improve, as I say, how the average basket continues to sustain in all of those, we see value to further embed.

Andrew Gwynn

Okay, great. Thanks, Kevin and Simon.

<u>Question 4</u>

Victoria Petrova, Credit Suisse

Hello, hello. Thank you very much for taking my questions, I have actually short ones left.

First is on discounters in the context of current trading, obviously, if you can provide any comments, they seem to start regaining market share, obviously, from a low base. What is your view on that? Maybe any observations or any chance you could quantify the benefits of discounters losing market share last year?

And my second question is about On Demand and immediacy players. Again, what's your view on this model? Do you see any impact on your convenience format in the recent months? Is your Deliveroo partnership with a 30 minute delivery offsetting it or sort of offering adequate competition to this habit? What's your view on that?

And my third question is always more of the same. Are you planning to go into automation or are you still comfortable with manual pick you were focussing on through the entire last year?

Thank you very much.

Simon Roberts

Victoria, thank you. I'll take the questions in turn and Kevin will comment to add.

So first of all, in terms of discounters, I think what we would say here is, of course, that there's no room for complacency. First of all, value will be incredibly important to customers. And as we were describing just a few moments ago, we're very focussed on our plan to improve value for money for customers.

But we do think we're in a much stronger price position than we've been in previous key points of time, and we've seen a strong switching performance versus the discounters and particularly relative to our other large store competitors. So we're very focussed on value. We're very focussed on making sure we can capture on that value.

And as customer shopping habits inevitably change over the coming weeks and months, we’re making sure we're putting value front and centre in the way in which we continue to drive our plans going forward. We do also think there was a marked change in how customers are going to continue to shop post the pandemic. We’ve seen three things already happen in that space.

One, our customers valuing the safety of the large store environment. And I think even as the lockdown eases over a longer period, that will still be a feature of how customers think about what's important to them.

The second thing is the wider assortment. Clearly in the large store and upwards of 40,000 SKUs being able to go to the store once or online once and be able to access that full range of products is a second point, and I think thirdly, clearly the access to the online environment to as we've talked about.

So, you know, it's hard to be definitive about the long-term customer change and to what extent it will shift. But I think those three features will be very important.

So we're focussed on delivering against our value plans. We're focussed on making sure we also bring a lot of innovation into the mix on a combination of value and innovation that we will deliver a very strong offer to retain customer spend and loyalty that we've seen through the pandemic. That's the first point.

In terms of your question on demand. Absolutely. It's a very relevant and important question that we're all thinking about as we've seen this growth in on demand and substantially shift through the pandemic and over the recent period. And when we think about what we're doing today, we think we've got a unique online platform today in the combination of home delivery, Click and Collect, Chop Chop and as you say, the partnership with the Deliveroo and UberEATS that we now have in place.

And just to headline some of the key elements of what we now have. So, we're delivering clearly home delivery from 250 stores today and getting to 98 percent of the population with an average basket of £100 at one end of our platform online.

And on the other end, in terms of On Demand, Chop Chop has now scaled to 17 towns and cities, 40 plus stores and interestingly, within with an average basket of north of £30 now, which I think just shows the shift in customer mindset to shop on demand more extensively and to shop for a wider range of products and then clearly UberEATS and Deliveroo are following the same pattern in 200 locations today.

So we're watching this carefully and we think it's an important feature of how we adapt and change the business to meet this immediacy mission. And I think it really links into your last point, really, which is that Kevin shared the economics and the way we're thinking about the in-store pick model today. And I think that when we reflect on where we are with that, what we would say is that clearly the in-store pick model continues to really deliver performance that we expect.

And there aren't, as we look at it today, any MFC or automation solutions where the economics are immediately compelling and that’s particularly because what's out there today doesn't enable you to pick the full assortments. It requires having a parallel operation in the store.

And so, as you'd expect, we're scanning technologies around the world. We're talking to everyone in this space. We're learning and watching closely what's happening. We think over time, the relative cost benefit of automation versus the cost of labour will be an area that we'll continue to look at.

And obviously these expectations around immediacy will become more important. And so it's continuing to drive the in-store pick model. Let's continue to understand the move to immediacy, and continue to evaluate the options out there. But at this point in time and continuing to drive the store model and use the on-demand platform we have, this is where we are.

Kevin O'Byrne

Victoria, one small build on the immediacy point. You know, it's obviously very important that we move with customers. It's very important that we try and experiment, learn, but also just to point the scale here. And just to put it in some context, if this is a £50 million sort of business right now on an annual basis, that's also based obviously on £23 billion. So, you know, it's relatively small in the grand scheme of things.

Victoria Petrova

Yes. Thank you very much. That's very helpful.

<u>Question 5</u>

James Anstead, Barclays

Good morning. Simon, Kevin, I've got two questions, if that's okay.

The first one is you're obviously trying very hard to improve your price perception. So it just seems a potential missed opportunity to introduce a new strapline with no explicit price or value element. I'm sure thousands of hours were probably spent discussing the change. So I wonder if you can talk about why that price element was dropped.

And the second one is, as you mentioned, SmartShop getting to 30 percent of sales in the stores with handsets is a pretty impressive number. Just to follow up on that. What does that mean in terms of as a percentage of overall store sales? But I wonder how much higher that can go. Perhaps you can give us some colour about the stores with the highest participation of SmartShop.

Simon Roberts

Thanks James, so I'll talk about what we're doing in terms of the brand and how we want to really use that as an acceleration of being Food First and we'll pick up SmartShop between Kevin and I.

So I think just in terms of Help Everyone Eat Better, we think about this in the broadest context of making food affordable, easy, healthier, tastier, more sustainable. So it's a combination of all of those things. And to be absolutely clear, good value, great value food is at the core of our plan to put Food First and explicit in our commitment to Help Everyone Eat Better, both from an affordability point of view, from a taste delivery and from how sustainable we become.

So you can absolutely expect us to be extending our value credentials as we make this change. And I would say that you'd expect we are listening to thousands of customers all the time to make sure that we're really driving improvements in price perception in the way that we've laid out this morning.

And I hope when you saw the TV ad this morning, the latest TV out going out today, you can see within both, our expression of the vibrancy and taste of the food as well as I say, the value of it coming through. So that's absolutely explicit because it is critical in our plan

In terms of SmartShop, so you can see, I think, in the presentation this morning, that we continue to extend our performance on Smart Shop. It's been actually, from a customer perspective, as much driven by speed and convenience as it has been by safety. And now the combination of smart shopping in handset stores, but also on mobile as well has extended, we've seen customers really get more comfortable with using that platform.

So it's something we continue to push hard. It really works for customers, we think the extension of Nectar is really important with this. And as we think to the future, as we look to Nectar - more personal in terms of the offers that we can provide customers, so we believe the use of SmartShop will grow and become more important as a way of connecting those customers.

That's the way we're thinking about it from a customer proposition.

Anything else on participation, Kevin, you'd want to add?

Kevin O'Byrne

James, I'll have to get back to you, on total sales participation. In handsets stores, it's 30 percent in hybrid stores with people using their own mobile. It's more like five, six percent. But as far as the percent of the total sales of sales James or I will get back to you.

James Anstead

That's helpful. Thank you.

<u>Question 6</u>

Rob Joyce, Goldman Sachs

Morning all. So I've got three.

First one, it obviously makes sense to use 19/20 as the base year, but just to help us understand that you're a bit better, if you could tell us why the bonus was so unusually low in 19/20. What happened that year? I don't remember too much going on out of the ordinary.

Second one is just in terms of that profit bridge, as we look at it, if we were to break Argos out, am I right in sort of thinking it could be around £150 million incremental in FY21 given the gross margin, given the cost savings and given the considerable operating leverage and just how we think about that or how you're thinking about that, I guess in the guidance for next year, how much of that would be given back?

And then the third one, just to do a bit more on your partnerships with the delivery apps and just wanted to know, are you seeing the sales, the immediacy sales as incremental? Do the sales through the third party apps, are they are they profitable as they stand? And then, Kevin, you mentioned that it's still very small scale at this stage. Is that your anticipation that this remains small scale or do you see early, early signs that this could be a meaningful part of the business? Thank you.

Simon Roberts

Thanks, Rob, so Kevin do you want to pick up on the basics here and maybe the profit bridge?

Kevin O'Byrne

In simple terms, we didn't hit the targets that the remuneration committee has set. There is a bit of detail in the annual report on the remuneration report. So that's probably in simple terms, which we didn't hit all the targets that were set and hence at the level of variable pay paid out was lower than we would hope to do if we hit the targets this year.

Simon Roberts

And then if we move on to the profit bridge, which maybe just in terms of your question, Rob, as you'd expect, we're not going to specifically comment on the value of that within Argos, just to lay out the key components of it. And I'm looking at page 48 in the presentation at two key elements. So the first, as you remember, we said in November that we're going to take a more disciplined approach on promotion in the Argos business, and that will drive marginal benefits, as you say.

And then the second is that we are clearly well on with the Argos transformation plan. And that delivers you'll remember £105 million of benefits over three years, and that delivers broadly proportionately over each of the three years.

And so as we move from the standalone stores into store in stores, as we adjust to the local fulfilment network, those benefits will flow. And there's some other benefits from a cost perspective. Clearly, we stopped the catalogue. We've changed the operating model from the point of view of Check and Reserve. We've taken some benefits as we've integrated the Habitat business, and the rents and rates benefits flow as we close the standalone stores.

And that's about as much as I think I can say on the bridge in the Argos model. One other point I would make is that we've seen that on a broadly flat sales assumptions, that the value is driven from the combination of the margin and the cost delivery.

Rob Joyce

OK, so quickly to clarify, we think there's Argos in that sort of guidance for the year. Is Argos EBIT in your thinking higher or lower in FY22 versus 21?

Simon Roberts

It'll be lower than in FY21, but I think as you see in the chart, standing back from the plans we put in place, the delta in profitability from 19/20 to this year is a significant shift in profitability. But clearly, the sales level, the top level in the year to go from the year just finished will be of a different magnitude and that will have an impact on the profitability.

And then On Demand, just in terms of your question, I think if I were to frame what we're doing here and we've got, as Kevin said, a £50 million scale business across Chop Chop, Deliveroo and UberEATS - a very small proportion of the overall business. But I think a very important learning for us and remembering the fact that we've been doing Chop Chop now for just over four years and the team have been working really hard to understand the incrementality and also the efficiency of that model, too.

And there's no doubt that there is some incrementality in there and it's a very different customer mission to be able to access a grocery delivery within 30 minutes to a planned next day delivery that you may put an order in days or longer in advance.

So there is incrementality in that, where we're working on understanding the scale of that. But I think we're very clear that we need to be in this mission for customers. The market is moving there. We're learning a lot as we do it. We're scaling Chop Chop and improving that model. And we're clearly getting more reach with Deliveroo and UberEATS. So if we look at where this will be in four or five years' time, I think that it will be the element of how customers shop that will move significantly. And we therefore need to be in that space

Rob Joyce

And are you all on the orders to the third parties? Are they profitable yet, to the third party apps?

Simon Roberts

So I think the key point, though, Rob, is the basket level, and I think what I would say is that we we're seeing basket levels ahead of what we expected. And then we've got around 1,000 SKUs on the platform and the basket level has grown substantially ahead of what we expected. We'll see how that plays through in the post-Covid environment, so to say. Yet in terms of where that will land, we'll give you more colour on that as the next 12 months open up.

Kevin O'Byrne

The orders make a small contribution. The question is how much is incremental. And, you know, it's early days and we're just measuring that.

Rob Joyce

OK, all right, thank you.

Kevin O'Byrne

Can I just pick up James's point on the SmartShop as well before the next question? And if we look at supermarkets, it's about 17 percent of sales.

Simon Roberts

Thanks Kevin

<u>Question 7</u>

Xavier Le Mené, BofA

Good morning. Thank you for taking my questions, two if I may. The first one: we've seen some of your initiatives like removing counters, following actually some of your competitors.

So I just want to understand how you see Sainsbury's today and how you compete, how you differentiate actually yourself with your peers. So what is your key strength today and the key opportunity for you to differentiate your offer versus your competition? That would be the first question.

The second one is more about the competitive landscape. So have you seen any change in the recent weeks and how you comment on for instance, the Kantar data we have seen yesterday with actually showing low inflation, to actually some deflation. What is your view going forward about inflation or deflation?

Simon Roberts

Thank you. OK, I'll take it. I'll take each of those. The first in terms of the differentiation, in the offer. So as you say, we announced in November that we were closing the counters in meat, fish and poultry and deli in our stores because it would seem customer demand for products in those parts of the store declined not just through Covid, but over an extended period of time.

And I think one of the things that we are determined to do, which is a key element of Sainsbury's being a differentiated grocery destination for customers, is to significantly grow the level of innovation in our food offer. And you'll see us this year treble the volume of new products arriving in the business. We are well on with this work. That team are doing a fantastic job and really prioritising innovation and working in close partnership with our suppliers to do that.

So we will land, for example, over 400 new products over the coming weeks as we go into this summer. A summer where we think customers will spend a lot of time with family and friends, a summer of celebration at home.

And so bringing new and innovative products at this point in time and as we look forward, we think is really important, we will introduce around 1,900 new products into Sainsbury's this year. And we will renovate i.e. improve the specifications or packaging or existing design of a further around 1,900. So in total somewhere just short of 4,000 either new or improved products this year coming into the offer.

So in the heart of your question, this is absolutely front and centre for us in putting Food First, building the muscles again of innovation in the business, giving customers reasons to come to Sainsbury's for those products, and continuing to develop new products as customer eating and shopping habits change, in certain areas of customer behaviour. For example, in dairy alternatives, meat, alternative vegan products, we've seen a huge growth in demand for these areas and we're innovating at pace to make sure we can respond to that.

We've also put a number of the products from the counters actually in-aisle and we've seen customers buy into that. So we'll continue to make sure that we convert as many of the missions that were on the counter back into the aisle.

And in terms of the competitive landscape, I think that we've talked to a couple of the earlier questions.

Three things would be: I think essentially firstly, we talked about value for money. This is a fiercely competitive industry. And I think when we think about the environment post-Covid, we are determined to make sure that we offer our customers the value of money they expect. It's never been more important. And as I've described this morning, the combination of all of the activity that we're putting in place on value, funded by the self-help of our cost saving programmes is going to be critical for us.

We're very focussed on, obviously, making sure that we deliver both range and service and convenience that sets us apart. You will have seen in our presentation this morning the work that the teams across all of our channels have done a brilliant job on this year to deliver on customer satisfaction.

Now, with clear improvements both in the supermarket environment and in the convenience environment, in areas like availability, speed of service, friendliness of colleagues. And as online continues to scale, we think we can do a better job there. We've held our service fairly flat over the second half of the year. We think we can improve it again to create further differential there.

So I think the competitive landscape that is there for this industry is characterised by value for money, by service, by convenience, and making sure that we create products for customers that encourages them to choose shopping in Sainsbury's.

And then on the Kantar data, as you say, there's all sorts of anomalies really, given the year on year comps, it's a difficult picture to read. But we're looking at the two-year numbers, given that they give, I think, a clear read of the momentum in the business on a on a two year basis. And you can see both over four and 12 weeks, when we look at that period, the work we're doing on value and innovation and online is showing up in our performance on

Kantar and there’s no room for complacency on this at all. But we're very focussed on making sure we sustain that momentum as we look ahead.

Question 8

Borja Olcese, JPMorgan

Morning. May I ask on your views or learnings [inaudible: on the apps such as Gorillas all these guys]. Do you think they can become another source of pressure for your convenience business or not at this stage?

Simon Roberts

I'm really sorry, would you mind just repeating the question for me? I think the line was just crossed. I couldn't hear your question, apologies.

Borja Olcese

Apologies [inaudible] apps like Uber, Gorillas, all these new speed convenience guys, do you think they could ultimately become another source of pressure for your convenience business, or is it very early days?

Simon Roberts

OK, I think I'm really sorry, it was quite a tough line. I think your question was as the immediacy on demand picture changes, could that be a source of competition for our convenience stores? Was that the question?

Borja Olcese

If you get these [inaudible, apps like Gorillas] all these new speed convenience offers. Yeah, I mean, they can become a source of pressure for your convenience business?

Simon Roberts

Yes, thank you. So I think we've got to the question, it was it was a little hard to hear there. So I think on two key points I would make. I think as we come out of the impact of the pandemic, it’s really clear to say, isn't it, that the speed and access to convenience has never been more important than what we're going to see in the period ahead now, customer expectations of on demand and being able to access grocery and other items quickly is going to be essential.

And I think when we look at where our business is, we've got over 800 convenience stores today. And one of the features of our convenience estate is that the vast majority of those stores are in local communities close to where people live. And I think, as we look to expect different ways of working, hybrid ways of working, where we would expect customers to spend more time working from home, maybe three days at home a week, maybe a couple of days in the office. We think that the role of the convenience store, not just Sainsburys convenience stores, but more generally across the industry, will become even more important.

And so when we think about the locations of our convenience stores today, we think they're well placed. We've seen the stores that are what we would call ‘local’ have grown by 13 percent over the course of this year.

Clearly, the stores in very urban locations have had a challenged year, but those that are where customers are living are up 13 percent. We're going to open a further 25 to 30 stores in each of the three years as we look ahead and so to your question, I think the convenience sector will see intense competition.

We will be really focussed on making sure our offer in convenience, our access really delivers what it needs to for customers. And the one last thing I would say is that clearly these convenience stores and Sainsbury's, the 200 UberEATS and Deliveroo locations and Chop Chop, are being fulfilled from convenience stores.

Borja Olcese

Thanks for the thoughts.

Question 9

Thomas Davies, Berenburg

Just two questions from me. Firstly, on retail profitability. We've seen supplier income fall by about £80 million this year. Can you quantify how much was up from the cancellation of the Argos catalogue? And I guess more importantly, do you expect that to inflect like with the Nectar360 initiatives?

And then secondly Simon, on the sale relating to the banking business. Simon on the presentation gave you said, the continued discussions with potential counter parties. I mean, do you think your bargaining position now has improved, given the performance of the business and also the external environment with some of your banking peers has seen better improvement?

Simon Roberts

Tom, thank you. Well, I'll take your second question first and then ask Kevin to pick up on your first question in terms of the retail profitability numbers. So, I mean, just in terms of confirming what we've said this morning, first and foremost, as you've seen in the presentation and in the second half, numbers that the Bank had delivered, the bank team are absolutely focussed on delivering the plans we laid out at the Capital Markets Day in 2019.

We've got a really strong team at the Bank led by Jim. They're very focussed on how we're strengthening the balance sheet, how we're simplifying the business and how we're reducing costs. And you can see in each of those elements how that's come through because clearly it's been a difficult year. And you can see within that, that the team has taken a number of timely and decisive actions on areas like cost, but also a good performance from our loan book and hence the improvement in performance in the second half.

In terms of your question about more broadly what's happening here, as I said in November, we had a number of expressions of interest and where we are today, we continue to evaluate those. But it's not something that you know, moves quickly. These things take time to evaluate. And, if and when, there's more to talk about on this, we will clearly come back to you.

But the most important point I want to be really clear on is we're very focussed on delivering the plan that we laid out in September 2019. Kevin, do you want to update us?

Kevin O'Byrne

On supplier income, there's a lot of moving parts as you can imagine, and catalogue is an element of this. For some suppliers, a change in trading arrangements where there’s more in the base margin. But fuel promotions are the key driver here year on year. And you'll see that across the industry. But we reduced promotions in the year and see that right across the industry. So that's the biggest driver

Operator

Thank you. No further questions back to Simon for any closing remarks.

Simon Roberts

Well, thank you. Thank you, everyone, for your time this morning and your questions. It's been really good to connect this morning and look forward to speaking again soon and look forward to sharing our further progress as we talk in the coming weeks.

Thanks everyone.

End