J Sainsbury plc
2021-22 Preliminary Results Presentation
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Presentation

Simon Roberts
Chief Executive Officer

Good morning, and welcome to our 2021-22 Preliminary Results Presentation. Thank you everyone for joining us today.

First, I want to take a moment to speak about the dreadful events in Ukraine and the huge impact this is having in so many ways. All of us at Sainsbury's stand in absolute solidarity with the people of Ukraine. Working with our charity partner, Comic Relief, we have already donated over £2 million to support the humanitarian efforts, in addition to raising £6 million for Red Nose Day this March.

We will continue to do all we can, to bring all our support and our help to this humanitarian crisis.

Now, I'm going to make a brief introduction, covering the progress we've made against the priorities and metrics we've set out as part of our three-year plan. Kevin will cover the financial highlights, and then I'll go into more detail on our strategic priorities and delivery, one year into our plan, and what we're expecting as we look to the year ahead.

To begin with, a brief reflection on the last year.

It's been another year of unprecedented change, for our industry, our customers, our colleagues and our suppliers. Our response to this has been exceptional, and we enter this next year a stronger, more agile and more capable business.

Fundamental to everything we've done, and everything we've achieved, has been that we have consistently put customers and colleagues first, and we've listened really hard to what they wanted and needed, every step of the way.

Customers have trusted us, above all others, to help them shop safely, and from day one, we prioritised those who needed to shop online, with a big increase in capacity.

We also, of course, fully supported our colleagues throughout. When they needed to be absent, or self-isolate, and through all the challenges our people faced each and every day.

Everything we have achieved has only been possible through the outstanding effort and teamwork of everyone working across Sainsbury's. All of our people, our entire team, have done the most brilliant job, and I can't thank each of my colleagues enough for their unwavering commitment and resilience throughout.

We have recognised and rewarded our people with additional thank you payments, and we've prioritised investment in colleague pay. We were the first of the major supermarkets to commit to paying the living wage for all retail colleagues, and we brought forward our annual pay review announcement as soon as the cost-of-living crisis really started to hit, in January.

We've also stepped up our efforts to ensure that as much surplus food as possible go to those who need it most. We have made a big difference here, and in turn delivered substantial reductions in food waste.

Whatever the industry impact and scale of challenge over the last two years, we've also really seen what becomes possible through trusted partnership and collaboration working across food supply chains.

We've leveraged our strong supplier relationships and our scale, working closely with our suppliers, and supporting them as much as we can. In turn, our suppliers have really supported us, to improve availability, and deliver for our customers, as we've navigated some of the most significant labour and supply chain challenges.

This determined and relentless commitment to do the right thing for our customers, colleagues and suppliers has shown through in our customer satisfaction and strong volume market share performance.

Customers have responded to the focused, improved value we're delivering, to the faster pace of product innovation, to the changes we're making to our stores, and to the great customer service, delivered day in, day out, by all of our people.

So, if you look to our volume performance over the last two years, we've performed ahead of all the other big box grocers, and broadly in line with the total market.

Now, these were the priorities that we set out in November 2020, with the key value creation pillars of food first, brands that deliver, and save to invest, underpinned by being connected to our customers, and delivering our integrated plan for better.

Looking at how we've performed over the first year in delivering against that strategy, you'll be familiar with these eight key metrics we set out in November 2020. These are how we are judging our performance internally, and as I committed then, we will always share the latest data with you every time we report.

So, looking at each of the measures, and how we've performed, in turn. As I've said, we've seen a real shift in our market share trajectory from where we have been previously. We've outperformed all the other big box grocers and performed broadly in line with the total market against a pre-COVID base.

On customer satisfaction, we've maintained a consistent lead versus our competitors across our supermarkets and convenience stores. However, you'll notice that we've scored ourselves amber here, and that's because, whilst we're pleased with our strong relative progress, we believe we can do better, and so are setting our sights on further opening up our lead. In Online, we have improved the trend over the second half, but we are not yet where we want to be, and so more work to do here.

To be at our best for customers, we know we can only achieve this with the most engaged, happy colleagues. We've put a lot of our focus and leadership into this, and as a result, colleague engagement has seen an encouraging improvement through what have been some of the most challenging times and against a strong base.

Momentum is building in our plan for better, as we fully integrate sustainability objectives within our strategy, with good progress against our carbon Scope 1 and 2, and food waste targets.

We have much more to deliver, especially on plastic and Scope 3 emissions, but with a fast-developing pipeline, and strong plans, we expect to make progress in the year ahead.

Kevin will go through our detailed financials shortly, but at a headline level, starting with profit growth, we have clearly had the benefit of a grocery demand tailwind over the last two years.

Key to profit delivery has also been our programme to take structural costs out of our business, and we've delivered an 83-basis point reduction in cost to sales versus the base in 19/20. This means that after year one of our plan, we are on track, but clearly, this target has become more demanding, given current levels of cost inflation, hence, we've marked ourselves amber here.

On the remaining financial metrics, the key outputs of this strong profit performance and our disciplined approach to capital spending are a strong retail free cash flow and higher return on capital employed.

Now, to drive our momentum, we've made significant investments over the last year, where we said we would. In improving value for customers, in bringing new products to customers across food and general merchandise, in technology, which has delivered personalised value and better service to customers, and helped us to reduce costs, in the new store openings, which are performing ahead of expectations, and, as I've said, we've ensured that we continue to reward our colleagues well, and ahead of competitors. We have also fully supported the communities where we trade.

So, looking to the year ahead, we face a particularly challenging set of conditions, but we believe we are in a strong position, and well prepared for the headwinds we expect to face.

We're very focused on delivering against our strategy for the long term, and on further building our momentum in each of these areas.

We have a strong plan to deliver for both customers and shareholders. We're seeing continued good momentum in the grocery business on value, innovation and service, and we're very clear how we can build further on this.

We've also got a strong programme of investment going into our stores, and we are well progressed with our year two cost saving delivery, as we work to realise the 200-basis point reduction over the life of the plan.

We have reset the operating margin for the general merchandise and clothing business, through cost and margin transformation, and we are now focused on driving improvement across the GM product ranges and the customer proposition.

We are well progressed in developing these plans for the next two to three years, with the first phase of the changes we're making starting to deliver benefits later this year.

Our plan for better, we're really moving forward and very focused on fully integrating our customer, commercial and sustainability objectives.

I'll now pass over to Kevin, to take you through the financials.

Kevin O'Byrne
Chief Financial Officer

Good morning, everyone, and thank you, Simon.

As Simon said, I will now cover the financial highlights for the 52 weeks to 5 March.

I'm going to start with sales. As at interims, you will see that in a number of areas through the presentation we've given comparisons versus two years ago, as well as the prior year, in order to provide context against a 19/20 base year, uninterrupted by COVID.

Starting with grocery, sales were broadly flat, year-on-year, and up 7.6% over two years, driven by sustained COVID-19-driven demand, with increased in-home consumption, particularly through the first half of the year, and, as Simon said, a strong volume market share performance ahead of competitors.

General merchandise sales were down, year-on-year in both Argos and Sainsbury's, as we annualised very strong lockdown-driven comparatives, particularly in categories relating to home working and entertainment.

Sales were also down on two years, reflecting availability challenges in key product areas, and our focus on profitable sales, including a reduction in promotional activity and a strategic decision to exit less profitable categories, such as entertainment, in Sainsbury's.

Clothing sales grew, reflecting weak comparatives, and we were also up 3% versus two years ago, despite significantly reduced promotional activity.

In total, retail sales, excluding fuel, were down 2.6% year-on-year, and up 4.6% versus the pre-COVID year to March 2020.

Including the impact of fuel sales, which were up strongly versus a very weak 2021-year, headline full year sales growth was 3.4%.

Retail operating profits were up 7% against the 19/20 base, driven by cost savings, higher grocery and fuel sales, and more profitable general merchandise and clothing sales, partly offset by investment in the core grocery offer.

Financial services made a profit of £38 million in the year, with the main difference year-on-year being the absence of the COVID-related bad debt provisions charge that we took in the prior year.

Alongside the benefit of lower interest costs, this drives UPBT of £730 million, and increase on a two-year basis of 25%, and more than doubling year-on-year. This profit benefited from increased sales, driven by the extended pandemic.

At a statutory pre-tax level, we reported a profit of £854 million, as we booked £182 million of income primarily relating to the settlement of legal disputes, as described at the interims, which more than offset restructuring charges, which in turn were materially lower than in the prior year.

Free cash flow was strong, despite a predicted working capital unwind, following exceptional inflows last year. Average annual free cash flow over the last three years of £633 million exceeded our guidance of at least £500 million per year.

We delivered a strong reduction in non-lease net debt of nearly £500 million, driven in part by the conversion of £240 million of the convertible bond to equity.

We delivered our net debt reduction target a year ahead of schedule, even if we exclude the impact of the convertible, reducing net debt by nearly £1.4 billion over three years, against a target of £950 million over four years.

Two-year growth in underlying earnings per share of 28% is ahead of UPBT growth, due to a lower underlying tax rate. This is also reflected in the proposed full year dividend payment of 13.1p per share. This is the highest dividend per share we have paid since 2015, in line with our 1.9 times cover policy, and hence fully reflecting the very strong earnings performance.

Last year we maintained the full year dividend per share, despite lower earnings, choosing to protect shareholders from the downside impact of COVID.

This waterfall summarises the UPBT movement versus the pre-COVID year to March 2020. Behind the headline £63 million improvement in the retail profit, there are a number of moving parts, some of which I will refer to later, but which include around £50 million to £60 million of headwind, from an unusually low level of variable compensation in 19/20, and the reinvestment of costs savings and higher general merchandise profits into the core grocery offer.

Lower interest costs reflect the material progress we have made on paying down debt over the last three years, as well as lower IFRS 16 lease interest, due to new leases being written on lower interest rates.

This waterfall shows the drivers behind the improvements in retail operating margin versus 19/20.

As you know, we are targeting a 200-basis point reduction in our retail SG&A to sales ratio by March 2024, and have made very good progress towards this, with an 83-basis points improvement delivered, versus the '19/'20 base.

The 73-basis point decrease in the second bar is made up of a few elements. First is the normalisation of variable pay versus lower levels in '19/'20 that are referred to on the last slide. This accounts for most of the decline.

Second, is the movement in gross margin, which, at a net level, accounts for a very small element of the movement. There are a number of moving parts within the mix. Food gross margins were lower, as we invested in prices, to drive volume, in line with our food first strategy, and this was partially offset by higher contributions from fuel and from higher general merchandise and clothing margins.

As I said, we are pleased with the 83 basis points operating cost to sales reduction delivered so far, as we work to deliver the 200 basis points targeted for March '24.

As Simon said, this has become more difficult in recent months, with a much higher level of base cost inflation this year than we would have anticipated when we set out the plan. We continue to see material cost reduction opportunities and Simon will cover some of the key programmes behind this later on.

We remain in a very strong position relative to our competitors, through the strength of our cost-saving programmes and the level of savings available that are unique to us.

Looking now at the financial services two-year profit movement, the two big areas of headwinds come from lower travel money and ATM activity, and lower lending, albeit with the impact of lower lending having some significant offset from reduced funding costs.

We have also made good headway on simplifying the business to reduce cost.

In the year, the P&L benefited from the release of £12 million of COVID provisions, as we flagged at the interims. This led to an underlying profit of £38 million, after a loss of £21 million last year.

You can see on the right-hand side that we are starting to see a return to growth in unsecured lending, along with some recovery from travel money, and this supports our view that we expect to grow financial services profits in the year ahead.

We also announced today that the Bank has declared and paid its first ever dividend of £50 million to the Group, marking a significant milestone in the strategic plan.

Going back now, to the Group P&L. In order to provide a clear view of our underlying performance, as usual, we exclude P&L items, which, by virtue of their size or nature, do not reflect the Group's underlying performance. These are outlined on this slide. Note that the prior year results have been restated to reflect the removal of business rates from the onerous property contract provisions.

Restructuring costs were significantly lower this year than last, when restructuring and impairments reflected the announcement of our food first strategy. Our guidance for total restructuring charges for the three years to March '24 is unchanged, at £900 million to £1 billion, except for the roughly £40 million relating to onerous rates, which will now be recognised in future years, when paid. To date, we've incurred £640 million of these charges.

More than offsetting this, we booked income from settling legal disputes, two of these relating to overcharges from payment card processing fees. We've now received all the cash in relation to these settlements, receiving £93 million in the financial year.

£76 million of the net £55 million gain noted in property finance and acquisition adjustments related to an unrealised gain on forward purchases of wind-generated power.

This was another period of strong underlying cash generation, despite the unwind of roughly half of the exceptional working capital inflows seen in the prior year, partially offset by the receipt of nearly £100 million from the settlement of the legal disputes.

The waterfall on the next slide shows the movement in net debt more clearly.

We generated free cash flow of £503 million. With the dividend payments of £238 million, offset by the conversion to equity of £240 million of the convertible bond, we reduced net debt excluding lease liabilities, by around £500 million, from £640 million at year end 2021, to only £141 million by the year end '21/'22.

In the year lease liabilities increased by nearly £800 million. During the year, we served notice to purchase 21 stores at the end of the leases from two investment vehicles, which contain 26 stores, known as Highbury and Dragon, in which we hold a 49% interest. As a result of this decision, we have recognised a substantial increase in our lease obligation, based on the estimated value of these properties. By doing this, we are able to retain a small

number of the stores as freeholds and sell and lease back the majority on lease terms that we want.

Between now and the financial year 2024, as the leases expire, we will decide which of these stores we will retain or sell and lease back. The adverse net debt movement we've seen this year will reduce once all the transactions are fully complete.

This slide shows the strength of our free cash flow generation over the last five years, generating £2.8 billion of free cash flow, of which roughly 60% has gone towards repaying debt and deleveraging, to strengthen the balance sheet and improve our financial flexibility. Over £1.1 billion, or 40%, has been paid as dividends to shareholders over this period, more than 20% of our current market capitalisation. This is equated to paying out just over 50% of net earnings.

The conversion of profit to free cashflow each year has strengthened over time as we've taken action by lowering pension contributions, lowering interest costs, and stopping capital injections into the bank. Leverage is now at 3.1 times and we have very limited non-lease debt.

In that context, I would like to share our updated priorities for capital allocation over the medium term, given that less cash will need to be allocated to debt reduction going forward.

(1) we will invest in the business to support and accelerate our strategy, with CapEx remaining in the range of £700 million to £750 million each year. We reiterate our guidance of generating retail free cashflow of at least £500 million per year.

(2) we will use some of this free cashflow to deleverage further, targeting a solid investment grade balance sheet consistent with target leverage of net debt to EBITDA of three times to 2.4 times. This will provide us with a degree of financial flexibility that we think is appropriate.

(3) we are focusing on returning a higher proportion of underlying profit to shareholders, in the first instance through the ordinary dividend, where we will increase the dividend pay-out ratio from around 53% of underlying earnings to around 60%. We will then selectively invest in projects such as lease buy-ins where commercially interesting opportunities exist.

(4) we expect leverage to move below three times over time, particularly as the impact of the leverage of the Highbury and Dragon transactions drop away. Once we are comfortably in our target range, we expect to be able to return more cash to shareholders through share buybacks or higher dividends.

So, in summary, we are reporting a strong performance for the year, benefitting from sustained COVID-driven grocery demand and the investments we have made in the food offer driving our volume market share performance. This, together with strong cost-saving progress, particularly at Argos, has led to UPBT growth of 25% over the '19/'20 base year.

Underlying free cash generation was above expectations and we have delivered our net debt reduction targets ahead of schedule. We are therefore able to start returning more of our profits to shareholders.

It is a difficult backdrop for the year ahead with plenty of uncertainties through the supply chain, cost inflation, and cost of living increases for consumers, hence we are expecting underlying profits in the range of £630 million to £690 million, significantly ahead of the £586 million reported in '19/'20 but lower than the elevated level of £730 million reported in the financial year 21/22.

We know the structural changes we've made to the business, the momentum we've got and the strong plans we have to continue this pace of change over the next two years put us in a very strong position relative to our competitors. Thank you very much for your time. I'll now hand you back to Simon to take you through our operational highlights and progress against our strategic priorities.

Simon Roberts
Chief Executive Officer

Thank you, Kevin. Let's now turn to our strategic priorities. By now, you'll be very familiar with these priorities, which we set out in November 2020, alongside our plan to transform this business over the three years to March 2024. We're now one year in. This plan is all about putting food back at the heart of Sainsbury's and we're delivering on that.

As you've seen, we're delivering through progress against all the priorities, with our other brands delivering better profitability while our cost savings are allowing us to invest back into value to an extent that others can't match.

Let's turn to Food First. The result of our focus back on food has been a grocery volume performance ahead of our key competitors over both one and two years.

Importantly, we've seen strong performances relative to the market in both stores and online. This is important, as while the market has made a permanent shift to a higher digital participation, shopping habits are now continuing to normalise. In supermarkets, basket sizes are falling and transaction numbers rising. In grocery online, order numbers and basket size are both falling and we've seen some normalisation across our convenience business with total sales up nearly 9% over the last year as more urban city centre and Food on the Move stores recover.

This slide shows the significance of the sustained shift to digital trading, although there was a lot of movement behind these averages, given the phases of customer behaviour through the year. For example, online grocery penetration is now closer to 15% than the average of 17% over the last year.

Customer satisfaction is a key point of differentiation for us and so I'm delighted that customer satisfaction in our supermarkets has remained ahead of all our direct competitors and is now moving back towards top position in online. More for us to do, as I said earlier, given we are setting the bar really high, but strong and sustained momentum where it matters most, in what we're delivering for our customers day in and day out.

We all know availability is really important to customers and I'm encouraged here too with how fast we recovered from the tough challenges in grocery supply chains through the middle of last year. We were agile and focused to drive through rapid improvement with great work from our teams and our suppliers, and you can see the scale of improvement that followed into Christmas and Quarter 4.

Looking to some of the key customer service metrics versus the '19/'20 base level, there were some clear standouts here and this was a direct consequence of staying close and relentlessly listening to our customers every day and then investing in the areas that mattered most to them.

I'm really proud too of what we delivered on value across Price Lock, the investment in key fresh items that matter most to customers, and Sainsbury's Quality Aldi Price Match, we

delivered a real shift in our value position over the last 18 months. We continue to build momentum and cut through on the key products which customers buy every week. Our latest phase of Sainsbury's Quality Aldi Price Match launched just last week with over 240 lines in total and 150 fresh products price matched to Aldi.

Now, you can see the strength of our value focus here. We have consistently inflated less than others in the market. Customers have been noticing and are responding and you can see in the right-hand chart that we're gaining more spend from those customers who previously wouldn't have trusted our value across the whole basket, and to be clear, we're not finished.

We know we have more resources than many of our competitors to be able to continue to improve our relative value position at a time when value matters more than ever to our customers. It is clear the focus is working. We are driving more volume and more customers into Sainsbury's and we intend to keep very focused in building on this momentum.

Product innovation is the lifeblood of any retail brand and I'm delighted with our progress in launching the highest number of new products onto Sainsbury's shelves in many years. We delivered on our target to triple the amount of new product innovation and this has driven the opportunity for trade-up and the confidence for our customers to cook more creatively at home with our fantastic new Inspired to Cook range of ingredients and meal kits.

We have also reformulated another 1000 lines, improving quality, reducing salt, fat, or sugar content, or often changing packaging to reduce plastic. Taste the Difference continues to go from strength to strength with growth of 15% over the last two years and we intend to go further in driving the clear trade-up opportunity and in leveraging the Taste the Difference brand over the year ahead.

It's not just about trade-up and quality either. We are helping everyone to eat better, providing advice, recipes, incentivisation, and more choice in healthier and sustainable food. We're making strides on improving our welfare standards and we are the first UK supermarket to offer 100% ASC certified fresh Scottish salmon and we've increased food distribution through our partnership with Neighbourly.

We are in the middle of a significant program of work to further improve our stores and the shopping experience, ensuring they better reflect the way that customers are shopping now.

As you can see on this slide, we're upgrading our fresh food offer in hundreds of stores, transforming food service through partnerships, expanding our world food offer in more than half our supermarkets, and continuing to gain market share in beauty with the rollout of our new format. We're also creating destination space for general merchandise and clothing and improving customer service and efficiency with investments in checkout technology.

Looking to the high fat, sugar and salt regulations which come into place this year, we've taken advantage of this to bring innovation to our product displays and we're very encouraged with the trials we've been running. This is a significant cost and operational undertaking in relaying our supermarkets to meet the new regulations, but we're on track to deliver this change and we believe we can drive further advantage as we do so.

This slide gives some impressions of the changes we're making and the results we're achieving across key parts of the shopping trip: in produce, bakery, beauty, and world foods. We're encouraged by the sales response in the stores where we've launched and we intend to drive these improvements out at pace across our supermarket estate.

Now, earlier this year we announced the transformation of our instore dining and Food to Go offer, following trials with Boparan and our existing relationship with Starbucks. This rollout will reduce our operating costs and bring a radical improvement in the quality and choice we can offer for customers. The full program will take us two to three years to implement but will position us and our stores with dine-in, dark kitchen, and home delivery capabilities as food service demand and immediacy become even more important to customers over the next three to five years.

Looking outside stores to our online business, we have inevitably seen a normalisation of demand this year but clearly, demand remains at a far higher level than pre-pandemic. Broadly, we are still delivering twice the volume of online orders compared with two years ago and against the pre-COVID base. We have gained significant market share as you can see here, but as this online participation continues to normalise, more customers are returning back into our stores.

Looking at our online performance in more detail, importantly we've sustained improvements in online profitability through better productivity with drop densities and item pick rates per hour above pre-pandemic levels. We're additionally very encouraged by the increase in more loyal Delivery Pass holders.

In recent months, we've had a lot more questions about our convenience business in the light of the growth of On Demand delivery and some of the changed shopping habits as a result of the pandemic.

I hope this chart gives some helpful context. Overall, it shows that sales through our convenience stores are down 1% on pre-pandemic levels with sales having recovered by 9% over the last year. Trade in less urban stores are significantly up on pre-pandemic levels and in more urban, slightly up. Together, these account for just over 80% of our total convenience sales, while our smaller Food on the Move business is still heavily impacted.

The chart on the left shows the scale and growth of our On Demand business. We think this is now probably the biggest on demand grocery business in the UK, through the platforms of Chop Chop, Deliveroo, and Uber Eats, but it is still very small in the context of the scale of our total convenience business. We are making really good progress with the second key pillar of our strategy, brands that deliver, with Nectar and the bank and our general merchandise and clothing business supporting the core food business and delivering sustainable returns.

Nectar continues to grow. More than nine million digital collectors and more than one million customers are now benefitting from personalised Nectar prices. At the moment, this is only available on SmartShop, where it has delivered a very noticeable uplift in value perceptions. Looking ahead, we'll be rolling out Nectar prices across our other channels.

As we said at our Nectar Deep Dive event last October, Nectar is not just delivering value for customers, it's delivering additional profit to the business and we're running ahead of the plan that we set out, and digital media is the key contributor to this. We are pleased with progress to date and confident in our plans as we extend Nectar prices and grow the number of digital Nectar users.

Our brands that deliver objectives for general merchandise and clothing were to reduce cost to serve and improve profit delivery. We're encouraged with progress as you can see here, with structural cost reductions now flowing through the Argos transformation program and a better sales mix as we focus on more profitable categories and reduced promotional activity.

On this slide, you can see the impacts of reduced promotional activity and category choices and of the focus on higher margin clothing and home and furniture ranges. Stepping back from the tough comparatives at Argos and looking at the two-year trend, we are seeing some signs of encouragement as availability continues to improve and we have better managed the way that availability is presented to our customers.

Having said that, we're clearly heading into an environment where disposable income will be under more pressure than we've seen in some time, where product prices are more likely to be inflating, and where global supply chains will remain challenged. We will offset some of these macro headwinds through continued delivery of Argos transformation savings, but we have reflected these uncertainties in our outlook for the year ahead.

We hit a big milestone with Tu this year when the brand hit £1 billion of sales for the first time and we grew sales against the period last year when many competitors were closed, and these are more profitable clothing sales, given the significant increase in full price sales participation. We've also sustained the big step-up in the scale of our online clothing business that we saw this year and we're benefitting from improved efficiency and profitability in this part of our clothing business.

These are the objectives that we laid out for our financial services business in September 2019, pre-COVID. We are making progress with all of them, having tightened the focus and scale of the business on providing financial services for Sainsbury's and Argos customers, and in the short-term, we're expecting another profit improvement this year.

Perhaps the most important thing to note is that we've moved from an objective of the Bank no longer seeking capital injections from the Group to the bank paying its first dividend to the Group of £50 million, with the potential for more in the future. The bank continues to innovate in delivering financial services products for Sainsbury's and Argos customers.

As an example, I would call out the monthly payment plan now live at Argos, extending the appeal of credit to a wider audience versus the buy now, pay later product previously available. This is an important step for Argos in improving its proposition relative to other general merchandise retailers, and there are further phases of this launch to come, targeting high ticket areas such as furniture and consumer electronics.

Turning to Save to Invest, our third key pillar, reducing structural operating cost to fuel investment in the core business. Kevin covered our progress in operating cost reduction earlier on. As a reminder, we've targeted a 200-basis point reduction in our operating cost to sales ratio by March 2024. It's a goal that requires fundamental changes to the way that we work, taking out structural costs that won't return, and we've made bold decisions already, which have delivered 83 basis points of improvement versus the base in '19/'20.

Clearly, any absolute cost savings that we deliver are offset by cost inflation and of course, our task is now harder than we would have anticipated 18, 12, or even six months ago, and the cost environment has eaten some of the headroom we previously had. As a result, progress will be more backend loaded, but we do have strong plans in place and we're very focused on delivery and execution in order to realise the 200-basis points target.

Crucially, as Kevin said earlier, we know that we can continue to unlock savings that are unique to us, putting us in a strong position to offset cost inflation relative to our competitors.

Looking to some of the key areas of delivery, you will recognise some of these and others are new, as we communicate changes internally. We're often asked how we will improve online profitability. There are two great examples here. (1) through productivity

improvements in online operations, such as picking and order routing, but (2) by recognising the changing role of the front end of the store as more sales go through the back door and adjusting the cost base to reflect this through investment in future front end checkout technology, which additionally improves the customer experience.

In June last year, we launched our Plan for Better commitment, setting out key targets within the three pillars of better for you, better for the planet, and better for everyone. We committed, not only to setting bold targets, but being transparent in our reporting against them, as you can see on this slide. As I look at the progress made in some of our priority areas, I am particularly encouraged by the improvement against our food waste reduction target and against our trajectory to become Net Zero in our own operations by no later than 2035, a target which we accelerated from 2040 in November of last year.

We continue to work towards our healthy and better for you sales target, with a significant proportion of our value investment this year being on healthier products. It does, however, remain an ongoing journey to transition more of the basket into healthier choices. We recognise that we are facing into a greater challenge with our plastic reduction target.

We're pleased to have rolled out our flexible plastic recycling scheme to all supermarket stores during the year, but we know there is still much more to do on recycling and packaging. I wanted to pull out one key example of where we are using collective action across our industry to address a complex issue. During COP26, we signed the World Wildlife Fund Retailer's Commitment for Nature, along with four other UK food retailers.

One of the areas where we have committed to act together is on deforestation, in support of our commitment to achieve 100% deforestation-free supply chains by 2025. As a group of retailers, we've asked key traders to sign up to the ambitions of the UK Soy Manifesto on how they are working to become deforestation-free. In taking bold action in our own supply chain, we've rolled out our deforestation-free soy roadmap on animal feed to all our key suppliers.

This work will dramatically reduce our carbon footprint across meat, fish, and poultry supply chains, and will be a significant lever in achieving our Scope 3 target.

I've talked about what we've achieved over the first year of our Food First plan, but I think it's also important to reflect on how we are working to deliver this transformation. In looking back at what we've achieved, I think everything comes back to the commitments that we clearly made at the outset: putting customers and colleagues first, moving at pace, and using our cost savings program and improved returns from our portfolio brands to invest back into the proposition.

We are holding ourselves to account against the key metrics we set out to deliver and we are consistently reporting against them. This is how we as a leadership team are committed to lead and deliver across Sainsbury's today.

So, in wrapping up, I wanted to return to some of the themes I started with. We're one year into a three-year transformation of our business and we're delivering against that plan. We've got real momentum and we've got that by focusing on the things that really matter to our customers and to our colleagues. We're taking cost out of the business where it's not needed and we're investing it back into the areas that matter most to customers.

Most obviously, we've transformed our position on value. We've been building real trust from customers in our value over the last 18 months and this puts us in a strong place to weather the storm that customers now face. We know it's really challenging for customers right now

and that's why we're going to be doing everything we can to support them, delivering the best value where it really matters, in their shopping basket week in, week out.

By no means does this make it easy, given the pressures on our cost base, on the cost of living for consumers, and on discretionary spending, and while we still face considerable uncertainties on key parts of the supply chain. But I hope we've also demonstrated that we're in a strong position to offset more of those cost pressures and put more back into the customer proposition than others.

So, as a result, we're confident that we can maintain our momentum and that confidence is reflected in our commitment to shareholders. We've delivered strong cashflows, we've reduced leverage, and we're confident that we can continue to generate strong, sustainable cashflows. In turn, this means that we can now commit to returning a higher proportion of our underlying profits to shareholders. Thank you for your time and for listening this morning.

Question and Answer Session

Simon Roberts
Chief Executive

Thank you. Good morning, everybody, and thanks for joining us on our preliminary results call this morning. I know it's a busy morning, so we really appreciate your time. I'm joined here this morning by Kevin O'Byrne, our CFO. I hope you've had a chance to read both the statement and see our presentation that we posted on our website earlier today.

We've had a year of unprecedented change and as a business we've really responded to this and we're a stronger and more agile business as a result. This has only been possible through the outstanding efforts of everyone working across Sainsbury's, our entire team. I want to register a huge thank you to all of my colleagues for their unwavering commitment and resilience throughout the last year.

Looking to the year ahead, there will be further significant external challenges that will impact our business, our colleagues, and our customers, but we are well-placed to deal with these. One year into our three-year plan to put Food back at the heart of Sainsbury's we've delivered significant improvements in Grocery value, innovation, and customer service. We are determined to continue this momentum, building in particular on the far stronger value we are now delivering for customers. We'll do this the same way we've delivered the progress we've made so far, consistently putting customers and colleagues first, listening to what they want and need, and making bold decisions to fund and prioritise these.

This has shown through in our customer satisfaction and strong volume market share performance. We expect this to continue as we know we have more resources than many of our competitors to continue to improve our relative value position at a time when value matters more than ever to our customers.

What I hope you will have taken away from this morning's statement and presentation is that we are confident that we can maintain our strong competitive momentum. That confidence is reflected in our commitment to our shareholders. We've delivered strong cashflows, we've reduced leverage, and we're confident we can continue to generate strong, sustainable cashflows.

In turn, as we set out in our capital allocation framework today, this means we can now commit to returning a higher proportion of our underlying profits to shareholders. So, now I'll turn over to the operator and take your questions. Thank you.

Operator

The first question is coming from Andrew Gwynn, BNP Paribas Exane.

Simon Roberts

Hello Andrew, good morning.

Andrew Gwynn, BNP Paribas Exane

Morning Simon, morning Kevin. Thank you very much for the opportunity. So, just coming back to the statement around the consumer, obviously really beginning to see the worst of the energy increases coming through. What would you call out? Is there any pronounced change in consumer behaviour so far? Then just thinking about the two business lines obviously, within the General Merchandise business there's been some fairly significant availability challenges. Maybe over the year they start to improve, but do you think that would be a significant tailwind to offset some of the macro pressures? Thank you very much.

Simon Roberts

Andrew, thank you. So, in terms of the customer, what we're seeing, I think there's really three areas I'd call out. The first is to say that clearly, we're seeing a continued normalisation post-pandemic which is characterised by more customers coming back into store, online stabilising around 15% of total sales, albeit still twice the number of online orders that we saw pre-pandemic. And clearly, more customers are getting back to the office, traveling more, which is driving more food out of homes. That's the first theme.

I think in terms of the impact of prices and inflation, what are we seeing. Well, I think it's early days yet. Clearly this month's the first real impact with the impact of the energy cost and we're staying really close to it, but I think early to see any significant change in customer behaviour. But customers clearly are watching every penny and every pound. That's why, as you've seen in our strategy that we laid out in 2020, we've been really determined over the last 18 months to get our value in the position it's now in, which means that we can demonstrate that we're growing share, but also that we're inflating behind all our key competitors on the key products customers shop for. So, in the anticipation that the impact of inflation will be increasingly on customers' minds, we think we're really well positioned to be able to continue to present good value.

The third thing we're seeing in terms of customer behaviour I would say is, at certain points customers are looking to trade in and trade up. We had a good Easter relative to the market. The same was true at Mother's Day. We think about the events in the year coming up - we see those as opportunities where customers will trade in. So, that's on the Food side.

On General Merchandise to your specific question on availability, yes absolutely, we had some real challenges into the peak period over Christmas, particularly in consumer electronics, particularly in toys. That situation has been recovering and when we look at our availability stats now compared to even three months ago, we've seen quite a substantial improvement and one clearly we're continuing to push hard for. I think the outlook on availability, we're watching the situation in China closely. The team is working really closely

with our suppliers. I think it's hard to call yet what will happen there, but we've learned a lot over the last 18 months, and we'll be staying very close to it.

Andrew Gwynn, BNP Paribas Exane

Okay, great. Thank you. I'll hand over to somebody else.

Simon Roberts

Thanks, Andrew.

Operator

Thank you. The next one is coming from James Anstead from Barclays.

Simon Roberts

Hello, James. Good morning.

James Anstead, Barclays

Good morning, Simon and Kevin. Perhaps a question for you each, if that's okay. You've talked about the investment that you're already focusing on, your top 100 lines. That certainly seems to be working if we look at the volumes that you've showed us. How different would the price investments from the average selling price chart look if we saw the overall offer? Again, the results seem positive, I'm interested just to know how different the pricing might trend on the back book, as it were.

Perhaps a question for Kevin, which I'm sure a lot of people are trying to do the maths like me. In terms of profit bridge between the £730 million you've just delivered for PBT and the £630 million to £690 million you're guiding to for the year ahead, I just wonder if you can talk about some of the moving parts, which are the bigger elements to be aware of? Two particular bits, I think you've mentioned effectively there's £100 million profit benefit in the base year from elevated Grocery sales. Are you expecting that to completely disappear in the year ahead or just step backwards?

Just to be completely clear on General Merchandise, clearly, you've got these cost savings to offset the challenges that Argos is likely to face. Are you expecting Argos net:net to have a down year in terms of profitability? Accepting that anything you say at this stage is subject to lots of potential changes in the following 12 months.

Simon Roberts

Thanks, James. Why don't I take your question in terms of overall value position and then Kevin can take us through some of the outlook that we're thinking.

In terms of value, look as we, I hope, have laid out in the presentation, two key proof points. First, as you say, that we are deflating on the 100 products customers buy most often. More broadly, the reason we think our volume share has responded as it has, is that our value has improved against all of our competitors in terms of VI (Value Index) on the overall basket.

We've been able to do that because we've deployed already three key platforms on value. One, Sainsbury's Quality Aldi Price Match, products that customers buy most frequently,

fresh products, 150 new products last week with a real focus on fruit, vegetables, salads, dairy, meat. The products we buy week in week out.

Second, our price lock program. The most extensive in the market. Up to 2000 products, everyday staples, dishwasher tablets, tinned tomatoes, pasta, rice. Where we lock down prices for eight weeks.

Thirdly, the growing impact of Nectar Prices, where we are servicing customers, now over a million customers, are benefitting from this on the SmartShop platform, with unique prices just for you.

So, when we think about all of that together, that is the combination of the three-value platforms that we think is the driver between more secondary customers coming back into Sainsbury's and our overall value position improving. I'd just reiterate again, we've been on this for 18 months. We continue to refine our approach. Clearly, we're targeting the value investment where customers notice it and value most. So, our algorithms and our insight tools are working very hard to continue to pinpoint this value investment, which is what gives us the real focus to make sure that we keep executing against this plan.

So overall, of course, it's funded by improving volumes, but also our cost saving program. That's something that we think we've still got unique savings to go at, which gives us the firepower to invest back in price.

As you'll see in today's statement, we are absolutely determined to make sure we hold on to the value position that we've put out there. In terms of us against the market, if it's helpful, we were inflating 1% to 2% behind the market. So, we're slower in putting prices up and that kind of level behind where market inflation is. Kevin, do you want to pick up the outlook?

Kevin O'Byrne

Morning, James. As you said, it is very early in the year and as you can imagine, we're running a number of scenarios. If you think about going from the £730 million to let's, say, the midpoint of the range we've given you, there's probably four key things that we'd be thinking about.

One is the level of unwind of COVID benefit in the year and how much of that – you mentioned £100 million, how much of that – will we keep some of that increased food volume to operating cost pressures. Two, operating cost pressures.

Then the final two, which are the bigger elements, is the input inflation in Food and our ability to pass that through to customers and the General Merchandise demand, which probably is the most difficult to forecast at the moment. Particularly as we look into quarter four and increased fuel prices, energy prices for consumers as we come into Christmas.

If you look at our base assumptions, we're assuming significant volume decline in General Merchandise. That will be offset by transformation cost savings and some price increases. So, we're being cautious there. On the Food side we're assuming a small volume decline offset by small price increase. But the real critical factor in Food is the Food margin. We obviously have made a key commitment to sustain a relative value position. So, we're assuming that Food margin will be down slightly, and then the range of forecast will depend at the sort of pace at which we're able to pass on that inflation. We're assuming that we're passing it on more slowly, and therefore that's in our base assumption.

So, the two, if you were just going straight from your £730 million to, let's say, £660 million, the midpoint, the two big building blocks, lots of ups and down, most of it playing a draw, but the two big building blocks are gross margin on Food and volume on General Merchandise.

James Anstead, Barclays

That was very helpful. One very quickly follow-up on a slightly different topic. The Bank paying this £50 million dividend. I'm presuming that it would be a bit much to assume that the Bank can afford to do that every year going forward? You wouldn't be encouraging us to stick that in the model every year from now on.

Kevin O'Byrne

We're on a journey and obviously really, really pleased that we've gone from putting cash into the Bank, to the Bank being self-sufficient from a cash point of view. The Bank now distributing excess capital and we would like to get to the point where there's a regular dividend from the Bank. I think we need to see a couple of years sustained growth and then I think we could assume that. But you're right, I wouldn't be putting it in your models for this year.

James Anstead, Barclays

Very helpful. Thank you very much.

Simon Roberts

Thanks, James.

Operator

The next question is coming from Rob Joyce from Goldman Sachs

Simon Roberts

Hello Rob, morning.

Rob Joyce, Goldman Sachs

Morning, thanks for taking the questions. I'm afraid they're kind of just a little bit more sharpening some of the previous from James. So, the first one, I'm pretty clear on the moving parts in the guidance. To be clear, in terms of the General Merchandise, are we looking at – if we go back historically you can see, I think, in the '11, '12 real income squeeze Argos like for like was down about 9% and EBIT was down £100 million or so. Obviously excluding the cost savings benefit, which I know you have, but is that the kind of thinking we're looking at for this year? Is that the basis for how we look at this year on the GM side of things?

The second one is again on the other part of the guidance, the input inflation. Am I right in assuming – all the external data tells us that you guys are maintaining, if not improving, your price position? The market seems to be broadly passing through inflation. Is the guidance embedding a change in that, in that you have to start absorbing more of that input cost inflation than you currently are?

Then the final one – again all picking up from James' – on the Bank, paying a dividend and then guidance that Bank profits go up, but the guidance seems a little bit more bearish in the rest of the business. I'm just wondering how you reconcile those two messages? Thank you.

Simon Roberts

Rob, thank you. If I pick up you GM and Food question, then Kevin on the Bank. As you've just done, of course, we've looked at the history. So, within the discussion that Kevin's just shared with us, high single digits impacts on GM is what we've looked at in our model. Obviously, it's early in the year. I think we are particularly thinking about the quarter three October period onwards when the impact of fuel and energy comes again.

So, in answer to your question, that's the way we're thinking about GM at this stage. I would just say, you've seen what's happened in the exit point of this year, improvement in the trends are more encouraging sales and obviously availability improved. So, we'll see what it looks like, but without a doubt more challenging and therefore that would be our assumption.

Rob Joyce, Goldman Sachs

Simon, is that the kind of operation leverage though? Do you think there's still similar operation leverage in the business than back then? Is that the right analogy to use?

Simon Roberts

I think – let's just remind ourselves of what we're doing in terms of transforming the operating model in Argos. So, we are about halfway through delivering the value benefits of our Argos transformation program. £105 million, you'll remember, of cost out in the changes in our store model. Clearly, all of the change in logistics as we bring that together is part of a much bigger cost saving programme. Then of course as more customers are shopping digitally in Argos, now 80% of the sales in Argos are happening digitally, that is enabling us to keep driving efficiencies.

So I take us back to the core elements of our strategy, which is to reduce costs, improve margin discipline, make sure that we get the fundamentals of availability, really optimise digital and conversion really optimised, and obviously, as we take those costs out, holding onto the sales. That is the way we are thinking about how that will play through on clearly a more challenging outlook on the top line.

Then on Food, I think first principle we will maintain our relative position on price. We have worked hard to get to where we've got to. You can see what that is meaning in terms of our volume position. As you say, you can see that we are inflating behind others. As I said earlier to James's question, 1% to 2% behind market inflation is where we are today and putting the value where customers really notice it. But we of course are looking at what others are doing. The Food market we think so far has been rational. We are being prudent in our outlook on Food. Obviously, we want to make sure we maintain our volume momentum, make sure that the value is really clear in the offer.

I would say again that the cost saving programme that we have built, and we are now 18 months into is driving (1) a lot of momentum and (2) a lot of unique benefits in costs that we think we have, that others don't have. So whilst the outlook is clearly more challenging to make sure we can deliver value we think we have got a lot of tools in our armoury to deploy as the year unfolds. On the Bank – Kevin.

Kevin O'Byrne

Yes, Rob, I'm not sure if I fully understood your question but I think there are two separate things here, the dividend and the profit. Profit we think will increase this year for a couple of factors. We think we will have some disciplined increase in lending, credit cards, on the loan book and in areas like travel money we will have a much better year. Not back to pre-COVID but much improved. So those will contribute, and we are assuming a fairly balanced bad debt environment in that forecast. They are not up enormously but they will be up year-on-year.

On the dividend discussion it was always our plan and our ambition to improve returns and pay a dividend and that is something the Bank Board have been very focused on. The conclusion was reached that the future plans for the next years can be delivered. We can grow lending in a disciplined way and at the same time distribute capital to the parent, which is what they've done. Of course, it's an important milestone both for the Bank Board and for us that we have seen that. So that is if you like connected but disconnected - future dividends will be linked to future profit growth as we see how things evolve as we come out of the COVID period.

Simon Roberts

Yes, and maybe just the only other point to add Rob, just in terms of the Financial Services proposition itself, clearly within the environment that we are in and your question on General Merchandise, the teams have been working really hard end-to-end to make sure that we are improving the product proposition of Financial Services products to support Sainsbury's and Argos's customers. So, within the context of a more challenging GM outlook, for example, the launch of our new Monthly Payment Plan is a really key element of us serving the GM customer base more effectively in the way they want to shop, but also taking advantage of our financial services platform to grow its performance as the consumer outlook changes.

Rob Joyce, Goldman Sachs

Okay, thanks.

Simon Roberts

Thanks Rob.

Operator

Thank you. The next question is coming from James Grzinic, Jeffries International.

Simon Roberts

Hello James, good morning.

James Grzinic, Jefferies International

Good morning, Simon, Kevin, and James. I have a couple. I guess mostly for Kevin regarding the financial side of things. Can you perhaps talk us through why you decided to increase the pay-out ratio rather than going for stepping up the rate of deleverage and then redeploying that optionality on exceptional cash distributions? Should we think that you are just – it's a signal of sustainably higher-level free cash flow that you see in the business?

The second one is, can you perhaps go again through the details of the £800 million lease liability recapitalisation that will unwind in two years' time. I'm trying to understand the mechanics of that because obviously it makes a big difference in terms of the 3.1 is already 2.7 underlying on the leverage side.

Kevin O'Byrne

No problem, James. Yes, you have kind of answered the question, the first one, yourself. You are right. We felt that shareholders would appreciate a predictable improved dividend. If you think of the last number of years, I mean we have made substantial progress in deleveraging the Group, but of the £2.8 billion of free cash flow that we have generated in the last five years we have paid about 60% of it to pay down debt.

We are fast approaching a situation where we don't need to pay that money out to pay down debt so clearly, we have excess free cash flow, and we felt the first port of call would be to increase the proportion of profits that we gave to shareholders. It just I think demonstrates our confidence in the sustainability of the cash flow and the predictability and shareholders can rely on that.

Now the other point I would probably make. If you look at our allocation framework that we laid out on Slide 24, we said first and foremost invest in supporting our strategy and accelerating our strategy, then a solid Investment Grade, because we think that is really important. That gives us great financial flexibility to take advantage of opportunities as they arise and protect the business.

Then thirdly, would be improving the pay-out ratio. This year, we have said we will actually do it this year, even though we haven't technically hit the solid investment grade target, and that's just I think again a sign of our confidence in the ability of the Group just to continue to generate strong cash flow. So hopefully that helps on that front.

On the £800 million, yes, there are two structures called Highbury and Dragon, that were entered into many, many years ago leasing – about 26 stores were in the structures – and we are a joint venture, we have about 50% of the shareholding in that with another party. The way it was structured was if we stayed in the venture, we had two choices. We could either leave a store and just exit the lease at the end, or we could lease the store back. But we could only lease it on passing rent and on a 20-year lease.

Now we looked at some of those stores and we thought – we don't think the passing rent is necessarily the right rent and some of those stores we don't necessarily want a 20-year lease on them. Because of the strength of the balance sheet now and the position we are in we have exercised the option to actually acquire 21 of those stores, so we are going to leave some of the stores that we don't want, and then with those 21 stores as we acquire them we will retain a small handful because they are commercially interesting, it gives us some flexibility commercially, or there's a mixed use development opportunity. There will be a number of those that we will hold on to. I mean we will sell and lease back the majority, but we will do them on leases that we want, the right length, the right rent, et cetera, and the right terms on the lease.

That will take – the leases we can exercise and take action during '23 but potentially the process could take through until FY24 because there is going to be some arbitration negotiation with the joint venture party on the price of some of these stores. So we think the whole process will be completed by FY24 and then you will see our leverage come down because a chunk of that £800 million will be removed.

James Grzinic, Jefferies International

Can I just ask – thank you for that Kevin, very clear. But can I just ask what the net cash flow impact of buying the freeholds relative to surrendering leases would be, so what would be the net aside from the £800 million removal?

Kevin O'Byrne

James, I can't give you that at this stage. There is going to be some cash inflow from this process, but it all depends on – it just depends on the number that we retain and the sale at the margin between the sale and the leaseback. Clearly, we are balancing – we are not trying to maximise property profit here, we are balancing property profit and having the right lease structures for, if you like, the next generation in 10 years' time.

So clearly, we could maximise cash today by putting 20-year leases at RPI on all of these stores. We are not going to do that. So we are just going to get the right balance so we will have to come back to you as we go through those negotiations and give you greater colour. But there's no cash out, there will be a small amount of cash in, but it will just depend ultimately on the final lease structures.

James Grzinic, Jefferies International

Thank you. Can I just ask a super quick one, a follow up on, actually, Argos and perhaps you can clarify what the rental line would be for Argos this year compared to the period that Rob was referencing back when we had a big squeeze on top line because I presume it's very different now?

Kevin O'Byrne

It is very different. I don't happen to have that number right now but it's rates as well. I mean rates inflation has been higher than rent inflation for a number of years in Argos stores, so James can come back with that later. But it's clearly very material because we've put 400 stores inside Sainsbury's stores where we don't have additional rent and rates.

Simon Roberts

And, if it's helpful, on p.55 of our presentation you can see the key cost saving programmes laid out and specifically with reference to the Argos transformation both the store rationalisation and fulfilment centres. But also as you can see the big programme in logistics bringing together both Sainsbury's and Argos's logistics. So if we contrast that with the operating platform we had before you can see back to Rob's earlier question just how much operating leverage is coming through as that cost programme flows. And as I say, still half of that to come.

Kevin O'Byrne

James, maybe just building on Simon's point, we take out the rent and rate of the stores, we go into our stores where we don't have any additional rent and rates but we do put in a small amount of rent and rates in local fulfilment centres, but we are replacing retail rent, at a number of stores, with one local fulfilment centre on logistics sort of shared rent.

Simon Roberts

Thank you, James.

James Grzinic, Jefferies International

Thank you.

Operator

Thank you. The next question is coming from William Woods from Bernstein, please proceed.

Simon Roberts

William, good morning.

William Wood, Bernstein

Good morning. A couple of questions just on pricing. Obviously, you are showing volume growth above the market but from Kantar your value market share is down. Are you seeing any changes in customer behaviour in terms of net switching gains, winning net switching gains from your peers? I suppose secondly on the hearts and minds of pricing how is price perception changing for Sainsburys as a result of price match and things like that?

Then just a final point on price. Are you able to quantify the investment of price, is it as simple as you're not passing on 1% to 2% below the market and therefore it's 1% to 2% for sales, thanks?

Simon Roberts

William, thank you. So on your first question on what's happening on the share. I mean we were very clear at the outset of our plan. We judge our performance on market share on volume because that's the absolute clear read of how much food people are buying, and it's also reflecting the value we are putting into the offer. So that's why you can see our volume market share is growing where it is. Because we are inflating slower than others, in fact on the 100 biggest SKUs, as you can see in our pack on p.35, behind our direct competitors - again that is a key enabler of the volume market share growth versus value.

In terms of what we are seeing from customer behaviour, I mean I think, as I hope I stressed earlier, this isn't something that we started to do in recent days or weeks, this is something we have been working on for 18 months. We were really clear at the start of our Food First plan that we would be more competitive, and really the culmination of all the work over the last 18 months is meaning that more secondary customers are coming back into Sainsburys, both from the other big four but also from the discounters to shop into those products they can now be sure of the value at Sainsburys, and that has been something we have seen through the last year. We saw it further pick up over peak and that is why we are absolutely determined that we will hold onto our relative value position and why the cost saving programme is so key in doing that.

So the one thing I would say is that we are being very focused where we place the investment. I think there is a lot of noise in the market at the moment. We are deploying our value where we hear from our customers they really want to see it. As I said, that is in fruit and vegetables, that's in meat, that's in dairy products, and the items that go into the basket every week, bread, potatoes, and so on. So I think it's the real focus of the investment that is getting the cut through, which means we can balance how much it's costing us and the return that we are getting on it.

In terms of the overall position against the market, look I've said before, we are holding back inflation helped by our scale, helped by the relationships with suppliers, helped by the volume drive put in place - as I say, fundamentally underpinned by the cost saving programme.

In terms of what we are seeing on perception, just pointing to our pack for a minute. You will see that one of the things we wanted to pull out for you is just what is happening in terms of customer feedback. When you look on p.33 in the pack, what you can see there is that we are seeing value perception shift for the first time in a long while. These things as you know take a long time to move but value perceptions are up on two years ago. Interesting, also in areas like Nectar Pricing when we give customers personalised value the value perception shifts even more substantially. So all the focus on maintaining what we are doing, all the focus on maintaining relative strength in our value offer and continuing to execute against what we are learning.

William Woods, Bernstein

Great, thank you.

Simon Roberts

Thank you William.

Operator

Thank you. The next question is coming from Xavier Le Mene from Bank of America Securities.

Xavier Le Mene, Bank of America Securities

Yes, good morning. Two questions. First on inflation so I understand exactly what you are doing for this year, but how do you see inflation going forwards or more mid to long-term, so do you expect food inflation to stay for the long-term?

Linked to that, what do you make about Asda and Morrisons' announcement, so recent announcement, would you expect the competition to get potentially tougher? Is it part of your guidance - so you said the market had been rational, but do you expect in your guidance for the market to become potentially less rational?

Last one if I may, on the cost savings target that you have got of 200 basis points for SG&A cost reductions, given the labour cost inflation and the energy cost inflation, do you think that the target is still achievable and what do you expect potentially for this year in terms of reduction?

Simon Roberts

Okay Xavier, thank you. Well if I take the questions on outlook on inflation and competitor and then I will hand over to Kevin. Look I think – I mean a couple of things to say. Clearly, at the macro level we can all see some of the drivers of inflation into food, not least being amplified by the geopolitical events at the moment. So increased cost of production, fertiliser, fuel. I think these factors clearly are on everyone's mind and so the impact of inflation I think we would expect to be over a longer period than we would have certainly seen two or three months ago.

I think clearly within that as we have been working, we are doing everything we can to hold back the impact of inflation to the consumer through the combination of clearly working very hard with suppliers. I have to say through the pandemic, our supply base has done a fantastic job and we are working day in day out very closely within the commercial teams, who are doing a great job working really closely, to make sure we can find the right balance on value but also support what we need to.

I would just say in certain areas we are really leaning in to support. So, for example, on pork - the UK pig industry, it's a challenging time at the moment. We have looked at our model, we have changed it, we have invested further to support farmers there. The same in milk, the same in eggs. So in the parts of the industry that are challenged we are also doing what we need to be doing and doing the right thing to support against the context of this inflationary environment more broadly.

So I think what it means when we look ahead is that it will last a bit longer, but our job is to continue to do what we are doing which is to as far as possible ensure that we are passing less onto our customers than our competitors are and to do that funded by our efficiencies and cost saving and scale.

In terms of what that means for the competitors, look, as you'd expect I'm not going to speak about individual competitors and what they are doing. But I think as I say there's a lot of noise in the market on price and promotion and we can see some retailers using a lot more promotions. We can see lots of prices moving around. In the end I think customers are really savvy about these things and they can see all of that.

So our strategy and our plan is to make sure at the shelf edge you can absolutely see consistently a trusted position on value that customers believe in. That doesn't mean it changes in January compared to the autumn. It means that throughout the year, on the products you want to buy, that matter most to you, you can trust our value, and that's one of the reasons why I think our volume share and our switch of secondary customers has been happening. Kevin, do you want to pick up the second points?

Kevin O'Byrne

Yes, Xavier, I mean, yes, we are very, very focused on taking costs out so we can invest in the offer, and we have got detailed plans to do that. You are right in saying that the environment has changed. We didn't anticipate this level of inflation when we laid out the plan, that's for sure. In the current year we will make further progress but less than we would have originally thought because of the inflation. So our cost saving plans are very clear, but the inflation is higher than we anticipated. But you will see on slide 54 we still expect to make progress.

We are very confident in our cost out plans and then when we talk about the outer years there's more to do obviously. We are focused on delivering 22/23, at the moment. The only thing I would point out is obviously a basis points movement, there are two factors in there as we all know, what happens to the sales line and what happens to the cost line. And while there will be inflation in the cost line, we would expect some inflation in the outer years in the sales line as well which will come in the mix. So we will obviously talk in more detail as we get out of this year into next year.

Xavier Le Mene, Bank of America Securities

Thank you, that's very helpful.

Simon Roberts

Thank you.

Operator

The next question is coming from Clive Black from Shore Capital.

Simon Roberts

Morning Clive.

Clive Black, Shore Capital

Good morning guys, are you okay?

Simon Roberts

Good to hear your question Clive.

Clive Black, Shore Capital

I might just ask about online, which hasn't really been picked upon today against a backdrop of a lot of noise in recent times. First of all, where do you see Sainsburys' Online Grocery participation going and how does the evolution of the business involve your stores with online, in terms of a business model for fulfilment going forward?

In that respect, do you think online can be particularly vulnerable or otherwise in the General Merchandising side of what's coming down the line? You mentioned being concerned from October in particular. Then just as an adjunct to that, can you give us an indication what proportion of your Clothing sales are online please? That would be great.

Simon Roberts

Thanks, Clive. Yes, sure, so let's talk online. So first of all on the Grocery side - and if it's helpful just as everyone's looking at the results this morning, on p.41 and p.42 we've just tried to lay out in our pack what's been happening. So to your question, Clive, specifically on participation, you can see when we got to a peak of north of 800,000 orders a week, that was north of 20% participation. You can see through FY22 where that's got to a more stable position.

So we exit the year around 15% compared to just ahead of 20% at the same point last year. And what we would see here is a real return into store. So a lot of the customers that were shopping online are coming back into store as shopping trends normalise. So 15%, there or thereabouts, for this year is, I think, a decent planning assumption.

Of course, over the longer term, to your second question, we'd expect this to increase. But we think this is a good resting point for us because it means that we can continue to drive, on p.42, the benefits of our in-store model. Whether that be an item picked rate per hour or drops per hour, brand utilisation, or indeed on our ability to pick the basket size that customers are shopping into, you can see the efficiency benefits we're getting.

So I think a more stable picture in terms of participation and a longer trajectory to Grocery Online participation increasing again. Which I think to your second question then says look, two key objectives here for us. One, how do we optimise, as I say, the store model? Our teams are doing a fantastic job in this space to make sure we give improving service and good service and improve our productivity.

Also at the same time, really think about what's next and I think what I would say is that of course, we've got to look at new fulfilment solutions and as you'd expect we're looking at that all the time. But I don't think the rush is on as much as it may have been 12 or 15 months ago.

I think that's a good thing because we can really drive our in-store model, we can take our time to work out the most efficient long-term solutions. At its heart we've got 600 supermarkets here, just under 300 that we fulfil Online in, and we can optimise the use of those great locations to do a better job front of store and also back of store too. So hopefully that gives you a picture on the Online situation.

In GM, I think clearly the outlook is more challenging for all the reasons we've discussed and in that context - and I guess again, coming back to the situation in 2011/12, I think it's an advantage we've got such a developed online platform in Argos and in GM, because it means that customers can get access much more readily than last time to where products are available and also can see value as well.

So in many ways I think we've got to play that to our advantage. That's why we're so focused on availability right now and really focused on value too. And so how do we use 80%-plus of the sales in Argos coming digitally to our advantage, particularly in the context of customers wanting to pick up and get convenience quickly and that's what we'll be doing in that space.

Then on Clothing, hopefully in the pack we've given some sense of what's happening on our Clothing business and just if you look at p.50, you can see how much the online sales have grown. Online Clothing sales are 13% of the total sales now, they were 9% in 2019/20 and you can see the size of the growth that we're getting.

But we're encouraged with our Clothing performance, we've got a really strong offering in *Tu*, you can see how much the full price mix has continued to grow. And the team are really focused on how, as customers come back into store, we continue to strengthen our clothing offer. Thanks, Clive.

Operator

The next question is coming from Andrew Porteous from HSBC.

Simon Roberts

Hello, Andrew, good morning.

Andrew Porteous, HSBC

Hi team, thank you for taking the questions, a couple from me. Firstly, can you just talk a little bit about CapEx? I think you talked in the statement about £700 million to £750 million going forward. I know that was the plan for a few years, but I think your original guidance was beyond 2024 for CapEx to drop back to £600 million. Is that still the plan, or are we likely to see higher CapEx going beyond that?

Then a second question, really I guess related to Clive's, just when you're seeing that transfer of sales back into store from online, is that a net positive from a profit perspective for your business or not?

Simon Roberts

Thanks, why doesn't Kevin pick up your first question and then we'll come back and talk about online. Kevin.

Kevin O'Byrne

Yes, Andrew, that's right, we have raised the CapEx in our assumptions, in our plans going forward, we've kept it at the £700 million to £750 million level. At the moment, the base level is around the £600 million and the additional CapEx is going on the Argos transformation and the logistics transformation largely. What we've assumed is, I think, for planning purposes and for cash flow planning purposes, that we maintain that level.

A couple of factors there, (1) is just we would imagine that there'll be other areas of investing in the future as we digitise the business that we'd want to focus on. (2) There's going to be some element of inflation in the underlying CapEx costs and hence we think it's the right sort of level to ensure that we're maintaining both the physical and the digital infrastructure of the business and investing in the right areas and we can still deliver the £500 million-plus per year while doing that.

Simon Roberts

Thanks, Kevin. I think just in short to your second question, clearly customers fulfilling in-store versus online is a positive outcome in terms of their ability to fill at lower cost. So that's why we think the 15% gives us access to a whole lot of new customers shopping with us online. But also if they come back into store, that improves the operating efficiency too.

Andrew Porteous, HSBC

Brilliant, thank you for the answers, guys.

Operator

The next one is coming from Nick Coulter from Citi.

Simon Roberts

Good morning, Nick.

Nick Coulter, Citi

Hi, good morning. Congratulations on the Bank. I think cash out rather than capital in is indeed a watershed moment, so good to hear. Three, if I may.

I'll pick up on the outlook comment around continuing your volume market share performance and to what extent you'd expect to lose a greater level of switching to the discounters in this sort of environment? I appreciate they're laying space, that's the first one.

Simon Roberts

Yes, sure, Nick, thank you, let me take that one. I think the first and most obvious thing to say is there's no room for complacency on anything right now, for all the obvious reasons. Very competitive market and everyone's looking at their share and what they need to do to make sure it's where they want it to be.

So I guess my comments would be that our volume share gains have been the result of being bolder in our price investment decisions and where we've deployed them. And we would expect to be able to reinvest more than our competitors through the size of our cost saving programme. We think we've got substantial cost out still to go out and that's very much in our plan this year.

I should say that we would expect our cost savings in our plan this year to be at a higher level of inflation. So we'll take out more cost than the cost of inflation, which is a key measure of our ability to deliver on cost. The other thing I would say is that we intend and are committed to be very consistent so that customers can see week in, week out where there is value in the Sainsbury's shop.

So absolutely no complacency against others, I'm sure there'll be lots happening in the market on price, there already is. But we're just going to absolutely stick to our plan and make sure our relative value continues to be really clear to customers.

Nick Coulter, Citi

But you broadly expect the same shape of switching as you're seeing at the moment? So a net win or hold, but obviously mixed versus competitors?

Simon Roberts

I think in terms of my key point, which is we're going to invest value in the parts of the shopping trip that ensure that customers continue to see the strength of the value in our offer. I think of course there'll be moves backwards and forwards as the offer moves in others, but that's our absolute objective and we've built a plan and a forecast this year that underpins our ability to do that.

Nick Coulter, Citi

Okay, great, that's helpful, thank you. Then secondly, very broadly what sort of price elasticity do you expect to see in your General Merchandise category and I guess the Clothing category as well? I'd be interested to hear how you're thinking about this.

Then I guess a follow-on, how have you factored the resultant volume considerations into the buying cycle and also into your assortment, I guess, as you try to preserve price points? I would assume that peak planning is probably front and centre at this point in time. Thank you.

Simon Roberts

Yes, I think, as you say, there's lots of factors here that we're obviously looking at, looking at the history, looking at the trends we're seeing from customers. Obviously particularly in the market you mention, in Clothing, we've seen a lot of customers come back into store and obviously given the size of our Clothing offer that comes from our physical footprint, we're learning a lot about how customers are shopping that.

I think it's very early to say in terms of elasticity at this point in time. As I said recently, obviously lots of factors are driving, particularly in General Merchandise. Obviously discretionary spending's a factor, obviously the weather in Clothing is a factor, big seasonal period ahead. So we're looking at all these factors as we plan the outlook for the year.

We think we've got a strong offer and at a time when customers are watching every penny and every pound in their purses and wallets, having a strong clothing offer that's based on good value is a good place to be and it's one that we'll be deploying against. And as we look towards the second half of the year, we'll learn a lot over the next two or three months and we'll be making our choices for Quarter 3 and Peak as we see how the customer behaviour changes.

Nick Coulter, Citi

But have you built any additional flexibility into your buying patterns for the year, given the lead times involved and given what's coming down the track?

Simon Roberts

We have a pretty flexible model actually, Nick, in the way that we do this. Obviously, our supply base was developed over a long period of time. I would point you to how we've managed this through the COVID period. Clearly, we're placing our commitments a decent time out, but we are also being flexible and working closely with them to manage the situation as it happens.

So at this point in time, I would say the key principles here are staying very close to customer behaviour, making sure value is in the offer it needs to be. Most importantly of all, making sure we've got the right ranges and the right products that customers want to buy and we'll stay closely linked to how the demand curve moves and make sure we're responding accordingly.

Nick Coulter, Citi

Okay, that's helpful, thank you.

Operator

Your next question is coming from Sreedhar Mahamkali from UBS.

Simon Roberts

Hello, Sreedhar, morning.

Kevin O'Byrne

Morning, Sreedhar.

Sreedhar Mahamkali, UBS

Hi, good morning to both of you, thanks for taking the questions. Maybe just a couple of super quick questions please. You've talked about volume outperformance, fairly large volume outperformance versus the big four. Maybe expand a little bit on that in terms of what does that do to your negotiations and leverage with suppliers? That’s the first one.

Secondly, how do you build from there? What's the path to value share gain? What's the lead times and when do you start to see value share gain? The path, that'll be super helpful too to talk through.

Secondly, a very quick follow-up on GM. We've talked quite a lot about sales and costs, but I think in the year gone you also talked about gross margin being up in the segment. Can you give us a sense in terms of how you're thinking about the drivers for gross margin for the year ahead in GM specifically please? Thank you.

Simon Roberts

Okay, Sreedhar, thanks. Why don't I take the volume question and then maybe Kevin take the GM gross margin question. So, I think, without repeating myself, I think maybe just two points to state. The reason we're so focused on volume market share is clearly that's also a reflection of our relative value compared to others. And so clearly you wouldn't expect me to say that we would want to grow our value share ahead of our volume share, because we're so focused on getting our volume share as our point of difference, more customers shopping with us.

So when we look to what's happening here with suppliers, a couple of things to say. We've a longstanding and trusted relationship with our supply base, it's one of the things that I think makes Sainsbury's unique in the way we have built this over a long period of time. Our team, our commercial teams, are spending a huge amount of time with our suppliers. I've spent a lot of time with our suppliers too this year, really understanding what they're trying to achieve, what we're trying to achieve.

I think in the middle of that is really where our collaboration and partnership is really driving strategic value. Because as we make the Sainsbury's brand in Food more resonant with customers, so we grow volume and so we are able to also create value for our suppliers. So clearly as inflation is in mid-single digit in the industry, there's more still to come through the pipe. Because we're working so closely with our suppliers and because of our cost saving programme, that's why we can make sure we're holding our prices back 1% to 2% from that position.

So I think in terms of your outlook question here, Sreedhar, we intend to keep doing that and as I say, absolutely no complacency in our position but a real determination to continue to leverage our scale, our supplier relationships, our commitment to value and the delivery of our cost saving programme so that customers can keep being confident in the value they're going to get when they shop with us. Kevin, do you want to pick up the gross margin point?

Kevin O'Byrne

Yes, Sreedhar, our working assumption on gross margin in General Merchandise is that across the range it'll be down slightly in the year, as we focus on affordability in one or two categories. However, it's small in the scheme of the volume is the big lever that we're more concerned about and is behind the range of outcomes that we're talking about.

Simon Roberts

Thank you, Sreedhar.

Operator

Thank you. This is the last question for today.

Simon Roberts

Okay, so if there aren't any more questions, just to say thank you, everyone, for your time this morning. I know, as I say, it's a busy morning for you. I hope you can see we're very focused on the consumer, very focused on our strategy, 18 months in.

I would just stress again only one year into a three-year plan, so the whole team are really, really focused on how do we deliver the plan this year in what's going to be a different outlook to last year.

But I hope what you can see is we're focused on customers and we're very focused on our shareholders too and make sure that we can deliver for both of those key stakeholders this year with a team already behind that. So, we'll see you soon, thanks for joining us this morning and thanks for your questions.