J Sainsbury – Interim Results 2015
Analysts
Wednesday 11 November 2015

David Tyler
Chairman
Okay good morning everybody, good morning. Thank you everybody for coming. As you know this is our Presentation of Sainsbury's Interim Results for the 28 weeks to the 26th September 2015. Just a few words from me before I hand over as normal to John and to Mike.

If we cast our minds back to this time last year, you will remember that we set out then our new strategy and Mike will update you shortly on this. But from my perspective, I think we can reflect on good progress over the last 12 months. We have worked extremely hard to improve our proposition to customers, enhancing our price competitiveness and the quality of our offer. We have delivered more cost savings to date than we had targeted. We have looked after our balance sheet effectively, in particularly by cutting capital expenditure, and also by issuing new perpetual securities, enhancing our financial flexibility.

We are therefore, perhaps, a little bit ahead of where we expected to be one year in to this strategy. But of course there remains a great deal to do and I have every confidence that our highly experienced Management Team will continue to implement its plans as it has done with energy and with purpose.

And just before I pass over now to John to go through the financials, let me just confirm that we are retaining our normal dividend policy for our Interims, that is we will pay out 30% of our total dividend from the previous year and that means that we are declaring today an Interim Dividend of 4.0p.

So with that, John over to you.

John Rogers
Chief Financial Officer
Thank you David. Morning everyone. Just before I dive into the detailed numbers, I am just going to take you through some of the financial highlights for the first half. As David has already mentioned, we have had a relatively resilient sales performance in the first half, certainly relative to our supermarket peers, albeit in what remains a challenging market, particularly of course given the growth of the discounters.

Operational cost savings of £115 million in the first half, ahead of where we expected to be and therefore we are going to be updating our guidance for the full year to deliver savings of £225 million compared to the £200 million that we spoke about at the Prelims.

The pension deficit we have reduced that to £473 million, largely as a result of the £125 million that we have injected into the scheme this year. Of course there is another £125 million to go in the next financial year. We have improved our liquidity and flexibility through the issue of the perpetual bond. Of course we have announced the sale of our Pharmacy business. We expect proceeds to be around £125 million of cash subject to working capital movements. And we expect that to come in towards the end of this financial year. And as David has already commented

on, the Balance Sheet remains robust despite the decline in profitability. So those are the financial highlights for the first half.

Now going into some of the details on the numbers. Obviously the Group sales level overall sales down 2%, £13.64 billion delivering a retail operating profit of £332 million, down 14.4%. Taking account of the profit from the Bank, finance costs, share of profits from our joint venture delivers an underlying profit before tax of £308 million, down just under 18%.

Tax rate 25.3% in the first half, basically earnings per share 12p and as David has already mentioned, 4p Interim Dividend.

Items excluded from underlying results, £31 million and of course I will break that detail out for you a little bit later on, delivering a profit before tax of £339 million.

Okay, coming on now to some of the sales lines, retail sales lines. These numbers should be familiar to you from our Q2 Trading Statement. So like-for-like minus 1.6% offset by the benefit of new space at 1.5%, delivering a small overall sales decline of 0.1%. And again when you look at that broken down across different parts of the business, very positive performance from Convenience, Online and our clothing operation. So good growth in those areas. And as you can see from the slide, the continued challenge principally driven by deflation, of course in the supermarkets channel and in the food category.

So guidance for the full year. This is new updated guidance for the second half. We expect the like-for-likes in the second half to be similar to the first half. So the 1.6% decline if your reference point there. In relation to the contribution from new space and the contribution from extensions, that guidance does not change from the Prelims and is just repeated there for your benefit.

Coming on now to profitability. Clearly profitability has been impacted by our price investment and deflation which has reduced overall margins. So if you look at the underlying EBITDAR margin, down 45 bps to 7.41. And again if you look at the underlying operating margin, again down the same 45 bps to 2.65. So clearly the price investment that we have made through this year and the deflation that is taking place in the market has caused those margins to come down.

Thought it was just worth re-emphasising the impact of the price investment that we made. We talked about the price investment of £150 million in the second half of 14/15, we made that price investment broadly at that point in time for a number of different injections in price reductions. The impact that has on profitability year-on-year is laid out in this chart, so the half two for 14/15 we have already talked about, had an impact year-on-year on profits of £40 million. In this half, the first half of 15/16, that investment that was made back in 14/15 has had a year-on-year impact of £80 million and we are guiding to a year-on-year impact of £30 million in the second half because of course we saw some of the impact already in the second half of 14/15, that gets you to your £150 million in total. And of course the overarching point here is we will continue to remain competitive on price in this marketplace.

Sainsbury's Bank, good performance from Sainsbury's Bank at the headline level. Overall income growing by 6%, strong performance in our loan book. Strong performance in our insurance book, so good uplifts there. Overall profitability down slightly year-on-year, that actually reflects a more balanced phasing of profits through the financial year and you will note here we are not changing our guidance for the full year which is, we expect, mid single digit year-on-year growth in underlying operating

profit for the Bank. So good performance from the Bank. You will see some of the key ratios here improving significantly. So the bad debt asset ratio very low at 0.3%, that is a very good performance. And again our Tier 1 capital ratio has improved over the half to 14%, so good uplift in the overall strength of the Balance Sheet of the Bank.

Coming on now to the Bank transition. We now have a core banking platform that is being built. It is currently in its testing phase. What we are announcing today though is a delay to the expected migration from the existing Lloyds Banking platform onto the new banking platform, because we really want to make sure that the transition for our customers is as smooth as it possibly can be. And hence to get that right, we are delaying that migration by 6 to 9 months and we think that is the right thing to do from a customer perspective. The consequences of that though, in terms of our transition costs, as you remember last time at the Prelims we guided to a range of transition costs of £340 to £380 million. We now expect the transition costs to be at the top end of that range. So the £380 million.

The Business case remains very compelling for the Bank, we continue to be excited about the opportunity to grow this business on a standalone basis but also with the synergies that that business has with our core food retailing operations.

From a Capital perspective, we looked at the funding of the Bank in the first half of the year and we looked at the options around funding in relation to equity funding or putting in some Tier 2 funding, based on the analysis at that time and we tested the market. We decided that the right thing to do for the Bank was to put more equity in rather than to go down the Tier 2 funding route. And therefore as a consequence we are updating our guidance today. We had previously guided to putting £80 million of capital into the Bank this financial year. We are now updating that guidance and we are going to be putting in £160 million of capital into the Bank this year, principally because we think it is better to fund the Bank through the choice of the equity from the parent as opposed to going to the markets for the Tier 2 funding.

Operating cost savings £25 million ahead of expectations, £115 million in the half. £225 million for the full year. Update a little bit on the guidance for cost inflation. So cost inflation at the lower end of our 2-3% range, albeit we do expect a half on half step up of £13 million in relation to the 4% wage increase that we announced for our store colleagues which takes effect from the end of August. So if you are looking at your models, expect what works out to be equal of £13 million step up of labour costs in the second half of the year compared to the first. And again just the updated guidance just confirming around £225 million savings for the full year.

And as always these cost savings come from a number of different areas of our business. Organisational restructuring, so we have changed the way we structured our store support centres. We have also changed the way we have structured our Retail business, all of which has delivered significant savings. So our Retail colleagues have gone through a lot of change over the last twelve months and hence why we felt it was appropriate to reward those colleagues for all their hard work with the 4% increase in salary.

Electricity usage, we continue to invest in energy saving initiatives. LED lighting is one great example, but we have actually reduced our overall electricity consumption 2.5% year-on-year, so very proud of the initiatives in that area. We have also done a lot of simplification of processes in our stores, simplification combined with automation. So whether it is inventory management or short life code-checking, all of which has delivered significant cost savings, which is why we are able to up our

target for the full year. But what we have really been pleased about is that it has had no impact on sales or availability. If anything the changes we have made have improved our availability, they have improved our service levels within our stores.

Coming on now to items excluded from underlying. Property profits £94 million. Most of that is the property profit from our mixed use development in Fulham. So we guided to £200 million of profit split over 15/16 and 16/17. You are seeing some of that come in in the first half of this year, most of that is the Fulham development. And we have got the Sainsbury's Bank transition costs of 25. A small reversal of an impairment. Remember this time last year we made the impairments in our store estate. We have seen a couple of reversals based on revised market expectations. And of course the usual other items outside of underlying, principally the pensions financing charge and fair value adjustment in our property investments among a few other bits and pieces to deliver the £31 million I made mention of earlier on.

Finance costs. 62 in the half versus 54 same time last year, driven by, so an increase of 8 driven by two dynamics, one of which is reduction in the capitalised interest, a trend of course we have seen ongoing over the last couple of years as we start to slow down our real estate rollout. And of course we have put in place the perpetual bonds for which there is a coupon of £4 million which also impacts on our Half One. From an accounting perspective, from a statutory perspective, just to be clear, we know we shouldn't account, we account for those coupons as a Dividend, as equity, that is the way you do it on a statutory basis. But just to be clear in terms of the way we report it to you and from an underlying profit before tax perspective, we will assume that the coupon on the perpetual bond is simply interest, just to be clear, okay.

So guidance for the full year, we expect our overall net finance cost to increase by around £10 million, maybe a little bit north of that year-on-year as a result of the lower capitalised interest and the perpetual securities coupons. And again just a guidance on tax, it does not quite fit on this slide, but it is the best place for it to go. Of course the Chancellor announced reductions in the Corporation Tax in the Budget, and therefore as a consequence we are expecting our tax rate for the full year to drop significantly to 22% as a result of the movement in the deferred tax balances driven by that reduction in the Corporation Tax to 19% and then subsequently 18%. So full year tax rate expected to be 22% from the previous, I think we guided to 25% previously. So reduction there in the tax.

Cash flow and working capital. Cash from operations delivered a £375 million obviously down from last year, driven by reduced profitability in the business. But I am pleased to say that we have been able to deliver a further benefit in our retail working capital in the first half of this year. Not quite as large as the benefit we were able to deliver last year, but we are doing a lot of work in improving our working capital position and we continue to deliver some benefit in the first half. I think an element of that will unwind as we go into the second half, so I don't think it is all there permanently, but we are maintaining our guidance and expecting a small improvement in our retail working capital position for the full year. And of course, once you take account of all of the other cash reductions, interest, corporation tax, dividends, investments etc, we come down to a net debt position of £1.86 billion. Now of course in the accounting here we have treated the perpetual securities as equity, hence a reduction in the overall net debt position, but just very simply as a footnote just to aid you here, we have also provided the net debt number assuming we treat the perpetual securities as debt. So you can see it either way in the numbers. We have broken it out for you.

Retail capex. Again in line with the guidance of continuing to reduce our retail capex to £298 million in the first half of the year, very much in line with our guidance and expected core retail capex of £550 million for the full year, and of course that does exclude the capex in relation to Sainsbury's Bank. So no change in guidance, very much on track to deliver that number for the full financial year.

Balance sheet. We have now got facilities available to us of £4.1 billion, of which £3 billion is currently drawn down if you include the perpetual security as part of that facility. We have got significant funding capacity available to us. Of course the perpetual securities were issued in July and we used some of those funds to help fund the pension scheme. And of course the perpetual bonds rank below the pension scheme claims. So they are a particularly attractive way of funding the pension scheme.

A few more details there around the interest on the coupon on both the bond and the convertible but a blended rate of 4.69%. Just to remind you, we also restructured our revolving credit facility of £1.15 billion in May and again just as a reminder, we now have no financial covenants across any of our borrowings. So we have significant funding capacity and availability for whatever the market may throw at us and we have no financial covenants across any of our borrowing, so very flexible and liquid funding position.

Overall market value of property has fallen slightly, 10.8%, we have seen a slight increase in the yield, not by much but very small increase in the yield which has caused the property valuation to dip slightly from the previous £11.1 billion to £10.8 billion, and again we have talked about the pension deficit already. We have put in £125 million, we will put in a further £125 million in the next financial year. So £250 million in total.

And in terms of guidance, net debt is expected to reduce significantly year on year due to the increase in the perpetual securities, partly offset of course by the pension contribution and, of course, the further injections into the Bank. But just to be clear, even if you treated the perpetual securities as debt, then again treating them as debt, we still expect to see a year-on-year reduction in our net debt position in line with the guidance that we gave at our Prelims.

And again if you look at some of the key balance sheet metrics here, we have seen a small dip in our interest cover, fixed charge cover beg your pardon, driven by the reduced profitability. And again if you look at the lease adjusted net debt over EBITDAR, if you take the perpetual bonds as debt, we are at 4.3, if you take them as equity, we are at 4, but again broadly in line with where we have been historically.

So overall summary, Trading Operations, we have traded resiliently and robustly during the first half of the year. We are of course being impacted by food deflation and the pricing pressures in the market which is clearly pulling down our margins, but we have seen some strong growth in the areas of clothing, convenience and online. What is pleasing is the price investments we have been making are driving volume and transaction growth. So we have seen volume growth in the first half of about 1%, we have seen transaction growth of about 3%. So it is very encouraging early signs from that price investment, and of course we are ahead of where we expected to be in relation to our cost reductions.

Key financial measures, I won't reiterate because we have talked about those already, and again you will see some of the key summary points in relation to the Balance Sheet that we have already talked through. Retail working capital improving

and the Pharmacy sale expected to deliver £125 million of cash towards the end of the financial year.

So overall, as already been commented, we have outlined out strategy, we are delivering against that strategy and if anything we think we are slightly ahead of the game, but still a lot more to do.

And with that, I will hand over to Mike to take you through the Business Operations.

Mike Coupe
Chief Executive
Good morning. Just to point out, we will try and get through by 11 o'clock, but if we don't finish by 11 o'clock, we will observe a minute silence at 11 o'clock, so if we can just bear that in mind.

As it has already been said, we laid out our plan this time last year, can't believe it is actually a year. And broadly speaking we have delivered against that plan. We are slightly ahead of where we expected to be and actually we have got a more robust and resilient business at this point in time. So I am going to talk a little bit about the consumer, where we think customers are, and then talk a little bit more about some of the things we have done to execute our plan over the last year.

First thing to look at is household discretionary income. Our customers, customers in general are around £20 a week better off than they were this time last year, so you would think that that was good news in the round for the consumer sector and particularly for grocery retailers. But we are not actually seeing that coming through in market growth, that money is being spent in other sectors, travel would be a good example, but equally, directly affecting our market is eating out. Customers are tending to eat out more than they were previously. And we have seen the market bounce along between 0-1% in terms of growth over the last year. So that clearly has put a significant challenge into the marketplace.

And we have seen the shape of the market year-on-year change reasonably significantly. We are actually seeing volume growth and we are seeing pretty robust volume growth, but that is against the backdrop where prices continue to deflate. And so we have taken a view over the half that actually we have seen deflation of around 2%, it has got slightly better during the course of the second quarter, but nevertheless we would expect that we would see deflation in our marketplace at least into the next financial year and beyond, there is no signs of it abating. And of course it disproportionately affects our business. It is not a bit deal in the overall scheme of things, but nevertheless the categories we tend to overtrade in, meat, fish, poultry, fruit and veg, things like that have tended to be where the deflation has hit.

And if we look at the shape of the market, we talked about this last year. I think some of us would have seen us, some people would have seen us as being doom mongers in terms of our predictions for the market, but broadly speaking they have played out. If anything we are seeing discounted growth ahead of our expectations a little bit. And in the end that continues to be the key dynamic in the marketplace, and we would expect that to be the case for the future. But nevertheless we need to keep investing in the things that make us different and I will talk about that in a minute, whilst also making sure that we make sure we are price competitive as we look forward.

So around our strategy last year, five elements, knowing our customers better than anyone else, investing in great products and services at fair prices, making sure that

we are there for our customers wherever, whenever they want, served by colleagues who make a difference and our values that make us different. So those are the five key planks of our strategy, but the key driver of our differentiation is our quality. And we continue to maintain a quality gap relative to our mainstream competitors for our customers. And we set out to invest in improving the quality of 3,000 products in our business over the year. And we continue to do that. But of course quality means different things to different people, so I will give you a few examples.

For instance, our avocados, I think we talked a little bit about this during our Quarter Two Trading Statement, it is about making sure that we look at the end to end supply chain when we think about the quality of the products that we sell, whether it is the base specification, the use of technology to make sure we get that right, you know dry matter at 21%, the amount of squeezability 1-4 pounds, I mean it is very important up front to make sure we get the product right at the beginning, that we have the right packaging to get it through our supply chains, that that packaging is appealing, the labelling is appealing that we talk to our customers about the attributes that they value and about the emotional side of the products that we sell. We make sure that we can transport the product through our supply chains. And ultimately we get the right ranges in our stores. And if you take a category like avocados, we already had a significant market share, we have actually seen that market share grow by about 1% from around 23 to 24% over the last period of time since we did this work.

Another example, orange juice. Orange juice is all about the top notes or juice is all about the top notes, making sure you get the essential oils right. And again it is about going back to source, making sure the base ingredients are correct and bringing that through the supply chains in a way that works for our customers.

Equally if we look at our bread range, our customers would have said to us that there were some gaps, particularly at the high end, and so we have introduced new higher quality products and we have also reformulated some of our existing products. In fact I was talking to somebody yesterday, their favourite is sesame seed and quinoa, they did actually phonetically spell quinoa for me just to make sure I pronounced it correctly during the course of the presentation today.

The other thing about our instore bakery products is that we do bake them in our stores. So most of our large supermarkets have scratch bakeries and it is important that we make sure the freshness is there day in day out for our customers. So we have a process called weigh baking, which is making sure we bake, listen and often in our shops.

Big change in our value proposition. This is a journey we have been on over a number of years, but simplifying our pricing, reducing the amount of promotion we run in our business, our promotional content has dropped from around the mid 30s to just over 30% over the last year and we have reinvested that back into base pricing to make sure we have the right value proposition for our customers as well as changing our Nectar scheme, so we are giving away the same number of points, we are just doing it in a more targeted fashion. We have simplified brand match to be more focused as far as our customers are concerned. And we are putting fewer price changes through our business and we are seeing an improvement in our customers pricing and promotional satisfaction and as importantly we are also seeing an improvement in our volume performance and our business has been driven by volume growth and by the number of transactions we are getting through our business week in week out.

And we have seen a significant closing of the gap in lots of ways you can measure it, but relative to discounters our prices are on average around 10% lower than they were relatively speaking this time last year. So there has been a big improvement in terms of reducing the price gap relative to the discounters. But we also accept that it is the big show in town that we will have to continue to make correct, targeted price investments in certain categories as we look forward, so that is something that is very much on our agenda as we think about what we need to do to build on the base pricing we put in place over the last period of time.

And actually it has, simplifying pricing has had a significant impact on our supply chain, a positive impact, we have actually seen a significantly lowering of our waste bill over the last year. That is I guess in some respects not unexpected, but actually we have been really pleased with the progress we have made on lowering our waste costs, but actually also improving our instore availability and I will come back to this later on. We think we run the best stores in the industry, we think our quality, our service, our availability is as good as anybody else, in fact better than anyone else and we think that is measurable and we have made another step on in the past year.

Talk a little bit about non food. Clothing continues to be a knockout performance, 10% growth on top of what was a pretty impressive performance the previous year. We have worked, are launching the Tu website so we are online. Online now represents sales which are equivalent to our two best stores across the chain, so growing very rapidly. Very early days, but nevertheless we are very pleased with the launch of that. And we have launched the range of Admiral products in menswear, an area we have traditionally underperformed in, so it has given us more credibility in that particular category.

General merchandise has been slower than we have been used to and that is largely a reflection of a couple of things. Firstly, the weather was particularly unseasonal, or unseasonable over the summer. So the seasonal categories were not particularly buoyant in the year or in the first half. And secondly, particularly big ticket electrical have been under pressure. So actually some pretty good performance in the context of what has been a difficult market.

And we continue to invest space into the categories where we think there is a degree of robustness, design, relative to the online players. So for instance, home wares, housewear, kitchenware are all markets where we think for the foreseeable future, customers will be tending to come into large shops to buy their products. And also it varies where we can differentiate relative to our competition. So design products in particular and the idea of delivering the proposition of supermarket, sorry the high street style at supermarket prices sits at the heart of the idea we are trying to deliver for our customers in non food.

The Bank, as John has already referred to, has had a pretty good half. Loan sales up 18%, insurance up 11%, travel money up 49%. Still got a relatively small share of the travel market money market, something like 6 or 7% so we continue to rollout travel money bureaus into our stores. We also want to make sure our Bank is consistent with the Sainsbury's brand and proposition and therefore we are seeking to always improve our service levels for our customers and that is recognised by a number of independent surveys. Indeed ATMs represent an opportunity for us and we have added more ATMs to the estate and we dispense, would you believe, one in every eleven pounds from the link network, which is something like 70% of all the cash transactions in the UK. So a big player in the ATM market, and again a sector that represents an opportunity for us in the future.

And we are very excited about the Bank, notwithstanding John's comments on the transition. We think there is a significant opportunity within the banking sector, the financial services sector as we look forward.

Talk a little bit about space. This time last year we talked about the fact we thought we had roughly 1.5 million square feet too much, roughly 6% of our overall square footage. We are certainly not immune to some of the dynamics we see in the marketplace, but we would argue very strongly that given the shape of our estate, the relative geographic bias and the relative size of our stores, we are not as exposed to some of the trends that we see in some of our competitors. So we think we are in reasonable shape, but nevertheless we need to set about addressing some of the challenges of that excess space. You can see by our performance over the last ten years, that continual outperformance has meant that our sales densities have also been more robust than our competitive set.

So three main dynamics for us to look at. First is how do we make our food shops easier to get round, easier to get in and out of, through a combination of layouts, range and indeed the use of technology? Secondly, we have fantastic clothing and general merchandise business, how do we get that to be more accessible to our customers in more stores? And as of today around 100 of our stores actually carry the whole range of general merchandise and clothing, that clearly offers an opportunity. And thirdly, to develop strategic partnerships, whether it is through concessions or indeed through things like click and collect. So how do we utilise our space and make our superstores a more attractive place to shop in the future?

And we have a number of trials underway. We have six stores now with various variations on the theme, by no means right. You would not expect them to be right, but clearly we are learning as we are going along. We will undertake further trials during the course of next year with a view to honing down the format that we want to work with in the future, with the objective of making it as I say, simpler for our customers, more focused on our points of difference like counters, bringing a fresh bakery through to the front of our stores so that again is very much at the heart of our proposition and customers will shop in a convenient way. Trailing technology, particularly things like smart shop and different kinds of checkout formations. Rolling out clothing and non food more generally. And lastly, working with concession partners as I have already said. Timpson's, Argos, all represent opportunities for us in the future and we will continue to explore those types of partnerships as we roll forward.

Convenience still is our growth area, growth opportunity for us. Our convenience sales are up 11%, not quite as strong as they have been previously, but nevertheless pretty robust performance. And convenience in particular is subject to more deflation than perhaps our mainstream supermarkets simply because the business is more focused on fresh food. You can see around the stores in this geography that the proposition is much more fresh food focused and therefore has been more prone to some of the deflation we have seen in the marketplace.

But we have continued to open at a reasonable rate, we said one to two a week. We have opened 37 stores in the first half so that kind of rate of development, rate of growth, has continued. We can certainly see our way to around a thousand stores. We are currently at around 750 as we speak. And we are doing trials with different types of format, whether that is smaller stores, micro convenience stores that you see over the road, which you can visit directly after this if you haven't already been there. And equally structuring the format the other way looking at larger format convenience stores and lower cost convenience stores. So over time we can open up

more opportunities to rollout further above and beyond the round about a thousand sites we can see our way to over the next period of time.

This time last year we talked about making sure that our online business was about serving our customers and not just about chasing volume for the sake of chasing volume. We have been very much adapting that, adhering to that strategy over the last period of time. Actually you have seen a pretty impressive performance, with orders growing by about 14%, although overall sales have grown by 7% and that is mainly because the cost to order has fallen in the marketplace over the last period of time, not least because of the introduction of delivery paths which has the effect of depressing the overall basket size. But nevertheless a pretty robust performance and actually last week we had our record week on grocery online deliveries, 250 odd thousand orders.

We have click and collect now in 84 locations, we will get to 100 by Christmas and we would anticipate during the course of 2016 probably towards the back end that we will open our first full performance centre and that is largely because we started to cap out in terms of capacity during the course of the next year in London particularly. So that performance centre is there to serve the needs of our customers in London. We have rolled out Brand Match online and we have also introduced a bagless delivery option, interestingly around 50% of our orders are bagless which of course means that 50% of our customers are opting for their deliveries to be bagged and they are now paying carrier bag charge on the back of that.

I am not going to talk a lot about Netto this morning. We have had a few questions. Nevertheless we have opened nine stores, they are trading well. We will open another six before the end of the financial year and we are learning a lot. And at this stage that is what we want to do, we want to make sure we get the learning so that we can review the business with our partners thoroughly during the early part of the next calendar year and we will update more fully when we get to the Prelims in May. But so far so good and certainly if you look at the fresh food performance, the offer is proving to be very robust and we are very pleased with the results I would say so far.

One of the things that we want to emphasise is that we continue to run what we believe to be the best shop in the industry. So whether that is our customer service, or whether it is our ongoing availability, whether it is the cleanliness and the tidiness of our shops, our customers really appreciate this. And we just picked out one stat which happens to be the Grocer 33. We won I think it is 7 out of the last 9. And we have won that particular accolade for the last three years running. And if anything we have seen our service levels improve over the last year. So not only our customer service as I have said already as a result of the change in our pricing and promotion strategy, we are seeing demands being more smooth and therefore the availability in our shops being significantly better.

And I think any external measure would suggest that we are running the best shops in the industry, but certainly our internal measures would say that, and that is one of the reasons why our customers come and choose to shop at Sainsbury's week in, week out.

And John has already referred to the 4% pay increase. We are now at £7.36 an hour. We think it is right, certainly something we have been planning over a number of years and we will continue to invest in our colleagues. It is important that we invest in our colleagues. In the end they are the people who are facing to our customers. We want to maintain our retention levels and we also want to maintain our service levels for our customers. So we can see how we have managed to do that over the last

period of time and we have also applied it to all of our colleagues. So the Chancellor has chosen an artificial break at the age of 25, we think it is appropriate to pay all of our colleagues the same rate of pay and will continue with that policy into the future.

We talk about knowing our customers better than anyone else. We already think that we have a lot of customer knowledge and that we use that customer knowledge in a variety of ways. But actually the next stage of the programme is to have what we would call a single view of our customers where we bring together all of our data sources, not just our Nectar database. And that will enable us to anticipate and fulfil our customers' needs on a more personalised basis. So that particular programme, the first stage of it gets implemented in the early part of next year. We think that will step us on again in the way that we personalise our interactions with our customers. We also have a programme called Trolley Talk, where real customers give us real time feedback. That means that we can constantly reiterate our business on a store by store basis to do a better and better job for our customers. And we have also opened our digital lab in the last period of time downstairs. You will be able to see it, where we are now much, much more fleet of foot in our digital technology and the ability to land things in the digital world more quickly. And that manifested itself in a lot of development for instance our online proposition.

The final part to talk about is our values making a difference. And at the end of the day, Sainsbury's is a business with a heart, it is a business that sets out to do the right thing and we have got a myriad of initiatives in this space. So as an example we are talking today about waste less save more. This is a programme that is aimed at our packing, the waste challenge that we have as an industry. But on a holistic basis, for many, many individual initiatives. We are offering £10 million over the next five years starting with a million pounds working with a single town. We have actually had close to 200 applications. And we will be choosing a town to work with over the next period of time, looking at how we can use all of our expertise and experience to work with that town to lower food waste both for customers within our shops and of course increase and improve recycling content.

We have removed a lot of sugar from products, so talked about orange juice where we have reduced the sugar content by about 10%. Similarly on yoghurts we have reduced the sugar content by 37 tons. There is a big issue. We have had a big challenge over the summer on the price that is paid for milk. We pay on the basis of the cost of production, which means our dairy farmers, the 300 people that supply us are to some extent insulated from what happens in the marketplace. And we think that is right in terms of building long-term relationships with those farmers. And that is just one example of how we work with our farmers to make sure we do the right things not just for them, but for our customers.

Every single store, every single department in our store centre, supports the local charity and again we make significant donations on a local level and indeed the proceeds from the carrier bag tax has been given back to our stores to be able to donate to local charities on an individual basis, which again we think is a good use of the market. And we continue to work on our diversity, our gender and ethnic diversity. Another example, we have been involved in the Business in the Community Race to Work survey in the last period of time, so we can work out better ways of encouraging ethnic diversity in our organisation.

So in summary, the market remains challenging and we expect that challenge to continue for the foreseeable future, it doesn't feel like any of the pressure is going to be relieved that we have seen over the last year as we look forward. However we are actually ahead of where we expected to be and we continue to seek to differentiate

on the basis of quality, service, availability, underpinned by the values of the organisation. We have invested £150 million in price over the last year and you have seen how the price gap relative to the discounters has come down, but we think there is more to be done. We are not going to do it in a blanket fashion, we want it to be targeted, we want to the thoughtful about the categories and the products we invest that money. But so far so good. We have made good progress against our strategy and we certainly have a more robust and resilient business than we had this time last year.

So that is it from me. We will now take questions. Thank you.

Q&A Session

Question 1

Bruno Monteyne, Sanford Bernstein
Bruno Monteyne, Bernstein. You are generating a lot of free cash in the food retail business, very high levels, even excluding the working capital improvements. You are not going to keep investing in the Bank forever, what should shareholders expect you to do with the excess cash generations over the year to two years out when you have gone through the bank investments? Where are we going to go?

Mike Coupe
I will let John answer that one.

Answer: John Rogers
I don't want to get too far ahead of ourselves. We are very encouraged by the cash generation capabilities and clearly given that we have significantly reduced the capex requirements in the business, without throwing off more cash. But it still remains a challenging market. Mike talked about we are much more resilient and robust than we were this time twelve months ago, but there is still uncertainty out there, so I would not be promising anything at this stage. But if you look at the maths of our corporate plan going forwards and if you look at the impact of that cash flow coming off the business and the other capital requirements we have said that we do expect for our net debt position to come down. And we would maintain that guidance today. The extent to which it comes down at this stage I think it would be dangerous to comment on.

Question 2

John Kershaw, Exane BNP Paribas
John Kershaw, Exane BNP Paribas. I suppose coming to the flip side of Bruno's question is, the price gap to the discounters, yours is 20% or so you may measure it slightly differently, but how much closer do you think you need to get, more importantly what do customers tell you, you need to do as an industry of supermarkets and you specifically, to get closer?

Answer: Mike Coupe
I would characterise it as a journey that we are on. I am not sure anybody could give you a definitive answer to the question. You can look at other markets, you could speculate that a price gap of 5-10% is the space you need to get into. But we also

think it is very much product and category specifics. So I don't think it is something that is a blanket price across the board because there are many categories where our basics lines are cheaper than the discount equivalent. So there are many categories where we think we are already ahead of the game, but equally we would accept there are some categories where we might need some more targeted investment over time. But if you look at the kind of area where you start to see a slowdown in discounter growth, but also perhaps a limit on their capacity to invest which is probably at least as important over the medium to long-term, you would need to be in a space somewhere around 5-10%.

Further question
I suppose just following on from that probably at least 100 basis points off the margins absent further cost savings if you assume let's say 20% overlap of the range. You have got your cost saving programme, but how do you retain those great availability levels, how close to the bone are you? Because yes your store standards are great, but you can't keep cutting costs willy nilly.

Answer: Mike Coupe
And that is the challenge. I would not shy away from the underlying premise of the question. However we have to continue to move forward on all fronts, so we have to be able to do all of the things above. And one of those things is to make sure we have an efficiency programme which maintains and improves our overall store standards. We have done a truly remarkable job over the last year, we are very pleased with the progress we have made. And there are any number of productivity initiatives which are about to take labour out of our stores more generally and still being able to maintain the right level of service and the right level of product availability. A simple example would be things like date embedded barcodes which would give us a significant cost saving if we were to roll that programme out. And also actually improvement in availability and customer service.

So there are significant numbers of initiatives that we would aim to land over the next period of time that would, if anything, at least maintain, if not in some cases enhance our overall store standards. But it is a balancing act, in the end it is all about taking ourselves on a sensible, structured journey which I think you can see we have done over many, many years and will continue to do so. So I don't think we can definitively answer the question and I suspect over time we probably will never get to the complete answer, but it is about balancing our store standards, our availability, our quality and our underlying pricing. But the most important thing for us is to start at that end of the spectrum, start with standards, availability, quality.

Further answer: John Rogers
I think it is also worth highlighting that there have been other win wins, so for example in reducing our promotional participation in our stores which we have taken down from the mid 30s, where most of the industry by the way still is today, down to just above 30%, the clear benefit of that from a customer perspective in offering customers regular low prices, and we have seen that in our price perception data, improving over the last year or so. But from an operational perspective it has greatly simplified our business. And that simplification has allowed us to take costs out. So we have identified a number of win, wins across the business where we have not only been able to take costs out, but also been able to improve the service standards in our stores. And we continue to look for those opportunities going forward.

<u>Question 3</u>

David McCarthy, HSBC

Hi, its Dave McCarthy from HSBC. Just sticking with the discounters first of all. You have narrowed the gap, the consumer is better off and yet the discounter growth is accelerating which can't be explained I don't think by just opening new stores. We know from looking at Neilson stats that something like 45% of consumers are going into a superstore each quarter and then doing their shopping in a discounter as well. So if there is something else you are missing at industry level, I don't just mean Sainsbury's, on what is really going on here, because price gaps and all that stuff means that the discounter growth should be slowing unless there is an area we have not looked at?

And then secondly, on the internet you have increased your sales and increased at a faster rate your order numbers, so you average order size is coming down. The average charge per order that you make is coming down which is via your path, so if you profitability or loss per order getting worse, just taking that without talking about loyalty amongst customers and so on, but just on a straight internet basis?

Answer: Mike Coupe
Shall I do the first one and let John do the second one, given the more challenge of the two. You are right. In the end if you look at the dynamic last year we described you would argue, I would argue that the discounters have done a little better than we were expecting and in the end we have to make sure that we maintain and improve our quality and service gap relative to the discounters, whilst continuing to go on the journey of reducing the price difference specifically on particular products in specific categories and do that in a way that is manageable within the overall P&L that we run. Of that there is no doubt. They are laying down lots of space, a lot of their space is used so they are going through the maturity curve and they accelerated their programmes a few years ago so they are benefiting from that. But in the end we need to make sure we make progress on all fronts. You can't get away from that. And that is the challenge for us as a business. We would argue very strongly and you can see this in the most recent data, broadly speaking we are maintaining our market share, actually over the last year we have lost about I think it is about 0.17, but that has been flatter in the most recent numbers, if not slightly ahead. So we would argue that we are doing a better job than some of the others, but equally we need to continue to do a great job for our customers.

Further answer: John Rogers
Just to build on what Mike has just said, you have highlighted the dynamic that is happening in the market which is customers are choosing to split their shop in essence both shop at the supermarket and shop at the discounters. Now you are right to say that supermarket sector overall has made inroads into reducing pricing differential, but depending on the way you measure that pricing differential today, it is the order of 15 to 20%. And in my view that differential is still too high to be able to convince customers and switch their behaviour from splitting their shop to doing their shop under the one facia. And this is where we come to the sort of prevailing view, hypothesis that remains to be tested, although it has been tested in perhaps other markets, there is an argument that says once you get the differential down to more broadly that 5 – 10% level, albeit it might be category specific, then the differential at that point is not large enough to convince shoppers it is worth their while to split their shop. I don't think you need to address it in its entirety, but I would say that whilst significant progress has been made, it is still too large to convince the vast majority of shoppers to not split their shop. We are still seeing that dynamic.

Further question
I get that, what we are talking about here is the numbers who are choosing to cross shop is actually increasing even though the price gap has narrowed. So I take your

point entirely that as it narrows you are not necessarily going to win people back, but as it has narrowed more have done it. So I am trying to work out the dynamic?

Answer: John Rogers
More have done it as a consequence of the impact of new space and we can't ignore that on the overall numbers. But I think we would still maintain the view that you need to get to a point where you remove price as a point of competitive advantage. Now we believe discounter facing perspective, and as I said it may vary by category, that needs to be in that 5-10% level. A the same time it is obviously facing into the pricing challenge and as a business we need to make sure we are focusing on all the other good things that make us a very differentiated offer. The quality, the service levels, that we are making great progress on. So we have already gone on this journey of reducing the differential on price, you are absolutely right, it has not had a massive impact today on the market dynamics, but there is an argument that you will get to a tipping point once that differential is reduced, a right level across the right categories. That is what we are making reference to today in the pricing.

Answer: Mike Coupe
There is just one other reflection David, we are trialling different formats because the other big dynamic is that customers perceive discount stores to be more convenient. Clearly we have got our convenience business which is growing pretty well and has grown over the last few years and that plays very much into the dynamic. And our challenge is to make our superstores more convenient in a broader sense, whether that is for convenient food shopping, which is why we are working on the layouts we are working on, as well as putting more things into the formats that allow more reasons for customers to come to shop with us. Now that is not a quick fix. So if we work out a formula in the next year, that will be going some. And clearly it will take us some time to rollout those ideas. But that is the other big dynamic in the marketplace. Customers just see smaller shops of which discounters are a part at more convenient places to shop.

Further answer: John Rogers
And just in relation to your question on online profitability, you are right, you know all things being equal, we are seeing precedent profitability driven by the lower delivery charges, driven by the lower basket size. And of course the reality all else being equal, we are continuing to make significant inroads into the costs of our online operation and actually overall when you look at the profitability of our online business year-on-year, we have actually improve the profitability as a function of taking costs out of those processes. The other point that we always make around online as a channel is that it is not really sensible to split it out in that sense because it is part of our overall customer offer. We have said this many times that our customers demand that offer from us. And we also see that when customers switch from shopping instore to shopping with us online, we end up capturing an overall greater percentage of their spend. So there is a loyalty dynamic as well. So looking at channel by channel and in isolation, it is sort of helpful from a management accounting perspective but you do need to step back and look at the overall business.

<u>Question 4</u>

James Collins, Stifel
Morning, James Collins from Stifel. So just following on online first. Do you think that same day will become common place and do you think that is an irresistible force given that Tesco are trialling it now alongside the Amazon threat?

Second question on a slightly different subject. You are talking about volume growth at 3%, does that include a mixed benefit? So when you break down inflation and volume, do you include mix within that 3% volume? And if so, how much of the 3% is mix and how much is unit volume?

And then a wider question, industry wise, clearly the chart you showed, shows significant volume growth and significant deflation, once deflation if you like normalises and we get back to flat or inflation, do you think the volume growth will continue or do you think that is a straight trade and the industry continues to produce no growth?

Answer: Mike Coupe
I will have a go at the first and third and John can comment on the second. Yeah I think it is the next stage of the online journey and we talk about serving our customers whenever and wherever they want. And you can see in most online markets now there is a step towards even faster deliveries. And you can see that in Amazon Prime for example, the Argos announcement the other week in terms of 4 hour deliver slots and clearly Amazon have raised the stakes within the food market by putting in effectively a one hour deliver time, albeit you have to pay quite a lot of money for it and can only order 50 products, but I suspect that won't stay that way for very long. So it is inevitable that it will move in that direction. Whether or not there is the customer demand for it, we will see over time because particularly in food, it might be less attractive because in the end it has to be a more planned occasion than perhaps one hour or four hour or same day deliveries in non food. But we will see over time, but I suspect it is inevitable that it will move in that direction.

As far as the industry-wide norms, if you go back and look at history over 15 years, broadly speaking the volumes in the market are growing in line with population and the population of the UK is growing by about three-quarters of a percent. And broadly speaking, inflation sits around 2-3% level, albeit it swings around all over the place. We have never seen a period of extended deflation in my 30 years in the industry so we are in very uncharted territory at the moment. But if you were looking at the historical norms those were the kind of places you would expect the market to get to over the next period of time. But that is by no means certain, that is a reference back to the last 25 years and as we look forward, who knows, there is certainly no sign that the deflationary pressures are abating as we look towards the end of our financial year and into the next financial year. Whether or not as we see inflation coming through, we might see a reduction in volume, I genuinely don't know, but we would expect if you took a medium to long-term view that that three-quarter of a percent volume, overlaid by 2-3% inflation ought to be a place we return to at some point in the future.

Answer: John Rogers
And James just to break it down and help a little bit in terms of volume growth by food and non food, just to be clear, I think you said volume growth 3%, what we said was transaction growth of 3%. Volume growth of 1%. And actually we are seeing volume growth at 1% across our food categories and broadly speaking deflation in the half of about 2% minus, depending on deflation 2%. When you look at the non food side, again we see volume growth of around 1%, but we have actually seen some inflation on the non food side of around 2% and of course that is very much mix driven, so that gives you two components of two channels, but combined for the overall business.

Further question

Okay, so the question is more about mix. So alongside unit volume are you including the impact of mix. Are you trading up, trading down as in the deflation number or within the volume number?

Answer: John Rogers
So mix in that context would be, it is all wrapped up in deflation.

Further answer:
Okay, so if you look at the shape of the business, our business, we tend to overtrade in fresh food categories and that has tended to be where inflation if the highest, and also interestingly the other way round where the volume growth tends to be the greatest as well, so there is a dynamic that is going on in our business which is changing the shape of our business a bit. It does make some or does have some impact on the headline numbers, but not a huge amount. The mix is relatively unimportant in the whole scheme of things.

James Collins
Okay, thank you.

<u>Question 5</u>

James Tracey, Redburn
Morning, James Tracey from Redburn. Three questions from me. First one from John, the depreciation and amortisation charge, why did it fall £10 million year-on-year?

Second question is on the price investments. Do you think that £30 million of price investments in the second half is sufficient given that the discounter gains are accelerating and you need to do more on the price gap?

And just on that second question, are you expecting Asda or anybody else in the market to cut prices significantly, is that baked into that £30 million guidance?

And the final question is, do you feel at a competitive disadvantage in online because your business utilises the store pick model versus the central distribution model which some people say is more efficient? Thank you.

Answer: Mike Coupe
Well if we take them in reverse order and then John can come back and think about amortisation and depreciation question as we go through. Actually the stats are remarkably close when we have looked at in terms of pick efficiencies, it is quite surprising and as John has already said, we continue to invest money in making sure that our pick and van utilisation efficiencies continue to improve. So we would argue that we run a pretty efficient online business relative to specialist picking operations.

Further question
Do you have lower delivery costs as well because you are closer to the customer?

Answer : Mike Coupe
Well I won't tell you what our average delivery cost is, but I guess in the end our drop densities are pretty high, we tend to be more biased towards London which inevitably means your drop densities are higher, I don't have the stats off the top of my head, we would probably have to go and have a look at it, but probably on balance you are right. But the most important factor is the pick efficiencies that some people would claim for a specialist warehouse are nowhere near as differentiated as cheap relative

to store picking as some people would make out, which is quite a significant consideration. Of course the other thing about picking in store is it is a hedge against the overall dynamics of the business, and it does mean that we run better shops as a result because you are getting a lot of volume coming through and you are then subsequently using your online operation.

Further answer: John Rogers
Because there is a strong commercial point, I would actually argue that our instore pick operations are a commercial advantage because the dynamic of the market is very much towards click and collect, we are seeing that increasing behaviour from customers, particularly if you take for example our clothing online business, a very high percentage of those orders, 80% are click and collect, it is the preferred choice of customers. And obviously an instore pick model plays itself very well into a click and a model where customers like to click and collect. So I think for us I see it as potentially a commercial advantage above and beyond those operators that decide to have dedicated picking centres.

Answer: Mike Coupe
It will be ironic if you get specialist online retailers having to deliver to a click and collect point, that has a sense of irony around it. You would have to ask Asda or indeed anybody else in the marketplace what they are going to be doing on price. I haven't got a clue. It is fair to say a big step down in pricing last year, you saw the gap close quite significantly and broadly speaking the gap between the big four players have narrowed to probably the narrowest it has been in my time in this industry. But coming back to the central point that we made already and that you are alluding to, we think there is more work to be done. It needs to be targeted for and we need to understand the cause and effect as we go through the next stage of our overall pricing strategy. So we are not going to see blanket wholesale £150 million investments like we made last year, but equally we would expect in some categories or some products we need to invest more money over time and we need to think quite thoughtfully about how we recover that elsewhere in our P&L. But there is no doubt the point we have already made that there will need to be movement towards closing the gap down relative to the discounters over the next period of time.

Further answer: John Rogers
Just to your first point on depreciation, it tends to be lower half on half because of course we are benefiting from the impairments of loan depreciation of the impairment charge that we took a year or so ago. We saw a £10 million benefit in the second half of last financial year, we are seeing a £10 million or so benefit in the first half of this financial year. We won't see that benefit repeat itself in the second half of this financial year.

James Tracey
Thanks a lot.

<u>Question 6</u>

Nick Coulter, Citi
Good morning, Nick Coulter from Citi. One for John please. And apologies I may have missed it if it was at the start of your presentation. But on cost savings, you are well ahead of the run rate for the three year target of £500 million, at what point have you said that you will review that or do you anticipate reviewing that target? Or should we expect that the cost saves will start to taper down?

Answer: John Rogers

I think it is under continual review. Clearly we are pleased with the performance to date and that is why we have announced the uptick to this year's number of £225 million of savings. We have got very good line of sights of savings now into the next financial year and we have even got pretty good line of sight into the third year as well. So as time moves forward, we have got more and more certainty on that £500 million number, pretty good certainty already and we continue to review it. So we are not today upgrading that number, but it is under constant review.

Further question
So we shouldn't necessarily expect that run rate of £200 plus to decelerate?

Answer: John Rogers
Well at the moment, to be absolutely clear with what we are saying, is we expect to deliver £500 million over three years. And this financial year we expect to deliver £225, so by definition the mass, the rate decelerates over years two and three and that is no different to what we announced at the very beginning, which was £200 and effectively £150 and then £150 over the following two years. So you would expect the rate to decelerate, but it is something that we are constantly looking at. We are becoming increasingly confident of our ability to deliver those savings over time, so it is something we are looking at all the time and if we need to update in due course we will do so.

Nick Coulter
Thank you.

<u>Question 7</u>

James Grzinic, Jefferies
It's James Grzinic from Jefferies, I have two. The first one is can you perhaps give us more detail on how we lower the promotional participation? Is it about fewer vouchers, is it about less instore activity? Is there a skew between own label and brand? And are you getting suppliers to translate reduced investment into promotional support into lower terms? I would be interested to hear about that.

And secondly, can you perhaps illustrate how your regional performance has changed through time? I am just wondering whether the south is particular accelerating against the rest of the country being left behind?

Answer: Mike Coupe
I will let John think about the second question. On promotional participation, we started around three years ago on a value simplicity programme. That started with the basic premise that we needed to simplify the way we presented value to our customers. Less promotions, less heavyweight promotions. They were cynical about half price and buy one get one free and we were seeing some categories where the promotional participation was over 90%, in which case customers were just ignoring the non promoted price and only ever buying on deal and we thought that was wrong and needed to be addressed. And to some extent that was a manifestation of suppliers behaviour and particularly keeping promotional monies on their side of the table. So we started experimenting with laying out proper category pricing hierarchies. So making sure the basics line was here, the standalone label was here, the brand was here and if there was a premium brand, it was a little bit more premium and our Taste the Difference ranges were here. So we got some fairly clear rules, but equally as we go through each category we discover different things. And rules don't necessarily apply to all categories.

The underlying premise of your question, yes we also have been very successful in taking in effect monies from promotional funding and putting it into underlying base prices. So our suppliers have largely come on the journey with us, some more positively than others. But in the end they have to trust us. So we are not going to go back and ask for more promotional monies once we have got the base monies or the other promotional monies in base price. But that is something we are working on and working on pretty successfully over the last three or four years and it has certainly taken Paul and I in my previous role going around literally talking to the senior management in Europe of a lot of these companies to persuade them it is the right thing to do. We are about 90% through now actually so we have made a lot of progress and it is not without risk, it is quite a significant change. The encouraging thing is we are seeing baseline volumes grow. We are seeing transactions growing and as importantly the categories where we did it first which tended to be the non food categories are the ones that have grown the fastest in our business overall on a sustained basis. So there are some, I always say that customers behave collectively utterly rationally. They behave completely irrationally individually, but collectively they behave rationally and we have seen that in our underlying price promotional strategy.

Further answer: John Roger
And James just in reply to your question on regionality, we actually look at regionality quite closely both across our supermarket business and our convenience business. And whilst you may see month by month fluctuations in performance across the different regions, in principle we find that much more driven by the timing of new space and the maturation of sales across our estate. When you look over the year more broadly, we don't see or we haven't yet seen any big regional differences. And that is, I know the question often gets asked and we continue to look at it and the answer so far has always been the same, there is not a massive variation either across our convenience business or our supermarket business region by region.

Further question
Thank you John. Since I have you can I have a follow-up quickly. Has the bonus accrual gone up year on year in Half One, I presume so?

Answer: John Rogers
We are half way through the year, still got Christmas to trade. We will comment more on our bonus payment when we come to our Prelims in May.

James Grzinic
Great, thank you.

<u>Question 8</u>

Andrew Borchers, HSBC
Hi, it's Andrew Borchers, HSBC. You have signalled a step up in cost inflation in the second half driven by staff costs. I was just thinking that will take some time to annualise in the first half of next year presumably? And then looking forward you have given the 2-3% cost inflation range for a few years now, should we expect to see a structural step up in that range as you seek to maintain things like differentials and staff share etc?

Answer: John Rogers
I don't know, I think it would be too dangerous to comment much beyond this financial year, but I don't see any reason why that 2-3% range should change. You are absolutely right, we will see a £13 million additional half on half charge as a result of the step up in our salary cost of 4% so we will see that come through in the second

half of this financial year and clearly you are annualising the first half of the next financial year so you will need to put that into the model to reflect that increase. But actually if anything, taking outside of that particular increase, the cost inflation in the first half has been perhaps slightly below the 2%, so if anything cost inflation has been a little bit below the 2% if you weren't to adjust for the increase in the salary cost. If you put that increase in it gets you to over the 2%. I don't see any reason at this stage why this should particularly change going forwards. It will clearly provide you with more detailed guidance when it comes to our Prelims in May.

Further question
Should we expect you at the higher end of it, to trade up within it then?

Answer: John Rogers
No I wouldn't even say that, I think let's just see where we get to. There is a number of inflationary pressures coming through, we comment a lot about business rates. Clearly salaries are one of those, but equally there are also deflationary pressures as well. For example if you look at utility charges coming through. Because we hedge our utility charges a year or so forward, we are not yet seeing the benefit of lower utility costs particularly coming through. We will see some of those benefits next year. So we will give you more detailed guidance at the time, but there is always going to be some pluses and negatives. I don't see any reason at this stage to be changing that 2% range, but we will provide you with the detail at the time.

Andrew
Thanks a lot.

Question 9

Rob Joyce, Goldman Sachs
Rob Joyce, Goldman Sachs. So on price, just to be clear. So you said you were looking to halve the gap or change the gap by the same magnitude again with the discounters. Does this mean we should look at another £150 million of price investment next year?

And probably quite linked, on deflation and the outlook. Previously you mentioned you saw inflation coming back towards the end of this financial year. What sort of change on that one? Thanks.

Answer: Mike Coupe
Yeah, I don't think we quite put it the way you put it. We recognise there is a price gap that still need to be closed. As we have done over many, many years, we iterate these things, we use our data to learn where it works, where it doesn't work. If you look at other countries, the observation, then the price gap needs to be around 5-10% in order to today's point, stem the flow to the discounters from mainstream supermarkets. So that is the order of magnitude if you look at other countries. Now we don't know if the UK is like that or not, but we would recognise there are particular categories and particular products within those categories where we have to make price investments and we will do that in a thoughtful and measured way. And we will do it in a way we think is affordable as well. So in the mix we will see how it plays out over time. We have yet to embark on that stage of the journey but we will do it in a way which is understanding, experimenting and ultimately implementing how we address that gap over time. So it would be wrong to infer that there is a £150 million dump coming out. And equally there are some mixed benefits. You should not lose sight of the fact that we have a portfolio of 100% of the products we sell, only about

20% of our volume directly faces into the discounters. So there are some mix elements that we can bring into play over time as well.

And inflation, to some extent your guess is as good as mine. The big dynamics of commodity price falls, exchange rates falls, combined with the Chinese and the Russians closing their borders to exports, are the big drivers and the extent to which those revert over the next period of time. I would probably be sitting on an island somewhere in the Caribbean if I could work it out, so there is still. It is yet to work its way through the system. The one thing I think we are pretty confident is we are not going to see much of a change to the dynamics we have described through the back end of this financial year and into the next financial year.

Further question
So I guess my question is, I think, correct me if I am wrong, but you previously mentioned you thought that inflation would start to come back over that same time period. Is there anything in the market itself that is directing that change in opinion?

Answer: Mike Coupe
No it is more to do with, this year. On balance you would always expect there to be some pressure on harvests. This year looks like it has been another good year. And again on balance you might have expected exchange rate movements, but again the movements have tended to be favourable for imports. On balance you might have expected the Russians or the Chinese to open their borders and therefore products to flow out of Western Europe and again that has not happened. So all of those things you could have speculated about 3,6 9 months ago, but as of yet none of them have happened and those deflationary pressures remain. And we compete very hard as do our competitors and generally speaking customers benefit from that.

Rob Joyce
Thanks a lot.

Mike Coupe
I think we are through. I am just conscious of time. No other questions in the room. Well thank you very much for being here this morning and thank you very much for listening and I would encourage everybody to respect the one minute silence when we get there. Thank you.

End