

J Sainsbury – Fourth Quarter Trading Statement
Thursday 16th March 2017 – 8.45am

Mike Coupe
Chief Executive

Good morning everyone and welcome to the Quarter 4 Sainsbury's Trading update call. I am joined by Kevin O'Byrne, our new CFO. I am going to ask Kevin to walk through the Quarter 4 highlights and then we will hand over to you all for the Q&A. Kevin.

Kevin O'Byrne
Chief Financial Officer

Thanks Mike, good morning everyone. I am delighted to be here and look forward to meeting you all at our Preliminary Results in May. I will now take you through the key numbers for Sainsbury's and Argos in turn.

Turning first to Sainsbury's, we saw a headline like-for-like sales decline of 0.5% over the Quarter, but after adjusting for Mother's Day and the build up to Easter, both of which will be three weeks later this year, we estimate that our like-for-like growth would have been in line with Q3 at about +0.1%. These timing differences have impacted general merchandise sales in particular, so while we delivered good growth in clothing of +5% against a tough comparative, non-food overall diluted our headline growth rate.

In clothing we were up against a tough comparative as I said in Quarter 4 last year, and our two year growth was consistent with Quarter 3 at an impressive 15%.

Against this, food performance is broadly unchanged quarter on quarter with Convenience and Online continuing to perform well, both growing at 7%.

Consistent with market data you will have seen we moved from food deflation to inflation over the period and we are confident that we can continue to deal well with the cost price pressures in the market whilst remaining competitive.

Turning to Argos, where we have seen another good performance with customers responding well to improvements we have made to the Argos website and app, and good growth from technology products. We now have 41 Argos stores in Sainsbury's and we continue to be very pleased with their performance.

So overall, a solid performance and we are comfortable with the consensus profit expectations for the full year.

And we will now open it up to questions.

Question and Answer Session

Question 1

Mike Coupe
Morning Andrew.

Andrew Gwynn, Exane
Morning, how are we all doing?

Mike Coupe

Very well thank you.

Andrew Gwynn

Well two questions for you first. First one would be on profit. I see on the wires you are sort of broadly happy with where consensus is, around about 578 of PBT. I think at the Half Year stage Edouard kindly did the maths for us, but the margin implicit was down about 40 basis points, but since then it would seem to be that Argos has probably traded ahead of expectations. So is the core food retail margin maybe a little bit worse than that sort of maths that Edouard did for us all?

And just on the second question, just on Argos actually. I mean could you elaborate a little bit more on why trading is quite so good there and, really very early stages I know, but a little bit more detail on the integration process? Thank you.

Answer: Mike Coupe

Yeah, I mean the first comment to make is that the revised consensus move from 573 to 578, maybe if Kevin could give a bit more colour on it. So the consensus has reflected some change in performance, but maybe Kevin can?

Answer: Kevin O'Byrne

Yeah I mean Andrew the underlying margin in the figures, we are happy with it, there is no material change there. Consensus has ticked up a little bit and we are happy with that and the range that we guided for Argos we are happy with.

Further answer: Mike Coupe

As far as the Argos performance is concerned, you know we never subscribed to the idea that the business was not competitive and we are pleased with what we are seeing, actually a slight improvement in underlying sales in the Quarter and actually an outperformance to market by a couple of percent. So it shows the business is in good shape. As far as the concession rollouts are concerned, we're now up to 41, if you look at the 10 that have annualised, we are seeing continuation of the sort of 25% or so like-for-like so that gives us some confidence that it is a sustainable performance. In this Quarter it will be around 25, we are going as fast as we possibly can and we have already talked to you about the fact that we are committed to moving around about 250 Argos stores into Sainsbury's stores, whether they are relocations or new white spaces. So six months in, so far so good. We are in line with, if not slightly ahead of, where we expected to be so we are very pleased with where we are.

Further question

I suppose to just summarise on the food retail business. You know you set out fairly cautious expectations for the first half. Those have largely played out. Is that a fair summary?

Answer: Mike Coupe

Well as in the first half coming up or the first half last year?

Andrew Gwynne

At the first half of this year you set out this fairly cautious guidance for H2 of the year that has just finished, down 40 basis points. That has broadly been the case, is that?

Answer: Mike Coupe

Yes I think broadly speaking we performed in line with where we would have expected to be in what was an incredibly uncertain and challenging marketplace. So we are very pleased that we have managed the business in the way that we have managed the business. It gives

us a lot of confidence in terms of our future prospects. We are doing the right things. We are investing in the right areas of the business as we said numerous times before. As I say, reflect on the fact that the last 9 months has been probably one of the most challenging environments we have seen for a very long period of time. So in that sense we set I think the right expectations, but also delivered against those expectations.

Andrew Gwynne

Okay, perfect. I will let you move onto questions around inflation, I am sure we will get plenty.

Mike Coupe

Thank you for that!

Question 2

Niamh McSherry, Deutsche Bank

Hi, I just had one question actually. Can you tell us how many relocation Argos stores are now in place? At the Interims you said you would have two by Christmas. And I was just wondering if you could give us a bit of an update as to the situation now and also any plan that you have?

Answer: Mike Coupe

So far we have relocated three. So again there is nothing in the numbers which would undermine any of the case that we have already put to you. We are pleased with the performance. We haven't specifically split out the 250 simply because it is important for us that we talk to our colleagues in stores before we talk to the outside world. So we haven't broken down the ratio of that 250 to relocations compared with white spaces. But again I will reinforce what I have already said, we will go as quickly as we possibly can. We are 41 down and counting, which is pretty good going. We think we are going to get to at least another 25 in the next Quarter and we will update you more fully when we get to the Prelims with a bit more colour around the plans because we will have a few more months of experience by then.

Niamh McSherry

Okay, thanks.

Question 3

Rob Joyce, Goldman Sachs

Morning guys. A couple from me. Firstly just on the grocery volumes in store. We have got sort of Kantar inflation which suggests maybe volumes falling in grocery around sort of 1-2% in the stores. Why do you think that the volumes have fallen so quickly in the face of what is still pretty low inflation in the market? And how do you think about offsetting this in the months to come as inflation pressures rise?

And the second one was just on Argos and the general non food market actually. Can you give us a feel for the levels of price inflation you are seeing in the non food market as a whole and how volumes have responded to where you have seen inflation come through? Thanks very much.

Answer: Mike Coupe

Yeah, this is a short period of time so it is only 9 weeks and it is very heavily distorted or distorted by the effect of Easter and Mother's Day so we have to be slightly careful to read too much into the numbers. And of course for the first time in quite a while we have seen a negative impact of our general merchandise business because of the timing of Easter and

Mother's Day. So broadly speaking, the underlying food volumes are in line with the previous couple of quarters. So I am not sure there is a lot of news in that. And of course I point at all the things that we do in our business to offset any challenges in the marketplace. We have to be price competitive and we continue to believe we are price competitive. All of the market data would suggest there is inflation in the market overall, but also in our competitive set. We must invest in the quality of the products and services that we offer. We continue, we believe, to run the best shops. And I think that is borne out by a large amount of market data and we continue to invest in the growth areas, whether that is online, Convenience or our general merchandise and clothing business.

As far as inflation in non-food is concerned, well headline 4.3 like-for-like, we had volume growth in Argos, we outperformed the market by a couple of percent. So you can have a go at back solving the arithmetic, but you can draw your own conclusions in terms of the level of inflation in the Argos business. It is positive, albeit against a backdrop of positive volume growth.

Further question

And when we look forward, do you see that inflation meaningfully having to step up? I think Argos previously said hedges were 12 month rolling?

Answer: Mike Coupe

Yeah I mean we live in uncertain times and you know it is very, very difficult. And I know it sounds a slightly glib answer, it is very, very difficult to predict what is going happen going forward. If you think about the last nine months we have been through an unprecedented series of challenges and I think it is testament to the competition in the marketplace and also the great job that we have done in terms of mitigating cost price pressures and the impact on our customers that we haven't seen inflation coming through at anything like the levels that were predicted at the time of Brexit. So it is important for us to remain competitive, but equally if you take fuel as a very obvious example, it went up on the back of the Brexit vote because of exchange rate differences. And then we have seen more recently the price of oil fall and you have seen this week that people are announcing that there are price cuts coming through. So there is a lot of volatility out there, very difficult to predict what is going to be happening in the future.

Rob Joyce

Okay, thanks a lot.

Question 4

Edouard Aubin, Morgan Stanley

Hi guys. Sorry just Mike sorry to come back on inflation, but I think last Quarter you mentioned that deflation, your basket deflation was around 0.5% and 1% at the Quarter before that. So what numbers should we be thinking about for Q4, is it anywhere between 0 and 1%, would that make sense as an estimate?

Answer: Mike Coupe

Well we would acknowledge that we have gone from, as we entered the Quarter, deflation. As we exit the Quarter, inflation. The numbers are distorted by the timing of Easter and Mother's Day and it is a very short Quarter. So we are not picking out a specific number. I would just point you at the market data that is already out there, whether it is Nielsen, Kantar or ONS, all of which paint a similar picture, would describe the kind of levels of inflation in the marketplace and also the fact that it is being experienced in all of the major grocers. So I think that is just generally the rising tide that you are beginning to see.

Further Question

Right, but because if you extrapolate the Kantar implies inflation just for the month of February, I think that implied around 2%, above 2% inflation, is that the number you think makes sense or that would be overestimating inflation in February?

Answer: Mike Coupe

I won't get drawn on specific number. Directionally, as I said, we have seen the line of travel from negative from deflationary to being inflationary. I am not going to comment specifically on the numbers, just to acknowledge the fact that I think you see market data out there, Kantar, Nielsen, ONS say slightly different things, but broadly speaking, point in the same direction.

Edouard Aubin

Okay, thank you.

Question 5

Nick Coulter, Citi

Hi, good morning. Two from me if I may. Firstly, given the complications of mix in quite a short period, could you or would you confirm that the like-for-like grocery volume trends are a small negative and then kind of update on your initiatives to drive a better trajectory?

And then secondly on Argos, could you elaborate on your Retail Week Conference comments, I think you said, synergies are coming through faster, but it would be interesting to hear you reiterate or discuss your comments there. Thank you.

Answer: Mike Coupe

Yeah, I will say what I said earlier, that broadly speaking the food volumes are in the same position they were in the last two quarters so slightly negative. We continue to do what we believe to be the right things to mitigate that. Our job is to do a better job for our customers, improve the quality of the products that we sell, invest in the channels for growth like Convenience which grew by 7 and Online which also grew by 7. I didn't actually say what was quoted. What I said was first of all that we are confident that we can deliver the Argos synergies, I am just repeating what I said numerous times before. And if we could, we would accelerate them and do it faster, but I did not actually say we would. So have to be slightly careful with what I say, but we are confident we will deliver the Argos synergies and I think if you go back to the transcript, what was reported is not what I actually said.

Nick Coulter

We'll re-watch, thank you.

Mike Coupe

We will talk, this is a Trading Update, it is a very short period of time. We will clearly give you more colour when we get to the Prelims in 7 or 8 weeks' time.

Further answer: Kevin O'Byrne

There are very solid plans behind the synergy work.

Nick Coulter

Thank you.

Question 6

Mike Dennis, Lazarus

Good morning.

Mike Coupe

Good morning, Mike. You got in quick, you were almost cut short.

Mike Dennis

I know I was surprised. I wanted to ask you a question about growth between Own Label and Branded goods within this Trading period and obviously coming out of the second half, so the whole of the second half period. I mean have you seen more recently with fuel price increases, more people trading down to Own Label? And could you give us an idea of what Own Label is doing in terms of growth sort of year-on-year?

Answer: Mike Coupe

Yeah, first thing to comment on is we already have a pretty high Own Label penetration compared to our mainstream competitors. And broadly speaking the participation of Own Label has stayed flat over the year. So I am not sure there is anything I could particularly pick out. I have made the comment before that if we see any squeeze on household incomes, that is usually beneficial to supermarket chains, because people start to eat in a little bit more. And when they eat in they tend to buy nicer stuff. So, in the past, not necessarily an indication to the future, but in the past we have seen stronger growth in areas like Taste the Difference when we have seen these kind of dynamics. But I have said already, it is very, very difficult to predict how the future will play out. We have been through a very interesting period of time over the last year and we think we have done a pretty good job of managing our way through that.

Further question

Is there anything within that in terms of growth between sort of Basics and Taste the Difference? Is there anything particular in the sort of trading?

Answer: Mike Coupe

Well we have tended to do better in areas where we have invested in quality. So if you look at the overall trends, we re-launched our On The Go range pre-Christmas, that is doing well. We re-launched our Free From range, that is doing well. So in areas of added value fresh foods, we are tending to do better where we have added quality and where we have added value. But as I say, in terms of the overall mix, broadly speaking our Own Label participation is where it was this time last year. There are not any single, there aren't any meaningful movements one way or the other.

Further question

Okay, and on another thing. Just looking at your new store openings and the mix between the food business and Convenience and Supermarkets, could you give us an indication of how fast your Convenience store business is growing now? Is it growing in line with the market or ahead?

Answer: Mike Coupe

Our headline levels of Convenience business grew by 7%, there was actually a strong underlying like-for-like as well. So a pretty pleasing performance in the Quarter. We are now up over 800 Convenience shops. I can't remember the exact number.

Kevin O'Byrne

We opened 10 in the Quarter. 799 in total. 806 including the Euro garages.

Mike Coupe

Yeah and we have opened the Euro garages franchises as well. So we have again said we are only going to invest in Convenience stores where we can make the right returns. We are not going to be driven by a number and that seems to be working its way through pretty well. So, pleased with that performance and of course it plays to the changing shape of our business, you know our Online grocery business is up 20% year-on-year. Convenience up 7% plus I think 6% the previous year, so not far off 15% over the two years. And that shows the way the market is changing.

Further question

And while I have got the mike, what about the Online business? I mean you talked about that in terms of trends obviously getting better, but how are you seeing that market? Obviously the whole market is growing at a lot slower rate in terms of online growth?

Answer: Mike Coupe

Yeah as I said, we grew our or we have grown our Online Grocery business by 20% year-on-year sorry over two years and 7% year-on-year in this Quarter. So we are pleased with that performance. We have said consistently now, we are not going to chase volume for the sake of chasing volume. For us it is about building sustainable business which serves Sainsbury's customers brilliantly well. Examples of that, we have now integrated our Homemade Recipe site with our Grocery online site so when you click on a recipe you can download the ingredients automatically into your shopping list. Something like 25% of transactions are now amended or ordered using our Online Grocery App and of course we shouldn't forget that the Argos business itself is now pushing towards 60% initiated online or on mobile phones. So that business is to all intents and purpose is an online business. So in the previous Quarter Online sales accounted for 18% of the company's overall turnover. So you can see that the business is very rapidly moving in that direction.

Mike Dennis

Okay, thank you very much.

Question 7**Mike Coupe**

Hey Rob you have had one already!

Rob Joyce, Goldman Sachs

Yes I didn't want Mr Gwynn to go home disappointed, so I have to turn inflation on in there for you.

Mike Coupe

I thought we had answered that one already.

Question:

Well you maybe can tell me it has been answered, but I was going to say, as you sit here now, do you see input cost inflation being fully passed to the consumer in your own business and industry? And how have you sort of mitigated it thus far because there has been inflation on the input side for quite a while?

Answer: Mike Coupe

Yes I guess I am repeating what I have already said. I mean the first thing to say is that we have done, and you can argue the market more generally, has done a remarkable job considering the input price pressures in mitigating within supply chains. So that means looking at sources, making sure we are buying from places which are competitively priced, working hard with our suppliers to look for ways to mitigate cost price increases. And

making sure that we look at our own business and look at our record of delivering cost savings. We have done a pretty good job in the last couple of years of delivering cost savings as well. So all of those things mean that we have been able to pretty largely to mitigate any cost price pressures in the marketplace whilst acknowledging the fact that we have seen food price inflation return for the first time in 2.5 years. We will continue to do all of those things. Equally we live in an uncertain world so commodity prices, currency fluctuations will impact pricing going forward. And we just have to keep doing what we have been doing in the last period of time. But I guess having been through the last 9 months of quite a lot of volatility we are confident we can manage whatever comes our way over the next period of time.

Rob Joyce

Okay, thank you for repeating that, sorry.

Mike Coupe

That is okay, don't worry. Good, I think we haven't quite broken our record, but thank you very much for coming on this morning. We will see you all no doubt at the Prelim Announcement in the early part of May, and if not in-between times, we may or may not see you. And I am sure Kevin will be out talking to, some, if not all of you over the next period of time as well. So thank you very much for coming on.

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