Sainsbury's Supermarkets Ltd
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Interim Results Announcement 2019

Kevin O'Byrne
Chief Financial Officer
Good morning everyone.
Welcome to our Results Presentation, covering the 28 weeks to the 21 September. Thank you very much for joining us here in Holborn, and for those of you joining us online. I am going to take you through a summary of the key financial highlights and I will hand over to Mike to talk about the operational achievements during the first half.

As many of you know this is our first set of results under the delightful IFRS 16. We published, restated numbers for the Half Year and Full Year in October so hopefully you've got all those. The change as you know reduces our underlying profit before tax by about £34 million in the full year, but has minimal impact on the total lease adjusted indebtedness of the Group and clearly has no impact on our free cash flow.

Underlying profit before tax for the period was down £41 million year-on-year slightly better than the pre IFRS £50 million guidance that we gave in September. Now about half that difference was because of the lower IFRS 16 impact and half was a slightly better outcome for the first half. And I will cover the main P&L drivers, including the one-off costs in the financial services numbers on later slides.

In the period we generated strong free cash flow of £698 million albeit impacted by some working capital, seasonal benefit which is usually in the first half and unwinds in the second half. Our full year net debt reduction guidance of at least £300 million remains unchanged and we completed the triennial valuation of our pension schemes during the period and agreed a new longer-term asset backed funding plan. And we will pay an interim dividend of 3.3p per share in line with our policy of paying 30 per cent of the prior year's full year dividend at the Interim.

Sales were broadly flat year on year held back by tough comparatives during the first quarter in particular. Retail operating profit was down 10 per cent as guided in September with the main drivers being the phasing of cost savings, poor weather against exceptionally good weather last year and higher marketing costs in the first half. We continue to make good progress in our cost reduction during the first half.

Financial services profits increased by £4 million with a small underlying decline offset by the benefit from the change in transfer pricing which reallocated some profit from the retail business into financial services. Underlying interest costs of £219 million is split by about £49 million of what we call conventional interest costs down from £53 million last year with the balance being charges relating to the IFRS 16 lease liability.

In the period we booked a material one-off expense of £229 million largely relating to impairments and store closures following the store estate review which we discussed with you in September and these are largely non cash. We therefore generated £9 million profit before tax in the period and as much of the write-down is not tax deductable. Our basic EPS after tax was a loss of 2.2p.

Growth in all categories was impacted by weather comparisons in Q1 with momentum as you can see improving significantly in the second quarter, when total retail sales were broadly flat and grocery sales increased by 0.6 per cent. We also delivered an improved performance in general merchandise and clothing in the second quarter.

Performance in all our channels was also impacted by the tough Q1weather comparisons, but in addition in supermarkets we were impacted in the first quarter by general merchandise and clothing weakness. And while like-for-like growth in our Convenience Stores remains strong. This was also impacted at a total level by lower contribution from net new space. And as you can see groceries online continue its consistent track record of strong growth.

These charts show performance relative to the market across all three categories. Firstly for grocery we show the progress we made with our volume performance over the course of the period relative to some of our key competitors and you can see the improved momentum across the period. On the right hand side you can see Argos sales growth continued to be stronger than a weak general merchandise market. And finally below that you can see that in clothing we consistently grew ahead of the market and gained share.

Financial services profits increased by £4 million as I said year-on-year with a modest underlying decline offset by the benefits from a change in transfer pricing that we flagged. This as I said moved profits from the Argos Retail Business into financial services which is covering the cost of the capital employed in Argos financial services.

As you can see on the right hand side of the slide lending and deposits both grew significantly mainly driven by the growth of mortgage balances of £1.4 billion to £1.9 billion. And this growth of the mortgage book was also the driver of the lower net interest margin and the lower bad debt ratio.

As we outlined at the Capital Markets Day in September we stopped writing the new mortgage business at the end of the first half and we are currently reviewing options for the mortgage book. The Group injected £35 million into the Bank in the first half. And again, as we said in September, we expect to make no further capital injections. And we continue to expect financial services underlying operating profits of £45 million for the full year.

Looking to the wider definition of financial services profitability that we showed you at the Capital Markets Day, profits in the period were broadly stable year-on-year. The cost:income ratio was broadly flat on returns. We are down given the growth of the balance sheet. As a reminder our five year targets includes doubling of profits and returns and the reduction of the cost:income ratio to around 50 per cent.

One-off costs in the period were £229 million and as you can see £203 million of these related to store closure review we announced in September, when we guided to a total cost of £230 million to £270 million for this programme. And there will be further costs booked in the second half. These are predominantly non cash impairments and we continue to expect total cash costs relating to one-offs to be below £100 million for the year.

In September we outlined plans to close 10–15 supermarkets, 30-40 convenience stores and 60-70 Argos stores during this financial year and next. And we expect to close 2 supermarkets, 25 convenience stores, around 20 Argos stores by the end of this year.

Restructuring costs of £25 million relate to the reorganisation of management structures in Argos stores and the closure of an Argos distribution depot.

Total capex fell year-on-year by around £30 million driven by the end of the Argos integration programme with underlying retail capex broadly flat.

We completed our triennial valuation as I mentioned during the period with the deficit falling to £538 million from £1.1 billion in 2015, and we are very pleased we have agreed new long-term asset backed funding plan providing greater security for pensioners but also reducing our cash contributions and reducing the risk of trapped excess cash in the scheme. We are contracted to contribute on average £75 million a year to the scheme down from £124 million.

Cash flow remains strong and in line with our expectations and as I said as usual in the first half working capital benefits from some phasing which we expect to reverse over the second half and we continue to plan to reduce net debt by at least £300 million.

Following the introduction of IFRS 16 going forward we will talk to you about two debt numbers, we will talk about total debt and we will talk about net debt excluding lease liabilities. Net debt excluding lease liabilities is the debts we owe to bond holders and to banks.

On this slide you can see how net debt excluding lease liabilities reduced from £2.1 billion at March 2016 to £1.5 billion at March 2019 and as you know we upgraded our net debt reduction targets in September committing to reduce net debt by a further £750 million by March 2022 which will increase our financial strength and flexibility.

On the subject of the dividend we have changed our policy to offset the dilutive impact that IFRS 16 has on earnings. Now obviously IFRS 16 has no impact on our cash generation, so by changing our full year dividend cover from 2x to 1.9x, we will pay the same dividend as we would have paid pre-IFRS 16. For the first half we have maintained the same policy of paying out 30 per cent of last year's full year dividend.

So summing up, we were pleased by the improving sales momentum across all divisions over the course of a challenging half. Profits were down in the period as we highlighted in September driven by a number of factors that we expect to reverse in the second half as we annualise last year's 15 per cent colleague wage increase and marketing costs and weather comparatives normalise.

As discussed the reported results were impacted by the property related write-downs. And finally, cash generation remains strong and we remain on track to deliver significant net debt reduction this year and over the medium term.

I will now hand you over to Mike.

Mike Coupe
Chief Executive
Good morning and it is fair to say what I am going to cover this morning is largely a repeat of what we talked about in Southampton at the Capital Markets Day so I apologise for that in advance, you have probably heard most if not all of the Presentation already. There are a few extra data points which will give you some belief and some understanding in how we see the continuation and improvement of our overall performance. And actually we are very pleased with the progress we have made to date against the plan that we originally talked about in May and subsequently the plan that we updated you on in September.

So the reality is our market remains challenging, whether it is the growth of the discounters and there is no sign they won't continue to open stores, roughly 100 stores between the two of them going forward and indeed that does not include people like Home Bargains and B&M Bargains.

The rise of digitisation in our industry and you can see that having a real impact on a number of competitors and a market where there is low or no growth. And if anything the political backdrop has probably got more challenging and therefore that impacts on our customers' sentiment and will continue, unless and until there is some resolution of the current political environment. So those factors continue to weigh heavily on our industry and you can see that impact almost day by day in the news flow.

However against that backdrop we have confidence in our core and ultimately we believe the core of our organisation can deliver strong cash flow, accrete earnings over time and we laid out the plans in September as to how we think we can achieve that. But above and beyond that we think there are some real opportunities in the way that we integrate our customer offer in the way that will bring our organisation together and the way that we invest in some quite new and exciting areas in the future.

Our ambition is to create a multi channel, multi brand business and we are well on the way to doing that and some of the things that we have demonstrated in September should give you some confidence that we are bringing a number of our digital assets and our physical assets together. If we do that we will maintain a strong cash flow. We are able to see our way to significantly reducing our costs and if we have got strong cash flow we can continue to invest the kind of capital numbers that we think we need in our business. We can pay down our debt and we can pay a dividend. And ultimately as Kevin has already said, that gives us a financially stable business that should have the resilience to cope with whatever the political backdrop is and whatever the market throws at us for the foreseeable future.

Our overall core purpose is to help our customers live well for less wherever they choose to shop with us and we set out six priorities at the Capital Markets Day. Firstly to be more competitive on price and we have made a lot of progress in that area. Secondly to offer distinctive products and new categories. Thirdly, to make shopping more convenient and support that with great service in our shops. To drive efficiencies so that we can invest back in our customer offer and we think there are some opportunities which are unique to us in that sphere. To grow connected services, that is particularly financial services and the role of Nectar in our organisation. And last, but by no means least, to continue to offer a seamless customer experience and to join our physical and digital real estates together more closely.

So talking specifically about price. We showed you this chart, at least the one on the left hand side in some of the work we have been doing with the meat, fish and poultry. In the end one of our challenges that we identified in the May Presentation was that we are losing market share in entry price point products and that was the biggest source of loss in our business. So we set out introducing new entry price point products. We have a programme of around 250-260. We have already got 120 in our business and we will get to something like 200 by the end of the financial year.

But if you look at the chart, within the meat category the challenge we have is to restore the volume losses that we were seeing going to other of our competitors in specific categories, but not to do it in a way where our customers, existing in our business actually down-trade. And as we can demonstrate through the work that we have been doing, as long as the purple bar is bigger than the orange bar, we are winning more than we are losing. And that is the important part of the way that we think about this. And you can see in the meat category as an example, that trend has continued. I think there is another 4 or 5 data points relative to where we were in September.

And again, another case study would be the bread category where we have re-engineered the ranges. We have re-launched our Taste the Difference range, we have introduced a number of new products within the mid-tier and we have also introduced dailies in the form of an entry price point and new brands to our business. And again we can demonstrate that we see a sales increase and a volume increase. And we have been really pleased with our volume share. If you look at our volume share underline, we are pretty much maintaining our volume share in the industry, which given the impact that we have from the discounters is a pretty significant turnaround in the performance since the beginning of the year. So really pleased with the progress on that.

Also we made a number of price investments in key volume lines, in key commodities. And again you can see the change in volume related to that. We have highlighted a number of examples, chicken wings up 12 per cent volume, chestnut mushrooms another key line, up 45 per cent. White pitta bread up 15 per cent. And again we have seen our suppliers coming towards us, particularly our big branded suppliers helping us improve our value overall and again that is reflected in the underlying performance of the business. And we are expressing that through the price lockdown mechanic which you will see increasingly used in our stores.

And despite what you might read, we are less dependent on promotions relative to our competitors. If you look at the promotion or participation in our organisation it remains lower than the market and to all intense and purposes it hasn't changed year-on-year and we believe that it is important for our business to maintain about this level of promotions because although we would recognise it from a customer point of view, it creates excitement and difference and newness in our stores. From a supply chain point of view it is not the most efficient way of running our business and therefore keeping a cap on the level of promotional content is important to make sure our business runs in a cost effective and efficient way.

But you can see that relatively speaking our Spend on Deal has not actually changed that much year-on-year and it is significantly below a couple of our mainstream competitors.

We also showed you this chart in Southampton. On the right hand side you can see that relatively speaking our price position to our mainstream competitor and by extension our other mainstream competitors is as good as it has ever been. And you can see that our pricing relative to the discounters has also improved pretty dramatically during the course of the Half. Now we would recognise there is work to do on both of those dimensions, but nevertheless we are pleased with the progress that we have made.

If you look at the left-hand chart as you look at the screen that perhaps looks at the data in a slightly different way which shows the relative value of items sold in our business compared with our mainstream competitors. And again that would demonstrate that the pricing experience by our customers in the items that they buy week in, week out would have significantly improved relative to our other big competitors. So you can see that effectively in terms of price of items sold we are in a deflationary cycle whereas our competitors are still relatively speaking inflating their prices.

So again we are pleased and that is another proof point that demonstrates why our customers are experiencing better value than they would have been at the beginning of the half.

We talked at the Capital Markets Day about the need to think about a Balance Portfolio. You can see on the left-hand chart the position at the beginning of the year where we were losing undoubtedly value and volume at the entry level part of our business. That is one of the issues that we set out to address, and as I have said already, we have made lots of

progress. We would like the chart on the right-hand side to be more balanced. You can see we have made progress on entry price points, but there is still work to be done, we are roughly about half of the way through the programme. So you would expect that to improve over time. But we are not in the business of deliberately down-trading in our organisation and that is something that we have to be very mindful of as we introduce entry price point lines.

Equally at the other end of the spectrum, our customers do give us permission to trade up from their point of view. And you can see that within the premium tiers of our business we over-trade quite significantly relative to the rest of our mainstream competition and we have continued to push very hard on that with the introduction of 350 new products within our Taste the Difference ranges. And we continue to see our performance, particularly in added value food categories like ready meals. So very pleased with our premium and own label products and it plays to the fact that on balance our customers are more affluent and that is at least in part because of the geography of our stores.

We have also worked on a programme of distinctive brands. So this is where we offer the opportunity to new and innovative companies in our business. And actually that reflects itself in our branded share. So it is not reflected as an own label contribution to sales. So that is one of the reasons why we have tended to see our branded business grow over the last period of time. And actually it is a pretty substantial business now at £100 million worth of sales that are incremental. 57 per cent of our customers buying into one or some of our distinctive brands. And we have introduced 37 new brands in the first half across fresh foods and grocery. And an example of that was the introduction most recently of Leon products where we have got a three year exclusive partnership and we have introduced 14 products across around 600 of our stores and we will see how that goes. But you can see how that creates some form of exclusivity at that end of the market within the business.

Again it is not just about the products that we sell, it is also about some of the areas where we think there are opportunities within categories. We talked about Beauty. We have roughly a 3 per cent market share, our customers give us permission to play in that category. With the demise of a number of large department stores it is an area where suppliers are more prepared to come to us to sell their products in our business, particularly the big branded suppliers. And we have already rolled out our beauty concept into 60 of our stores. Our customer numbers are up 7 per cent. Spend per customer up 25 per cent and we have roughly doubled the range of beauty products in those stores.

Now there are plenty of other categories. So we talked about wellness as being another example of a category where we think there is an opportunity. Pet, similarly we think there is an opportunity. So we are already trialling a number of other opportunities as we look forward that we might at some point in the future roll out further into our business.

We haven't talked about our CSR credentials for a while. But we made a very significant commitment during the course of the Half to reduce the amount of plastics in our business. By a country mile it is the single biggest reason that customers contact us and contact me. It is one of the big topics on their minds, the biggest topic on their minds and so it is a very significant commitment to reduce the impact of plastics by 50 per cent by 2025. And we have already made a couple of big steps on that journey removing plastic bags from our online delivery service and replacing single use bags in our produce department with reusable bags, both of which have landed extremely well with our customers. So very pleased with progress, but lots of work to be done in that area.

Within Argos we have made a number of steps to improve our availability, so we have been through a big programme of rationalisation. So we have reduced our master assortment by about 30 per cent over the last three years which has eliminated a lot of duplication. The

Argos model ultimately is predicated on the cash profit per item sold and that is a very important factor in the way we think about how we engineer our ranges for the future. And what it has allowed us to do is to significantly improve product availability in our stores. So your likelihood of finding the item that you want to buy with any given shop or any given geography has improved markedly over the last three years.

And we are also rebalancing the ranges into the higher margin categories and that is the case, not just in Argos, but also in the supermarket chain. A good example of that would be entertainment where broadly speaking the market is moving very rapidly away from DVDs. It is actually relatively speaking a reasonably high sales market, but actually a relatively low margin market. And over time we want to gain share and are gaining share in categories like furniture, like home, obviously the clothing business and that again represents an opportunity which we are beginning to see significant progress on, in the last Half.

And we have also introduced a new advertising campaign which is highlighting some of the design credentials of the products that we sell, not just within Sainsbury's supermarkets, but also within Argos.

Clothing continues to be a success story now largely although not exclusively driven by online. So online clothing now represents around 8 per cent of our business. That was nothing a few years ago. We continue to invest in that proposition. So Tu online sales are up 52 per cent, albeit from a relatively low base, but nevertheless very pleasing progress. And we have 800,000 new customers in the online space and that is up 31 per cent year-on-year. We have done a good job of managing our mark down and our margin mix during the course of the Half, and again we have introduced a new advertising campaign for everyday use of our clothing as we look to extend the franchise. But we are very pleased with our clothing performance overall and it continues to be a driver of growth and we would expect it to be into the future.

If we look at making our shopping more convenient or making our shops more convenient, start with our supermarkets. Again we talked about the fact that we need to repurpose a lot of our space and we have already repurposed about 870,000 square feet since four years ago. Increasingly we are tailoring our investment which Graham will have talked to you about during the Capital Markets Day in the way that we think about our stores. And we have significantly stepped up the investments in the capital in our conventional supermarkets. So we will invest in 450 supermarkets of which we have already covered 172 in the first half. There are something like 40 currently going through some form of investment in this current Quarter, but we will get through roughly 450 supermarket investments during the course of the financial year. And we would point at the fact that our trading intensity, largely although not exclusively as a result of putting Argos stores in Sainsbury's stores has progressively improved over the last three years which is one of the key drivers of the economics of the supermarket.

Where we have made targeted investments we have seen that reflected in our customer metrics. So we talked about CSAT and lettuce know and how we can measure our service metrics literally by store, by department, by day and give our stores real time feedback. But it also highlights macro areas where we can do better. So with a combination of the investment in Smartshop now in roughly 350 shops and the upgrade in our self checkouts, we have seen a marked improvement in ease of checkout and checkout speed in the way that our customers look at our business. And that is very marked in the stores where we have made the changes.

Through the technology we have invested in and through our focus on customer service, we have improved our availability metrics and we have seen our CSAT score overall year-on-year improve by around three percentage points. And we continue to invest in the core fabric

of our supermarkets, so things like making sure that our toilets are up to scratch, that our car parks are well lined and well laid out. And that the fabric of the building is properly invested in, and again that is a big part of our programme into the future. And when we make these changes we do see it reflected in the customer statistics so we know that there is a cause and effect that where we make changes our customers recognise it and that would make them more likely to shop in our shops in the future.

Convenience, you know I have said it before, it is a fantastic business for us. Another half of growth. It was a little bit damp in the early part of the year so that is certainly reflected in the numbers. If you look at the second quarter performance, it was strong, very strong. And we continue to look for every opportunity in the convenience space that we can. And we talked about the programme in stores that we have got looking forward. Again in terms of our investment programme we will touch around about 200 Convenience stores during the course of the year. We re-set 158 stores in the first half and as we talked before, one of the things that we have done with our Convenience stores is to get a much more tailored range, such that only about 15 per cent of the range is common to all stores. And by definition 85 per cent is somehow different on a store by store basis. So much more focused on tailoring the ranges and individual SKU choice makes a huge difference when you are only carrying let's say 3,000 SKUs in a shop. So it is important that we tune that and continue to tune that into the foreseeable future.

And again a big part of our programme in terms of checkout investment, particularly self-checkouts has gone into our Convenience shops where speed and ease of shop is even more important than it is in a supermarket environment. And again we have seen the stats within the speed and ease in checkout move forward very significantly year-on-year. And there isn't a single measure within our Convenience Business on customer satisfaction that hasn't moved forward markedly in the last couple of years.

Again Grocery online, I mean it is remarkable how consistent the growth is now accounting for roughly 8 per cent of our grocery sales, but virtually every year for the last five years we have seen a 7 per cent increase in the sales. As Kevin showed we actually had a relatively stronger performance in the second quarter comparative to the first quarter. We now have same day delivery in 60 per cent of UK postcodes. The grocery online app accounts for roughly 20 per cent of the orders, so again the penetration of the online app is increasing month over month. We have extended the delivery slots so you should get more availability in terms of delivery slots than ever. And as I have said already in the CRS agenda, we have introduced bagless deliveries and we can certainly see our way forward in terms of the capacity for growth within our existing real estate for the foreseeable future. So we continue to invest in adding capacity within our existing physical real estate as in our stores, rather than through dark stores.

Argos again, if you look at the shape of the business, and that was the way it has changed during our period of ownership, the number of walk-in customers has dropped 7 per cent as a proportion of sales. We have seen Fast Track grow from 15 to 24 per cent. And again something like 64 per cent of the business is now transacted online either through delivery to home or through some kind of click and collect process. And we are very much in the throes of digitising that business as well, so we would have pretty much got through the digitisation of all of the Argos real estate. So got rid of all of the Fisher Price toy keyboards that you will all be, or some of you at least will be familiar with. So the vast majority of shops will have a digital offer, fast track payment, pay at browse payments, so that you don't have to go to a checkout which enables our colleagues to more obviously interact with our customers and not be stuck behind a checkout. So you can see that programme of change accelerating during the course of this year.

Again we talked in Southampton about how we think about reducing costs in our business. Our single biggest cost is our cost of goods. As Paul articulated, we think we are pretty good at what we call value chain analysis which is looking at the value chains that supply us and looking for leakage of value and finding out ways or working ways with our suppliers as to how to reduce our cost of goods by eliminating that leakage. Equally when we review categories we look at how we can make our ranges more efficient. Generally speaking by reducing SKU counts that allows us to increase the velocity of lines, the volume intensity and therefore that has an effect on the productivity in our business, but also in our suppliers. That enables us to improve our relative value, it allows us to offer more distinctive ranges where appropriate and overall that allows us to drive a higher cash profit.

Now we have engineered roughly half of the categories in our business by looking at our PQF, it is a continuous journey, it seems a bit like painting the 4th road bridge. When you have finished the programme you go back to the beginning and start again. But we still think we have got around half of our ranges to address when we look at the overall food volume in our business. And if you look at the cereals range it is a case study on the outcomes of this process so we have reduced our SKU count by about 20 per cent. We have more distinctive ranges so particularly with some of our distinctive brands as an example. We have been able to generate money so that we can reduce our prices and improve our value index. As a result of the work that we have done we have seen our volumes go up, but we have also seen our cash profit go up as well. So again that is an example of where our overall ambition is to grow our volumes and to at least cover the cash profit and to grow that overall when we look when at our category development.

Again we talked about our cost savings programme with two elements. One is a sort of pay to play. You would expect anybody in our sector to look at its cost base and roughly cover the cost of inflation. We do that and we have got a pretty good track record in all of the areas we have underlying cost pressures whether that is goods not for resale, whether it's investment in retail technologies, whether it is reduction of our shrink costs. We have got some quite interesting technology in that space. We have dramatically improved our retail HR systems which allow us to be more efficient and clearly during the course of the year in both of our businesses we have significantly streamlined our retail management structure. So that is kind of very much the pay to play.

But we also believe that by integrating our businesses more closely together, first of all the way we show up to our customers will be more co-ordinated, but secondly there are lots of opportunities to make structural and unique cost savings within our organisation. I gave the example at the CMD, we have 12 data centres if we look at our business overall, we probably don't need 12 data centres, we probably need half that number. And that is just scratching the surface in terms of some of the efficiencies that we can bring to bear. And we talked about making £500 million of cost savings above and beyond the pay to play of covering cost inflation during the course of the next five years. And with the work that we have done, particularly in the last couple of months, we have got better and better line of sight as to how we can deliver that. And we gave some summaries on the chart as to where we think the main areas of opportunity and improvement are. But a very significant cost transformation programme, and as we said in September, we believe some benefits which are unique to us.

In terms of things that we can do that give us belief that we can grow our earnings above and beyond the core business, we talked about financial services. And Jim laid out a plan for how we will double our UPBT, reduce the impact for the supermarket, for the Group as a whole, put less cash in in fact, no cash in and to provide a more agile offer to our Sainsbury's and Argos customers. So having laid out the plan in September, we are now getting on and executing that and the shape of the organisation looking forward will be more orientated towards products which connect with customers in Sainsbury's and Argos. Argos

storecards being a good example of that. In the commission based products such as insurance, ATMs, travel money, but as we announced in September, we have stopped writing mortgages and we are reviewing what we will do with the mortgage book in the future.

So in financial terms that means we don't need to put any more cash in. We will double the profits of the bank over the next five years. The bank will generate cash so at some point in the future there will be the opportunity of repatriating money back to the Group overall. We have an ambition to reduce our cost:income ratio to 50 per cent and we can see now our line of sight as to how we will do that. We have stopped mortgage acquisition, we will review our options as far as the mortgage back book is concerned and ultimately our ambition is to drive value within the Group because we know that if a customer has a financial services product they will be more loyal to the company overall. And the more that we can put those financial services into the checkout flow of our customers the more penetration that we think we can drive within the financial services business.

Nectar, we talked about introduction of digital Nectar which was very much on the blocks at the time of the Capital Markets Day. We have now launched it and it has been incredibly successful. So very pleased with the fact that we now have 2.1 million customers using digital Nectar. And it is one of the things that is at the heart of our strategy of connecting our customers together both in terms of the brands that we offer, but also between our physical and digital real estate. And of course the digital channel gives us the opportunity of talking to our customers in real time wherever and whenever they want and we want. So Nectar is the biggest loyalty scheme in the UK, we have 18 million collectors, it is the most recognised loyalty scheme. And as I said we are really pleased with the launch of digital Nectar. And at one point it was the, I keep being corrected, it was the most downloaded app in the UK for at least a weekend which would put us at the top of the charts. So pleased with that.

But in addition, we want to build a broader coalition. So you know the power of Nectar is not just within the Group. Again if you think about it, Nectar points are currency, they have an exchange value. And the more Nectar points we can put into the ecosystem overall the more Sainsbury's as a company will benefit from that. And we have added Esso as a partner as one example during the course of the Half, but equally we would want to broaden that coalition over the next period of time.

And I won't do justice to the Presentation that Clo gave at the Capital Markets Day, I have only got one slide, but looking forward we are doing some really, really exciting stuff in the world of digital. So whether that is the Nectar app now in the hands of 2.1 million customers, whether it is the Argos financial services app now in the hands of 1.4 million customers. Whether it is Smartshop in the stores that we are operating the penetration of sales is roughly 15 per cent. In the highest penetration stores it is pushing towards 25 per cent. And increasingly we are looking to join together our digital real estate so that you as a customer would have a seamless experience and increasingly we can join our proposition, our offer together in ways that show up to customers to satisfy their very immediate needs across a whole broad spectrum of products and services that we sell.

So we are well on the journey, there is lots of exciting stuff coming down the road. I won't do all the demonstrations that we gave you at the Capital Markets Day, but you can see that we've made even in the last 5 or 6 weeks significant progress along that road.

So in summary, we are confident in our core. If anything, what has happened between September and now has given even more confidence that we have maintained our relative volume performance and we have got line of sight to deliver against the things that we set out to deliver, whether that is entry price points, whether it is improving our value, whether it is increasing our efficiencies or the re-engineering of the bank as some examples. We

believe that there is lots of upside in our integrated customer offer and therefore not only can we underpin the earnings of the company, we think there is plenty of potential for growth in the future. We are creating what we believe to be a unique multi-channel, multi-brand organisation. We will continue to make sustainable cost reductions which will enable us to remain competitive and invest in our overall customer offer as well as covering the cost of inflation. Ultimately that leads to strong cash generation. We can invest in our shops, in our digital real estate. We can pay a dividend and we can pay down £750 million of debt over the next three years. And ultimately that also gives us a lot of financial resilience and flexibility in what is not to say the least a challenging market and challenging environment. So we are confident in our future.

So that's it from me, and we will now go for questions. Oh sorry, I am going to play you the two Christmas ads just by way of a bit of seasonal lightness. So I will step down and Kevin and I will then answer questions.

Question and Answer Session

Mike Coupe
So go on Bruno you had your hand up first

Question 1

Bruno Monteyne, Bernstein
Good morning, Bruno Monteyne from Bernstein. Mike on the profit guidance for the second half, there is a material shift into the second half that should be better and I think two out of the three reasons you quote are weather and change in marketing shift. Now my question is twofold, so is it really two thirds of that improvement depending on that and how much confidence do you have given that counting on British weather seems risky. And obviously we know that Tesco is launching Clubcard Plus and other activities, it might actually require quite a step of a marketing commercial activity. So how much confidence and how much of it really depends on less marketing and better weather in the second half? Thank you.

Mike Coupe
I will defer to my colleague on the right.

Answer: Kevin O'Byrne
Well there are three factors Bruno because there is also the phasing of cost savings and there is one material affect there, well it is too simple to just point to one, because there are lots of moving parts, is we don't need to have a. We had the wage increase in September 2018 so we don't have a wage increase in the second half because it was in the second half last year. So that is a big factor.

The marketing is a big factor and I would not overstate the weather in that. We are just saying we were expecting normal weather, we did not have normal weather. We're kind of assuming normal weather. Clearly if we get ridiculously different weather then we will talk about it later, but we are not expecting it.

Further question
So you are feeling quite highly confident that this step up H1 to H2?

Answer: Kevin O'Byrne
We are feeling confident that our plans, as you always, they come with some caveat as you are facing into pre-Christmas trading as always. But our plans are good, our products are good. If you think about what we said we would do in the first half, we said we would lower prices, we have lowered prices, we are in a great position from a price point of view. We

have launched our value brands at 123 - 200 by the year end. We have improved our service, our CSAT scores are up three percentage points in the half. We are investing in the stores, in our produce area and our bakery areas. So we are in a good position going into Christmas trading.

Further question
And do you see any probability that you will be forced into a response to a Clubcard Plus in a run-up to Christmas or do you think this is not a major event in the overall bigger scheme of things?

Answer: Mike Coupe
You probably know more about that than we do, but we have a set of plans we will get on and execute our plans. There are a whole bunch of things that we are doing in that space. We talked about Nectar and digital Nectar, that is our version if you want to put it that way round of Clubcard Plus. As Kevin has already said, at this point in the cycle we are 7-8 weeks away from Christmas so lots of things could happen between now and January 4th when we will dust ourselves down and see how we have done overall. But we are very confident in our plans and all of the volume trends that we saw in the second quarter have remained pretty stable if you look at the Kantar data. So we are pleased with the performance and it would demonstrate that you don't need some of the headline marketing activity to generate the kind of volumes that we need to generate.

Bruno Monteyne
Thank you very much.

<u>Question 2</u>

Rob Joyce, Goldman Sachs
Rob Joyce, Goldman Sachs. A couple more from me, a similar theme actually. So we look at the sort of headline market share data year to date. We have seen a very material improvement for you guys from maybe minus 40 bps to flat into September and then back down to sort of minus 35 bps in October. I was just wondering if it is not promotional cadence, what is really explaining that kind of volatility? And what would be a good sort of consistent number we should hope for you guys to achieve from here?

And the second one, if you look at your price chart versus Aldi, clearly material improvement this year. But at the beginning of the year it looks like Aldi improved their price versus you very materially as well. Is your guidance, I mean was that them pushing hard on prices and is your guidance assuming a similar step up in price composition in the early half of 2020?

Answer: Mike Coupe
You and I will always differ. If you look at any four week data it will have lots of pluses and minuses.
Tesco are running their 100th anniversary campaign for the particular period of time that you are talking about. But if you look at the 12 week data which is a more realistic read of the underlying performance, you can see that our volume share is actually pretty stable year-on-year and we see some other data that you don't see which will give us confidence that that is the case.

You know we have said that what would be our measure of success will be to at least maintain our volume share versus the market, ex the discounters. If you look at our current performance it is better than that. So that is why we have confidence as we go into the busy Christmas trading period.

And the other observation which hopefully comes out from the Presentation is that in the changes that we are making we are probably only about half way through the introduction of entry price points, the re-engineering of ranges, the investment in the store programme. And you know even if you look at the store programme there is an element of disruption that goes on as and when we touch each one of our stores. So against the backdrop of the market and against the objectives that we set out we are very pleased with the progress that we have made.

Answer: Kevin O'Byrne
Rob it's probably also worth adding, if you look at the four week data and compare it to Quarter 1 of this year and Quarter 4 of last year it is still an improvement on that. All be it will be changes week by week.

Answer: Mike Coupe
And I would just have to go back to the charts to understand exactly the point you are making. The point we would make is that relatively speaking with the introduction of the entry price point lines and some of the price investments we have made, we have seen an 800bp improvement in our relative price position to Aldi. Now I am sure before that it would have gone up and down and so I have to pick through the data just to work out exactly how much. But the most important thing is that step has been very marked in the half that we have just gone through and we would still recognise there is work to be done and we are on with that.

Further question
Thank you and are you seeing a competitor response at all?

Answer: Mike Coupe
You know it is the blood and guts of normal trading and we watch as you, I am sure you are fully aware how our competitors respond. But if you take well both of the price gaps, you know we have maintained the improvements that we made earlier in the year.

<u>Question 3</u>

Andrew Gwynn, Exane
So it's Andrew Gwynn from Exane. I will go for three questions, to be a bit greedy. So the first question, just on the charts you showed before around this switching on the value brands, I think that is sales data, but could you just provide a comment on the gross profit impact, obviously the down-trading into potentially lower volume categories could be a bit more significant?

The second one, you mentioned before about the market being maybe a bit more challenging in light of politics and whatnot. I was just wondering if you could elaborate a little bit on that, particularly in the context of the better volume performance you are seeing?

And then the third one, just on the Argos management integration. Obviously with the departure of John Rogers, you are essentially rolling that management role into the Group. Could you just comment a little bit more on the logic of that? It strikes me obviously the dynamics of the two businesses are still relatively different and I appreciate it is better integrated than it was, but still a very different sort of business. Thank you.

Answer: Mike Coupe
Yeah I mean we obviously don't comment on gross margins, but we try to give you some sense of what we are trying to achieve which is broadly speaking to grow our volumes and at least maintain our cash profit. The case studies that we have showed you would demonstrate that broadly speaking we have achieved that and in many cases we are actually growing our cash profit, not necessarily at the same rate that we are growing the

volume. But overall if you can sell more stuff and make at least as much money, that is where we would set our ambition. If we can get ahead of that, which generally speaking we are, then that is a great place to be.

Markets. Well your guess is as good as mine what effect an election will have on how customers are thinking and feeling. My own view is that almost regardless of what is going on in the world of politics and the economy, people will have a good Christmas, they will trade up either through the supermarket brands or within the supermarket brands. But the quicker we can get to some kind of end point, the more likely it is I think our customers will feel more confident about spending their money. We have observed before that if you look at net disposable income it is actually going up, so customers have more money in their pocket, but that is not being reflected in retail sales which is normally where they would spend some of that money. So depending on where we get to with the political resolution, you could have some belief if we get to political resolution that customer sentiment might move upwards. Look at the latest GFK data, it has gone backwards yet another step and customer sentiment is back to where it was after the financial crash.

Yeah and we have always had the journey, as far as Argos management integration, of bringing the organisation together. To the point about the significant savings we could make across the business, whether that is data centres, call centres, logistics, management overhead. And the way that we increasingly join our businesses together from a customer point of view, we can only do that by integrating the businesses more closely together. And there are a whole range of opportunities in the way that we do that. Equally you know we would be the first to recognise there are some unique things about the Argos brand and it is important that we maintain those as we go through that integration journey. But ultimately if we have the ambition of being able to sell any product anywhere, we have to have a more integrated logistics function as an example than we have today.
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Question 4

Nick Coulter, Citi
Thank you. Nick Coulter from Citi. Just on Argos, you spoke about managing the mix, but have you adapted your approach into peak given the volatility that you are experiencing with the consumer? I guess I am just trying to seek some sort of reassurance with respect to Argos across what will be a pivotal trading period with that consumer backdrop in mind.

And then secondly quickly on the exceptionals in the first half, is it possible to have a cash figure for the hit please? Thank you.

Answer: Mike Coupe
I'll ask Kevin to respond on the second one. I am a bit like you, I have got my fingers crossed at the moment. I mean we have planned for peak. We have great plans in place. We have all the resilience that we need built into the system and that really kicks off over the next 5 or 6 weeks. So it is very, very early in the season, but ultimately we are as well set up as we have ever been to deal with whatever comes our way as far as the Christmas trading period is concerned. Equally the jury is out, there are a whole bunch of things that could get in the way of Christmas, but generally speaking our experience is that people will behave in the same way that they have behaved historically.

Further question
But when you say resilience, could you give us some practical examples?

Answer: Mike Coupe
Well just making sure, well as an example Black Friday is a big peak, you know the maximum number of transactions that ever go through the Argos system happen on Black

Friday. Making sure that all your systems are in place to be able to deal with that peak would be a good example. You have got the people in the shops there to take the money from our customers when they buy the products that they need to buy etc, etc. So all that planning is going on in the background to make sure that we are as well set up as we can possibly be.

We have also made, as we have already described, a number of significant improvements in the overall offer, availability, pricing, ranging, quality which would stand us in good stead overall, not just within Argos, but within the business more generally.

Further question
But you are running with broadly the same levels of inventory into peak?

Answer: Mike Coupe
Yeah. I mean without going into the detail, we are planning for a successful Christmas,that is what we always do. Like any general merchandising and clothing business you always don't have enough of what you can sell and you always have too much of what you can't sell and that is part of managing the season. And we are as well equipped as ever to make sure that we deal with that.

Nick Coulter
Thank you.

Answer: Kevin O'Byrne
Nick actually in the first half, it was actually cash positive, but it is a meaningless number because well we sold some properties so we had a property gain and that is offset and we haven't actually incurred a lot of the cash costs for the property decisions. But we said in September that the total would be something in the region from a P&L point of view, 230 to 270 with £30-40 million of cash. Because it is largely asset write-downs. There is clearly some redundancies in there.

And the other item that was on there, Argos, there will be some redundancies in that number. But I would just bring you back to the number, we are managing to less than £100 million of cash this year. But in reality some of that will be decisions we made last year where the cash went out this year. Some of the decisions this year, the cash will go out next year, but we are managing to that £100 million cash out this year.

Further question
So I guess the question is what is the cash outflow in the second half then broadly? So you have already got something coming in in the first half, so what is the?

Answer: Kevin O'Byrne
Well the total for the full year will be £100 million, we are not breaking it down any more yeah.

Nick Coulter
Thank you.

<u>Question 5</u>

Clive Black, Shore Capital
Clive Black from Shore Capital. I was interested in your comments Mike about the discounters and you also touched on the bargain stores. Stepping back from results as an industry statesman, how would you see, well you are slightly older than me actually. Within the context of your experience how would you characterise the German discounters and the bargain stores, versus Sainsbury's today to the extent of, do they still represent the same

form of challenge as against the last decade or are you through the peak of their challenge? Or indeed are you on the other side of a peak?

Answer: Mike Coupe
As of today there is no evidence that they are slowing down their rate of store development and no matter how brilliant a retailer you are, you know if whatever, 600,000 square foot of space lands on your doorstep, one way or another that is going to impact your business. So as far as we can see for the next three years that rate of store development will continue. We would argue as you have heard us argue on numerous occasions, you have got businesses which are making a lot less money than they were three or four years ago, but continue to invest vast amounts of capital and at some point you have to believe that that becomes increasingly non returning. I would argue already that it is non returning, but let's assume at some point even the most irrational business person would have to take a choice that they would slow down that capital investment. But there is no sign that that is going to happen.

For us the bargain stores are less of an impact, we don't see it as much, but it clearly has an impact on our competitors and that reads through in market pricing in particular. But of course as they grow they start to have the growing pains of stop being insurgents and starting to be more stable businesses that you know, continuity of supply, relationships with suppliers become more mature and therefore the way they run their business have to evolve over time.

And the other charge that often gets laid at our door is somehow the discounters are going to invade the South-East of England and London. We look at this every time we get asked the question and there is no evidence to support that thesis. You know there is evidence that they are filling the pot roughly at the same speed everywhere across the UK. That does mean that they are opening shops in London and the South-East, but that is not disproportionate to where else they are opening shops. So again we would argue that our real estate in the round is on balance more protected from the potential threat of the discounters than some of our mainstream competitors largely because our geography is very South-East and London centric.

Clive Black
Thank you.

<u>Question 6</u>

Xavier Le Mene, Bank of America
Two quick ones if I may. Can you give us a bit more detail about the product quality framework? So you achieved 49 per cent going to 51 per cent, what is the time frame here? So when do you plan to achieve everything?

And how does it fit with the change of all your entry price products or how do you add things all together?

And lastly, what is the volumes expectation you can get to when everything will be done?

Answer: Mike Coupe
On the third one I am not going to speculate other than go back to what I said earlier. In terms of our minimum benchmark it is to maintain our share of the market ex the discounters. Actually if you look at how we are doing currently we are doing better than that. And if we can sustain that level of performance then that will be a good outcome from our perspective.

I am looking at Paul in terms of the PQF. He is looking at his phone, so he is not even listening to the question. So 49 per cent through when we will be through the whole programme?

Answer: Mike
About 2 years

Answer: Kevin
We did about 11 per cent in the Half.

Answer: Mike Coupe
And then on entry price points, we said we would 90 per cent of the range out by the end of the financial year. So there are some products around the edges, but it effectively means out of the 280 or so products we will be to 240-250.

But as I said during the course of my Presentation, once you have done it all, you then go back to the beginning and do it all again. So it is a continuous loop. So another way of looking at it is it takes roughly 3-4 years to do a full cycle of every category. And then when you finish that cycle you go back to the beginning and start all over again.

Xavier Le Mene
Thank you.

Mike Coupe
Any more for any more? Don't feel you have to.

Well thank you very much. Have a great Christmas and hopefully you have all downloaded the Nectar app and the Argos app and you will all be doing your Christmas shopping with Sainsbury's.

Thank you very much.

End