J Sainsbury plc
Interim Results Announcement 2020
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Kevin O'Byrne
Chief Financial Officer

Good morning and thank you for listening into this presentation. I will cover the financial highlights for the 28 weeks to September 19th first, before Simon covers our operational performance and the details of our updated strategy.

Let me start with the key numbers. Retail sales excluding fuel were up just over 7%, with strong grocery and general merchandise growth, and some modest dilution from lower clothing sales.

Fuel sales were down 45% in the period so retail sales including fuel were down 1%. Retail operating profits increased 27%, reflecting very strong execution and efficiency across the business and a good level of operational gearing in both our grocery business and Argos. This was despite first half costs of protecting customers and colleagues from COVID exceeding the benefits of the business rates relief.

Financial services made a loss of £55m in the half, in line with our expectations when we last spoke to you, largely reflecting an increase in provisions as guided in April as well as lower commission and trading revenue.

Together, that drove a group operating profit increase of 9% and UPBT up 26% benefiting from interest payments that were £20m lower year on year.

In the period we recorded a statutory loss before tax of £137m as we booked £438m of predominantly non-cash charges relating to restructuring and impairments. I'll cover these in detail later on.

Free cash flow was very strong in the half as a result of strong grocery trading, and working capital benefits due to the usual seasonal timing which will reverse in the second half but also the very good sell-through of general merchandise stock.

In the period net debt reduced by £912m. Deferring the last year's final dividend decision contributed about £160m to this reduction.

We have today declared a special dividend of 7.3p to be paid in lieu of final dividend for the year ended March 2020 and we have also declared an interim dividend for this year of 3.2p, in line with our policy of paying 30 per cent of the prior full year dividend.

This slide shows retail sales broken down by category and some of the change in trends we saw between quarter 1 & quarter 2. We continued to deliver strong grocery growth in the second quarter after lockdown had ended and this was against a tougher prior year comparison.

Clothing sales were hardest hit in the first quarter and recovered more strongly than we expected in Q2, helped by online sales up 75% in the half.

Likewise, we saw some recovery in Sainsbury's general merchandise over the half but the standout performer in Q2 was Argos, maintaining its quarter 1 growth rate despite a more normal weather backdrop.

This slide shows Grocery volume growth measured by Nielsen. We outperformed the majority of our grocery competitors over the half despite a tougher comparative in the second quarter. We were pleased with the strong execution across the business, in stores and online, and we also achieved record customer satisfaction scores as Simon will cover later.

The left-hand chart here shows performance versus the market across key categories for Argos, with the impact of COVID and the lockdown reflected in increased spending for the home, whether that be home office equipment or gaming. We were particularly pleased with our market share performance in categories such as furniture, reflecting strong availability and fast fulfilment.

During the first quarter, with all the standalone Argos stores closed, we pivoted to a 100 per cent online delivery and click and collect model.

The right-hand chart shows a strong market share performance for our clothing business, with a steady upward trajectory again supported by online growth.

This slide shows the movement in UPBT versus the first half last year.

Higher retail profits more than offset the financial services drop and interest costs were £20m lower year on year as we benefited from debt repayments and lower interest on lease liabilities.

The table on the right shows the breakdown of retail COVID costs in the period, with higher colleague costs the largest part of these as we paid the wages of vulnerable colleagues who were unable to work, covered higher than normal absence levels and paid frontline colleagues an extra bonus.

Over the full year we are expecting COVID costs to offset the business rates relief, although clearly there is some uncertainty around the impact that the progression of COVID and future lockdowns might have on these costs in the second half, particularly in the area of absence levels.

The waterfall on this slide shows the main moving parts of the financial services underlying profit for the year.

We saw lower ATM and Travel Money commission with reduced demand over lockdown and the fact that our travel money desks were almost entirely closed over what would normally be the peak holiday season.

We also earned less income as customers repaid loans and borrowed less on their credit cards.

But the biggest movement was the £43m increase in IFRS 9 provisions for potential future bad debts.

Against this backdrop management took decisive actions in response to the situation which I will come to in a minute. The net result was a loss of £55m in the period. We expect financial services to move back into profit for the second half of the year, with a greater benefit from management actions and some recovery in ATM volumes.

The bank management team are making good progress with the transformation plan we set out last September and have been proactive in managing the additional challenges of COVID. You can see here the benefits of the work done on operating costs and also actions taken to quickly reduce funding costs.

I talked earlier about the quality of our lending book and I have provided a couple of proof points here.

Firstly, on the left-hand side of the slide, we look at the proportion of lending in arrears at 18 months. Our figures of 0.9% across loans and 2.1% on credit cards compares very favourably to typical industry levels, in the 3% to 5% range, and this covers 83% of our loan book.

Arrears in Argos Financial Services, which is 17% of our book, are higher at 7.4%. This is again below retail credit averages, for a storecard portfolio, and of course this book earns higher margins and we hold higher provisions here.

Next, in the centre of the slide you can see the proportion of our customers who took payment holidays. At 6% of our book it is significantly lower than market averages which is well into the double digits. Of this 6%, 84% have now resumed payments and 5% of the 6% are in arrears which represents less than 0.5% of the total book.

Finally, the table on the right shows provisions in terms of coverage ratios split between unsecured and secured lending. You can see that coverage for unsecured has increased materially from 5% to 6.6% which is very much in line with industry averages while the quality of our book in terms of arrears experience is better than average.

The bank's balance sheet has strengthened in the period as we reduced our lending exposure. Despite booking a loss of £55m and increasing our bad debt provisions we are in a stronger position today in terms of capital, coverage and liquidity.

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

In the period we incurred a total exceptional cost of £438m. And there are three numbers I would draw out. Firstly the £259m of restructuring programme costs. The two biggest drivers of this charge are the Argos store closure programme that we announced today and the reorganisation of our logistics network as we combine our Argos and Sainsbury's networks and reduce our number of depots and stock locations. The costs include asset impairments, as well as closure provisions such as dilapidations.

Secondly COVID-19 and the accelerated structural change has led to a full impairment review of all the Group's assets. Further impairment charges of £214m have therefore been recognised across Retail and Financial Services non-current assets. For Retail this reflects changes in future channel mix and the impact on asset values. One example here is the value of some of our city centre convenience stores which we expect will be impacted by more customers working from home and shopping online in the longer term. £105m of the impairment number relates to the write down of intangible assets in the Bank.

The third number I would call out is the ATM business rates refund following our successful appeal. As this is material and not related to the half we have taken the income below the line although the original costs were taken above the line and charged to underlying profit before tax.

Taken together, these one-offs charges resulted in a small net cash inflow in the first half. Over the full year we expect total costs of around £625m, of which about £100m will be cash while over the next three years we estimate the total cost of restructuring including the £625m, will be in the region of £900m to £1bn with total cash costs of £300m. Simon will cover this later on.

We generated strong cash flow in the half. Most notable is the working capital swing in the period. You can see the typical seasonal benefit in H1 last year of about £250m. On top of that this year we've had much stronger grocery sales and very strong sell through of general merchandise stock, which together more than offset a £100m drag from lower fuel sales. Some of that will normalise in H2, particularly as we rebuild general merchandise stock. Disposal proceeds reduced from last year when we were unwinding the British Land joint venture. The result was free cash flow of £943m, an increase of £245m,or 35% year on year.

Below free cash flow, the other line showing £164m is largely the movement on our lease liabilities.

Net debt movement year on year benefited from the fact that we did not pay a final dividend and this will now move to the second half of the year with the payment of the special dividend alongside the interim both of which we have announced this morning.

Thinking more broadly about cash flow, we're now seeing the ongoing benefits of the structural changes we've made in the last few years. No bank capital injections, lower interest costs which continue to reduce, and lower cash pension contributions. These benefits underpin our expectations for strong annual free cash flow delivery going forward.

Before closing, I just wanted to remind you of our target of £750m net debt reduction by the end of next financial year. We are well set to achieve this and Simon will talk later about our confidence for strong ongoing free cash flow generation beyond that.

So a really good first half for the business with excellent execution, strong and profitable digital sales growth and a particularly strong contribution from Argos.

We recognised a high level of one-off costs reflecting our accelerated ambition and change within our strategy but these costs are largely non cash and will deliver significant longer term benefits.

Our strong focus on cash discipline continued and we have today declared a special dividend of 7.3p and an interim dividend for this year of 3.2p.

Turning to the second half of the year, we have continued to trade well in both Grocery and general merchandise and while it's fair to assume that Christmas will be different this year we are well set to deliver for customers in stores and online.

At the same time, there will be some offsetting investment as we continue to improve the value for customers and we will continue to incur COVID costs, with colleague absence levels, for example, having stepped up in the last few weeks.

For the full year, our central assumption is that our current sales projections would result in full year Group underlying profit before tax increasing by at least five per cent year on year.

Thank you very much for your time this morning. I'll now hand over to Simon to take you through some of the operational highlights during the period and our updated strategy.

Simon Roberts
Chief Executive Officer

Thank you Kevin. Good morning everyone and thanks for joining us today. I am going to shift gears now and spend the next 35 minutes talking about what we see ahead for Sainsbury's. But first I want to say, I'm really proud of what our team have delivered over the last six months and what our industry continues to collectively achieve to feed the nation. The last few days have reminded us all of this again.

Now as a business, we have cared, and continue to care, about what matters most for our customers, our colleagues and the communities we serve. Safety, availability, helpful service and supporting the elderly, disabled and vulnerable. This has been a time of extraordinary delivery, learning and adaptation. And I have witnessed a pace of execution and customer focus which we are determined to hold onto. And whilst this has been going on, I have also been taking a full look at the business and our strategy. Nothing has been off the table, we've had a thoroughly good look at everything. And as you'd expect I have done a lot of listening to customers, suppliers, colleagues and investors. And my main objective today is make sure you are clear on our strategic priorities and how we plan to accelerate delivery for customers and for investors.

So I am going to cover the following this morning. First of all COVID impacts with a focus on the strategic changes it has accelerated. And then my reflections on our business and our position in what is a rapidly evolving market. I will spend most time on our purpose and our priorities. Specifically what our focus will be and the changes we will make. And then finally, I will summarise what our plan will deliver for customers and for shareholders.

It has clearly been a unique first half. Our number one priority has been ensuring that customers and colleagues can shop and work safely. Our colleagues have risen to the challenge of COVID with a great energy, passion and a new determination. And we have responded to unprecedented changes in customer behaviour and the operational requirements that have followed. And of course this is far from over as we are seeing again from this week. An example of this is how we have doubled our grocery online business, expanding our capacity from 350,000 orders per week to a record breaking 736,000 orders last week. But as we look forward, I think these are the key points. We have found a new pace and agility as an organisation and regardless of how long COVID is with us, we expect that a number of these changes are here to stay.

And talking of changes that are here to stay, the rapid shift to digital. These charts do a good job I think of showing the huge step up in digital participation during the first half with digital now accounting for nearly 40% of all our sales. Online grocery sales doubled in the half, with sales participation increasing to 15% of sales. This continues to rise, and in fact participation last week was over 18%.

Now we have spent a lot of time and money in recent years investing in our technology and digital platforms and this has meant we were able to deliver this growth efficiently and profitably. Smartshop continues to fundamentally change the way customers transact in our stores. And as you can see on the chart on the right, sales through Smartshop are now 31% of our sales and nearly 20% of our transactions in handset stores are going through Smartshop. You can see how dramatic the change has been in the past year.

We will return to online profitability later, but as you can see here, we're fully embracing this rapid change in how customers want and need to shop. And at the same time, we're adapting our business at pace to address and mitigate the lower profitability of online.

Now on this chart we can see the digital shift is also happening across our non grocery brands with Argos and Tu online also stepping up significantly over the period. 90% of sales in Argos are currently online as we have seen dramatic changes in how customers are shopping Argos.

We've helped customers shop the way they have wanted and needed to and most importantly supported them to feel safe throughout the first half and this performance has continued over recent weeks.

Now on this chart we show the customer satisfaction measures compared to our key competitors both in stores and online. Online customer satisfaction was flat across the first half despite doubling order volume. And more recently it is now ahead of last year. And in our internal measures of customer satisfaction, availability now is also up year on year through the second quarter after a tough Q1. In other areas of our customer satisfaction, speed of service is up13% year on year and the friendliness and knowledge of our colleagues is up 7% year on year.

Now in moving on to talk about our business to reflect on where our business is at. Starting with what we are seeing through COVID in a broader market context. Now I know that nothing on this slide will be a surprise to you. But the pace of change of activity is clearly speeding up. The 5 major factors we expect, and which have informed our plan are shown here.

First, we expect the intensity of competition to continue and if anything increase, especially in driving value. The accelerated shift online I have just spoken about will not reverse. Amazon will remain as strong, direct and growing competitor. As will the Discounters who we expect to continue to expand capacity with continued focus on value. And all of this will be tough for us all, but especially for smaller players. And the Foodservice sector has clearly been dealt a firm blow by COVID.

So as a result, how will we compete more effectively? I think there are 3 important takeaways here. In this environment we must prepare for continued disruptive moves and we expect the landscape to further change. We must be ready and fit to participate. Scale has always been a key competitive advantage in grocery, but even more so through periods of turbulence. Our relative scale gives us the ability to absorb change and out-invest smaller competitors. And these challenging dynamics together will put continued pressure on industry margins. But they cannot be an excuse and I believe we can deliver better relative performance.

Again, no surprises here when we think about the key consumer trends and priorities. In this environment, people are shopping differently, with the resurgence of a big weekly big trolley shop and an enforced shift away from eating out. With these changes we see the following trends accelerating:

Value because its important, combined with ongoing increasing pressure on household spending. As highlighted already, a permanent shift to digital with sustained online and mobile growth, plus predominately contactless payment. Convenience, customers want to have it now, they want ultra convenience, combined with a growing desire and trend to source locally with renewed focus on provenance. And underpinned by health and

sustainability, with heightened public awareness and government initiatives to drive behaviour change. We, I believe are well positioned to adapt to these shifts in customer shopping behaviour. But stepping back, the right-hand chart, shows the customer priorities day in day out, remain the enduring ones we all know so well. Convenience, price, value and quality.

So, turning to the platform this business has today. It's clear to me we have great assets and great people. We're a heritage, trusted brand, loved by millions of customers. With scale number 2 position in food, operating in highly attractive locations with particular strength in the South and in Convenience. We have strong positive operating cashflows. We serve an attractive customer base with a bias to a more affluent sociodemographic than our key competitors. We've invested in digital innovation, and Nectar is now a firm basis with which to create customer stickiness and build proprietary data sets. This is a compelling foundation to build on. And it gives the team and I real confidence that from it, we can deliver improved performance.

Now despite the positive performance of the past 6 months, Sainsbury's has not been winning in recent years and we have not been delivering to our full potential. And as you would expect since becoming CEO in June, I've spent a lot of time listening closely to our key stakeholders. I have also taken an unvarnished look at the facts and economics of our different parts of the business. Let me draw out some of the key insights:

We have lost ground in Food. Customers tell us that we need to offer more consistently good value on everyday items, and regain our historic strength in food quality and innovation. Our colleagues say that they have never felt more engaged, as you can see on the middle chart. They want to bottle the new ways of working and up the pace of the business permanently. They also say we've added complexity to our business and this has brought cost and slowed us down. We have spread our resources too thin.

Suppliers say we're good to work with and they see the potential in our customer base. They also say we need to move faster, working more in partnership to innovate at pace and drive growth.

And finally, our financial and shareholder returns have not been where they need to be. Our shareholders are asking for clearer focus, a strong balance sheet and improved returns. There is clearly a strong desire from our suppliers, our colleagues and our customers, to see Sainsbury's winning in the marketplace. And given the strength of our competitive position in core grocery, I'm convinced that we can.

Being a better Sainsbury's, starts here, with a new, clear, galvanising purpose. Why do we exist? Why do 178,000 people get up every morning and come to work and do what they do? Driven by our passion for food, together, we serve and help every customer. This belief and this conviction has to be throughout our business with all our colleagues. We will put food back to the heart of this company. At the core of our purpose, all of us could eat a little better, no matter how much time or money we have. Tastier, healthier, more sustainable food, cooked and made at home, enjoyed together. Together we will serve and help every customer, helping everyone to eat better.

So now I will move on to talk about our priorities and the 3 priorities which will drive our resource prioritisation and deliver value over the next three years. There is a lot to be done to deliver the improved performance we all want to see. This is about focus, acceleration and delivery. Our three value creation priorities are: Food First, Brands that Deliver and Save to Invest.

So, what will be different as we look forward? I and we will put food first. However hard we pursue the multi brand platform, it can't succeed without a vibrant food business at the core. We will focus the role of our other brands more tightly in supporting food, ensuring they each deliver in their own right. We will step change our ambition on cost, going beyond cost savings to commit to structurally lower our cost to serve by at least 2 percentage points to sales. We will be open to, and pursue partnerships where they accelerate our priorities. We have built a robust plan to increase earnings and continue to generate strong dependable cash flows, we will continue to do this. And underpinning all this will be a clear set of metrics against which we will measure ourselves, directly linked to incentives. We will simplify how we work, cut complexity and accelerate our delivery, which I will measure through these key metrics.

We will have 7 metrics, 3 operational and 4 financial. This is critical internally to focus minds, and externally, to bring consistent, clear measurement of our progress and delivery against the commitments I am making today. By consistently report against these you will also judge our progress I know as we move forward.

So, onto our first priority, to win in food, to put food first. To inflect the trajectory of the business overall, we have to change the trajectory in food. So, what does it mean to me to put food at the heart of Sainsbury's? It means better value, getting credit for value and range especially at the centre of the plate. It means reigniting innovation and inspiration, improving the speed and success rate on new products. It means growing online, extending points of distribution to expand our reach and accelerating convenience store opening. It means being committed to sustainability, through Net Zero being fully integrated into our customer and commercial plans. It means we will tail a proposition by store and by channel, meeting the needs of local customers and being more relevant. Using data and advanced analytics gives us ways to do this which we did not have before. It means leveraging and adapting our supermarkets and their role as productive omni-channel locations.

And it means our store colleagues of course being the vital front-line ambassadors of our plan and our brand. And we will continue to deliver and offer helpful great service where it really matters to our customers.

Now it's critical of course we deliver this making full use of the technology and data enablers which we have invested in. At one level the 'what' we need to do is not all new, but the 'how' we do it will be very different. Seamlessly 'omnichannel' across stores and online, innovation fully connected to customer preferences, tailored price and range decisions driven by data in a way that was impossible five years ago. As a result, I am confident in our ability to inflect our performance in the core of our business in food.

We will address our value position. You saw the start of this focus at last year's Capital Markets Day. We're committed to being better value for money, with more consistent prices across the year. We will be competitive in key categories and everyday products that matter most to our customers. This investment is already in progress. In the last month we have invested in over 300 fresh food lines and it's already having an impact. Customer satisfaction measures on value are the strongest we have seen in recent years and where we've invested, we are seeing an 11% increase in volume in Meat, Fish & Poultry lines. Improving real and perceived value for money is a vital first step. And I will talk in a few minutes about the cost programme that is so key to underpinning the sustained investment in value we will make.

In innovation, we have lost our lead in recent years. Customers have high expectations of the Sainsbury's brand in range and in quality. And you can see here they still rank us highly on quality. However, they tell us we can do better on innovation and as I have already said,

our suppliers challenge us here too. We will innovate more, faster, and with a higher success rate. We're making this a priority.

We will innovate faster in our own brands, as well as being a home for branded innovation. We will speed up our processes to reduce the time it takes to bring products to market. Customers tell us we can do more for them in areas like Taste the Difference, Organic and healthier products in particular. And as an example of how we are moving faster, we've just reset our fresh food department in every supermarket for the first time in ten years. We've done this with a full space rebalance, launching over 200 new lines. Customer reactions and volumes have been ahead of expectation. And it is great to hear customers on panels talking positively about buying and enjoying our new fresh food products.

Now customers also tell us of course that they care more and more about the impact of their shopping on the environment, and we have a strong track record here, having led the industry across many initiatives over decades. We published our net zero targets earlier this year. And we're reporting progress against these for the first time today and this slide lists the 4 priorities we will be very focused on over the next three years. Reducing our carbon footprint, helping customers make healthier and more sustainable choices and reducing food waste and packaging. The next stage will be to fully embed these in the operations of the business.

Now we've been at the forefront of the shift to digital, investing ahead of competitors both in proposition and in our operations. And despite the challenges, it's been a clear imperative to be where our customers want to shop and this has served us really well. In my mind there is no doubt whatsoever, that the accelerated shift to shopping for Food online is here to stay. We've responded with focus and speed to double our online capacity. We've added just 15 new stores to fulfil orders, moving to 259 stores. As a result, we've strong operational gearing and very low capital investment required to scale to the volume we now have. And importantly, more than half the increase in online grocery sales is coming from customers who are new to Sainsbury's as you can see on the right-hand chart.

Just to be clear, this has been profitable growth for us. We have increased sales and are seeing better online margins, even before you consider the additional leverage on some of the store based fixed assets and costs.

Now there are 4 key drivers of online profitability. Drop density which has improved and we've seen orders per van increase by 35%. Our average basket size has increased by 17% and stem mileage has reduced. Our item pick rate which you can see from the right-hand chart, dipped at the start of the crisis is rapidly recovering despite ongoing social distancing limitations. We are now back at almost pre COVID levels. And through click and collect, we are now at 100,000 orders a week, that's 8 times greater than pre COVID levels with sales participation of click and collect at 20%.

We've also increased efficiency at the doorstep and maximised capacity through dynamic slot pricing and extending delivery windows. Put simply, we are driving shorter distances with fuller vans. And we can make ourselves more efficient by continuing to improve our Grocery Online operating model, and experimenting with new ways to operate this channel well and cost-effectively as it continues to scale.

Now onto our Convenience estate. And as I said earlier, customers are shopping more locally. We have a strong convenience estate and customers have really appreciated the opportunity over the last six months to shop Sainsbury's closer to home. Sales are up 15% in stores close to where people live. We are stepping up our ambition on new store openings, doubling the rate of growth. But importantly, focusing on sites close to where

customers live. And building on the success of the new neighbourhood store format, we will open around 18 of these stores in next 3 years and we will expand our convenience network to a further 110 locations in anchor towns in attractive underserved catchments or where we are sub scale today.

So to move on to the 2nd and 3rd priorities of our plan. These both support our ability to deliver in Food. Our 2nd priority relates to our non-food brands. We've spent significant time looking at how shoppers interact with these parts of our portfolio, and crucially we have looked at how they are positioned competitively. As a result, will make material changes in how we run these brands. As you know Sainsbury's has assembled a number of brand assets as part of a multi-channel multibrand group strategy. Bringing these together has delivered value in some areas, especially where they share overhead and store costs. But an unintended consequence has been to introduce complexity into our business and distract us from our core in Food.

Our brands do, of course, share customers and this is a strength and an opportunity. But they also have their own shoppers, especially Argos. Going forwards, we'll manage these brands with three very clear objectives: delivering for their customers, making a return in their own right and supporting our Food business. They must deliver profitable growth and we will invest in them in proportion to their potential to do so. This means different things for our different brands. And I will now take you through the headlines for each.

Let me talk first about Argos. Now it's no surprise that Argos has performed well during COVID as Kevin shared earlier and it continues to do so. We're starting a bold transformation of the Argos model aimed at making it more competitive and more profitable. And COVID has reinforced our confidence in making this change.

Let me share a few facts about how Argos shoppers are changing their behaviour. Digital penetration has been growing rapidly, even before COVID, 60% of sales were online and today is at 90%. Of these, more than half are click & collect. Our store in store locations continue to perform strongly. And finally, we know we must continue to improve both value and availability to enable Argos to remain competitive.

These are the facts that underpin our plan for Argos, starting with a full transformation of its channel and fulfilment infrastructure. So, over the next three years, we will close around 420 standalone Argos stores. We will open around 150 more Argos stores in Sainsbury's and will open another around 100 collection points, so customers will be able to click and collect at every Sainsbury's supermarket. Now there is a strong customer and cost-sharing logic to these moves, they will future-proof the Argos model and boost our ability to invest in the proposition and improve profitable returns. Around 12,000 colleagues work today in our standalone stores and we will be working really hard to redeploy colleagues where we can. We do expect around 3,500 roles to be lost as a result of these changes.

For support this shift, we will build around 30 new local fulfilment centres. These will give shoppers quicker access to a wider range and will improve availability. They will help us to take stock out of the system overall with real working capital benefits. Also, we will continue to improve our price position, and reduce the number of promotional events that we run. And we have already been reducing operating costs by stopping the catalogue production and there is more to do here beyond. Overall, these changes will reduce cost to serve at Argos by around £105m in the next three years. And at the end of three years we expect to have around 1000 locations in Argos to keep improving on the convenience and speed which are so critical to the Argos proposition.

Now Home and Furniture is a key area where we can differentiate and grow and the Habitat brand is an asset here. It's a really strong brand and we're going to maximise its potential for the first time by making it our main home and furnishing brand. We will launch new product ranges from Jan '21 and by the end of the year, Habitat branded products will make up almost 80% of Home products on our shelves. And we will fully integrate Habitat operations into our Argos and Sainsbury's operations.

Moving onto Nectar. Well this is an exciting business, which fundamentally unlocks our ability to connect with customers and drive that insight into our business decision-making. Nectar will support Food First, it will be fully integrated into the Food journey and deliver personalised value and content. The relaunched App is already on the way to having 10 million users. It is already a very profitable media business, and we will continue to grow this further.

It can also increasingly support and link our portfolio brands as well as driving increased value from scale coalition partners. And for example, Nectar rolled out in Argos in September and the uptake is already well ahead of plan. We see Nectar playing a pivotal role to support our overall strategy, as well being a driver of profit growth in its own right. And so, turbo-boosting Nectar will be a key priority for us and Mark and his team are fully focused on this.

Now our customers want and expect Financial Services products across Food, Clothing & General Merchandise and we are committed to providing these. We laid out a clear strategy and an ambitious plan for the Bank last September when you were with us at our Capital Markets Day. I'm confident in the delivery of this plan being led by Jim and Mike, despite the challenges of COVID. I said earlier that all our brands, including the bank, must deliver for customers and shareholders in their own right. And the plan for the Bank is entirely consistent with this. It aims to double profit and returns over five years and take no more capital injections from the Group.

So I now we move on to the third of our priorities, Save to Invest. We're very clear that the plans we've outlined for our grocery business are ambitious and we need to deliver a structural reduction in our operating cost base. We have not been good enough at this in the past. This must become a non negotiable, and one of the key metrics we report against. It requires a transformation in the way we approach costs and becoming a much simpler business. Operating cost reduction is an imperative of course to create fuel to invest and return greater value to shareholders. We also have a renewed commitment and believe we can work more effectively with suppliers to make sure we are giving customers the best value possible.

Now the change in our cost ambition should be clear here. We have a good track record of delivering cost saving initiatives but we have allowed our overall cost structure to rise. We now need to fully focus on simplifying our business to structurally reduce our cost by at least 2% to sales and doing this will create £600m of additional capacity to invest and deliver in Food as we have outlined. Savings will need to be higher than this to offset areas of unavoidable cost inflation and we will move further and faster than we committed last September. It is critical that we do this with real focus both to create the firepower to invest in our Food business as well as delivering better returns overall. And underpinning our ambition in cost, we will transform our ways of working to reduce complexity.

I and many of the team have overseen major cost reduction programmes before, and let me tell you I am under no illusion about what is involved. There will be tough decisions and we will need to work differently. We know where the cost needs to come out. We have spoken about some of these areas before, for example our logistics and supply chain reinvention,

targeting around £150million in savings. I have touched on a couple of other areas today already, namely our plans to reduce the Argos standalone store estate, which will deliver around £105million savings over 3 years. There is more work to do in our store operating model, and COVID has both increased the need for this, and shown us how to work differently. For example, counter closures will drive down hours, shrink and waste, worth around £60million in savings.

I now want to spend a couple of minutes now on Technology and how it supports our performance and efficiency. Phil and his team are at the forefront of leading our focus here. This has been a key area of investment for Sainsbury's and will continue to be so, although as you will have gathered from my previous comments, the prioritisation of that investment will shift to make sure it supports Food and our cost reduction programmes. As I mentioned earlier, we need to pursue our strategy fully leveraging the power of technology and data. Technology is fundamental to the channel shifts we are seeing, to unlock efficiencies, process change and make better and faster decisions in all parts of the business.

Let me give you a couple of tangible examples of how this is working already. In delivering our customer experience, we know that if we switch 1% of customer transactions to self checkouts and Smartshop this saves £5million a year. And we know that once customers use Smartshop they don't revert back. In driving structural agility & efficiency new supply chain systems will enable an end-to-end process simplification and improvement in what we can deliver. Technology is also a critical enabler to our plans for Nectar. Which in turn supports the journey we are on towards being a fully customer and data-driven organisation. Therefore, Technology and Data will remain a key focus for investment and we'll be making sure we deliver a tangible return on each element of investment we drive in technology.

So, turning to our team, we have the right leadership team to deliver this plan. I've made some key changes to the structure of our team to deliver the change necessary. On my first day in June, I wanted to be really clear that customers would be at the heart of this business and our decision making. That is the reason I promoted Mark Given to the board as Chief Marketing Officer to bring the voice of the customer into the heart of the business.

I am now changing the structure of our commercial leadership to bring the additional focus we need on Food to lead and deliver the plans I've shared today. We will have separate commercial directors for Food and General Merchandise and Clothing as we move forward.

Rhian Bartlett leads our fresh food business today she will step up to lead the food division going forward. And Mike Luck will lead the General Merchandise and Clothing division. I'm really pleased for them both and know they will do a fantastic job. Since June, we have also brought our channels together across retail and digital under Clodagh Moriarty reflecting how customers shop and the need for us to show up consistently for them. I would like to thank Paul Mills Hicks for his outstanding contribution to Sainsbury's. He will be working alongside me well into 2021 in an advisory capacity.

Now we touched on what will be different earlier, but I want to be really clear on what will be different in the plans we have laid out today. Together with my leadership team, we are bringing a clear sense of acceleration, focus and delivery. We can and will do better for our customers and our shareholders. And in the end, it is about value creation delivery of course.

We will deliver an inflection in our underlying profit momentum, driven by a stronger food performance, improved performance from our portfolio brands and the structural transformation of our cost base to drive at least 200 basis points of reduction. There will be one off costs of around £900million to £1bn over the next three years, but these are largely

non cash impairments, with cash costs of around £300million. We are maintaining the same tight discipline on cash and capital expenditure as you have seen in recent years. The increase in capital expenditure over the next three years will go to high returning investments in the transformation of the Argos network and our supply chain and logistics infrastructure. These will reduce cost to serve and unlocking working capital benefits. We expect to continue generating an average £500million a year of free cash flow in the three years to March 2025, which will allow payment of a consistent dividend whilst continuing to strengthen the balance sheet.

And so to close. I believe this is the right plan for what this business needs to do next. We've made some bold choices and set clear priorities. I am energised, passionate and determined about what I think we can deliver.

I want to thank you for your time and thank you for listening.

Question and Answer Session
Simon Roberts,
Chief Executive Officer

Thank you, Good morning everybody and thank you for joining us this morning on our strategy update and Interim Results Call. I am joined here this morning by Kevin O'Byrne, our CFO and James Collins our Head of Investor Relations.

Now I hope you have had a chance of course to read the statements and see the Presentation that we posted on our website earlier today. It runs through what has been an extraordinary first half of the year for us where I think the business has really shown its potential and executed very well. And I want to put on record again my thanks to all my colleagues across the business who have gone above and beyond to serve customers in really challenging circumstances.

But more than that, I hope that the statement and the presentation has given you a really good feel for what I think the opportunities are. To take advantage of the rapid changes we are seeing, the way customers are shopping, to accelerate the changes that we can make to our business to improve the customer offer focused on food. And to do that in a faster, simpler, more effective way.

So I am really looking forward to speaking to as many of you about this as possible over the next few weeks and to meeting you in person as soon as that becomes possible. But in the meantime, I am sure you have plenty of questions for us this morning, so I will hand back to the operator.

Question 1

Andrew Gwynn, Exane BNP Paribas
Morning, hope you are all okay. Just going back to the webcast actually and a couple of things that popped up on there. So the first was you talked about targeted price and targeting it by demographic, sorry by store catchment, I wasn't entirely sure how that might work, maybe perhaps through the Nectar. But if you could just elaborate on that a touch.

The Bank which I am sure will come up a few times, but the Bank obviously has some speculation, some suggestion that you may well sell it. You have obviously reaffirmed the targets to improve profitability, so what would it take, is there a plan B, I suppose is the simple question?

And then the final question which I am sure you are going to get tons of, but it is just about online. And again probably this is a boiler plate question which is essentially the profitability of the channel. So at present do I lead to margins, but not necessarily negative to absolute profit. Is that the view or I am just wondering whether the aspiration for that might be? Thank you very much.

Answer: Simon Roberts
Okay Andrew, thank you. I will take those and then maybe ask Kevin to come in as well on one or two of them. So just on your first question, yes absolutely is it part of our focus on food. One of the things we wanted to draw attention to is, we will tailor the proposition by store and by channel to meet the needs of local customers. And particularly we are thinking about that in terms of ranging and how we use our space to make sure that in local catchments our product assortment progressively becomes even more in tune with what customers would expect of us in each location. So that is one of the things we are going to be building and using data. And of course, as a part for analytics to give us the way of really understanding through Nectar as you say, what customers expect.

Yeah just in terms of on the Bank. We laid out a clear strategy as you will remember at our Capital Markets Day last September, an ambitious plan for the Bank. And Jim and Mike and the team are absolutely on track to deliver that plan, despite the impact of COVID and we expect to report a profit in the second half as you see in the Statement.

We have received some incoming expressions of interest from the Bank, that is not unusual, it happens from time to time to get the exploriodic stages and there can be no guarantee at this stage. So we are very focused on executing the strategy that we laid out a year ago, the team are making really good progress on that. As you will remember we committed to double our returns over a five year period and to bring our cost to income ratio down to 50%. So that is on the Bank.

On online, yes and it is clearly an area of the business we have been really focused on over the last six months. So maybe just to give some dimensions as to how we are thinking about that. We have doubled the volume as you have seen. So all the volumes have doubled over the period and this is profitable growth for us. So both the contributions from the growth that we have seen, 102% growth in online grocery over the half. But we have also improved the margin and that has progressively improved as we have really focused on the key economics of the model. So just to take us through the key elements of that.

We have been really focused on how we improve block density and we have increased the number of orders per van by 35%. We have seen basket size increase by 17% and are actually really focused here too on pick rate which of course if the key driver of the instore model. And it has been challenging for our colleagues because of course with social distancing, trying to pick twice the volume of orders it has been challenging. But we have seen the item pick rate return to broadly where we were before COVID. And then the final one is the mileage as we go to more customers so we can reduce the mileage.

So on the frame of the economics, Andrew we are encouraged by the shift we have seen in all four of those and as you have seen in the presentation this morning as well we have seen a big shift in click and collect, eight times the level that we saw before COVID and that is one of the things we have accelerated. So we are now offering a click and collect service in 323 big markets, we have put over 200 more click and collect locations in. And that is again obviously a more efficient way of fulfilling the volumes.

So very focused on providing the number of orders for what the customers want, very focused on how we drive the efficiency into the model. And as we look at stores end to end, we are also very thoughtful about as we put more volume at the back store to store so to speak in terms of online grocery, how too we can also look at efficiencies in the front end of the store too and will talk some more about that through the call.

Kevin if you want to add some?

Further question
Just to come back to a tailoring process, well a symptom really on a local level, it is entirely probable what I misunderstood what you said on the webcast?

Answer: Simon Roberts
Let me just try and clarify that. It is specifically tailoring the proposition by store. And as I say ranging would be one of the key focuses of that Andrew.

Further question
But could also be promotion I guess?

Further answer: Kevin O'Byrne
Andrew the reality is if you go into our convenience stores at the moment for example, 87% of the offer is tailored to that locality. So you will find more Taste the Difference ranges in some locations, more buy Sainsbury's in other locations. So in effect you have got different prices but it is because you go a different range. So as we tailor the offer in the supermarkets you see potentially more of that.

Andrew Gwynne
Okay that's clear, thank you guys.

<u>Question 2</u>

Rob Joyce, Goldman Sachs
Morning Simon, welcome, and brief from me. So the first one is just on the comments on FY22 PBT expecting to be at least in line with FY20. Could you give us some insight into how you are thinking about how top line will be behind that in terms of both the grocery business and the Argos business?

And the second one leading on from that, is the flat number you are essentially guiding to on a normalised basis. With all the different cost savings programmes and initiatives you announced today, is this a case of these are the things you need to do to offset some of the delusive impacts of online and some of the other headwinds you may be facing? Or do you think beyond FY22 these initiatives can really drive some profit growth?

And then the third one is just on the exceptionals. In terms of cash out, I think a £100 million this year, another £100 million roughly a year for the next three years. After several years of a similar level of exceptionals now in the business, I mean I don't the easy way to ask this, but at what point does this not become exceptional or should we start thinking about these exceptionals as more recurring? Thank you very much.

Answer: Kevin O'Byrne
Rob morning, Kevin here. I will start with the Group '22 guidance I think and then maybe pass it over to Simon for any thoughts on that as well. Obviously, March '22 is a long way away so we are not going to get into detail with the forecast, as you would expect. Given that this is a very unusual year you would expect the sales to be likely go backwards from this

year because of the exceptional nature of this year. So, the purpose of giving some guidance was we did have a concern coming into this as we increased our ambitions for online as we increased our ambitions to invest in value and more innovation in the business. But people might misinterpret that and think it was a profit reset. And we want to be very clear it isn't a profit reset. We have got ambitions to grow profit and hence we want to give some guidance and some shape for the year without getting into too much detail given that it is some time away.

And Simon if you want to add anything to that?

Further answer: Simon Roberts
I think maybe just the other point Rob would be. We are laying out a very different level of ambition this morning and the commitments we are making on both the focus on the food business and also our expectations on reducing our costs in the business by at least 200 basis points over the next three years, is all about driving an inflection in our profit over that period of time.

So when we get beyond the exceptional nature of this year, the COVID year, and we go beyond '21/22, we are very clear that we want to inflect and we believe we will inflect out profit trajectory beyond that point, enabled by the momentum in the food business that we talked about this morning on the presentation. And by the substantially higher level of ambition in terms of cost saving.

Further answer: Kevin O'Byrne
And Rob if I pick up the exceptions point. And I do understand what is behind your question. I mean we are very clear; we want to pull out anything that is one-off in nature or by its size is unusual because if we include it in the base business it would be confusing to understand what is happening in trading. And if you think of the items that are in there this year you know closing the number of Argos stores, we have talked about, reorganising our logistics infrastructure as we have talked about. And having reviewed the changing strategy, but also obviously the pandemic and what that has done to some of the carrying value of assets, you can see why they would be exceptional in nature. What we always try to do is have very clear disclosure both from a P&L point of view and from a cash point of view so you can hopefully read of the accounts, can interpret it and frankly you can move them if you want above the line. But we think that would be unhelpful if we did that. We obviously do also understand the level of exceptionals continuing, hence we have tried to lay out what we think is going to happen over the next three years so we have given some guidance on that. And we think that is what is necessary to complete the plan in what is by any definition, a mark that is changing dramatically in front of our eyes. So I think that is probably all I want to say on that.

Rob Joyce
Thank you, I appreciate the call, thank you.

<u>Question 3</u>

Fabienne Caron, Kepler
Yes good morning everyone. Three quick questions from my side. Simon in the webcast you say that the price perception for Sainsbury was at rank number 6. I was wondering if you could share with us the ranking in terms of price provision so we have an idea on the gap?

And the second question would be on trading down. I would be interested to see if you have seen so far some trading down in the UK in food, and if you could remind us of the weight of your opening price points please?

Answer: Simon Roberts
Thank you Fabienne. So just in terms of price perception first of all. I think to be really clear in the presentation this morning, we wanted to draw attention to the price perception of customers. But I think just to add some colour in terms of the price reality. So we start from as you know a lot of work we have been doing since the Capital Markets Day last year to focus on the competitiveness of our prices as you just highlighted. That started with the entry price point work that we began last year. And we have been progressively improving the competitiveness in the offer. It takes time obviously for customers in their perception to see that.

But as we stand today, we are in a stronger pricing position versus our largest competitor than we were at this time last year. And we are pretty close actually to the strongest we have ever been. And that has been driven by both the work we have done on entry price points, but also as we focus on investing in price in the areas of the offer that matter most to customers. So we have reduced the price of around 1500 products in recent months, specifically in the last few weeks we have focused on products for example in areas like meat, fish and poultry, the centre of the plate. And as we do that, we are seeing the volumes respond. So we have an 11% increase in volume as you saw in the presentation this morning as we focus on those core everyday products that customers want to frankly rely on us to provide really good value. And as they buy into those products so too the basket increases and they extend their shop across the wider offer.

So that is what we are doing in terms of price, perception price focus. And I would say this is accelerating what we have been doing and we are very mindful to make sure that where we invest in price it is in areas that we expect customers to really notice and of course we are balancing investing in price as well as driving improvements in the returns to shareholders over the life of this plan.

So that is how we are thinking about price perception. In terms of entry price points as I say, we launched that work last year, we are really pleased with how that is progressing. We have increased the number of entry price point brands and products and very much targeting that we have got core value as entry levels so customers see that, in the offer of14 brands today and really we are seeing very little trade down into those products. So we are holding within the hierarchy but we are winning those customers back particularly against obviously the discounters as that is an important part of what we are doing on price.

So a key focus on food, improve our competitiveness as we do that on a sustained and consistent basis, we expect price perception to continue to improve and ultimately to drive volume as a result.

Fabienne Caron
Okay, thank you.

<u>Question 4</u>

Xavier Le Mené, BofA
Good morning, thank you for taking my question actually. Two if I may. The first one, how do you see online grocery going forward? So you mention of course the significant service in click and collect, but what is your plan or how do you see the market if you look at click and

collect versus home delivery going forward and do you see the opportunity to improve if you significantly increase click and collect?

Linked to that, how do you see your store count over all. Do you think that potentially you have got too much pace going forward and you have to look at that in the next 2,3,4 years? How do you see the shop floor?

And just the last one, removing services from the stores. So you clearly are following you know what Tesco have been doing. Is it the right choice actually and how do you plan to differentiate Sainsbury's as is your peers going forward?

Answer: Simon Roberts
Thank you Xavier, so I will take each of those questions in turn. I think in terms of online, you know as we are all seeing, I mean you can see the volume double over the last six months has been extraordinary in terms of how that has happened. And we haven't hit the high watermark yet. We are still seeing an increased level of demand for online and our job first and foremost is to be where customers expect us to be. We are very focused on how we both service that volume, but also do it increasingly more profitably too.

And so the comments I was making earlier about particularly the economics of the online model, that work is front and centre for us so as we drive improved baskets, as we improve the pick productivity, as we reduce the stem mileage and as we drive the block density, we are confident we can continue to offset the headwinds of the higher online costs by improving efficiencies.

Just to add a bit more colour to this way we think about the box overall. We are serving online grocery from just under 300 of our supermarkets today. To move from 350 a week to 736 a week last week, we have added 15 stores to do that. So it is a very high gearing on the fixed costs and assets of the store in terms of the online volume, very low capital costs to do that. So effectively double the volume. So as we add more volume I think very low capex required to do that. And that is where click and collect to your point comes in. To add 323 locations today, there will be more that we can add, but I think that has happened quickly and is servicing that demand for us.

As we think about online going forward, I think market predictions would, expect that to drop back a bit from the peak, we are at 18% of our sales today. The market predictions would be that would drop back to mid-teens. We are planning for both eventualities here and we want to clearly make sure that we can profitably delivery the availability to customers they want. And that is the reason why we are so focused on the economics.

Now I should just say that if we look at our supermarket focus and one of our biggest stores for last week, Kiln Lane, in Epsom, top ten store in the business, we are seeing the combination of growth in grocery online with Argos store in stores driving sales growth in that store of 18%.So if we drive more volume in the store, you know one of the challenges in this industry for a long time is how we drive trade intensity. And we are seeing the intensity increase as we bring more of the Argos offer into the supermarkets, so too we can create more even for customers to shop in the store.

And as I said earlier, we shouldn't underestimate the efficiency opportunities we have seen in front of stores. So Smartshop is both a safer and a faster way of customers checking out. 31% of the sales now going through into Smartshop. I expect that to continue to accelerate, that drives efficiency for every 1%, a swing that we can drive in how customers check out. That delivers a £5million efficiency benefit. So as we think about the context of the box overall and how we drive the economics from within that, I think that is key in terms of online.

In terms of store count, to your second question. You remember that we announced last year our property strategy programme and we said at that point in time that 10-15 supermarkets and 30-40 convenience stores we would expect to close over two years and you are seeing our statement today that we have updated that guidance and we now expect 15-20 supermarkets and 50-60 convenience stores to close as we continue to look at how customers are shopping. So we are very focused on the portfolio and making sure we are driving profitable returns from the space we have and we are very focused on how we deliver against that.

And so I think maybe just in terms of the store count, Kevin I think you wanted to add on that?

Further answer: Kevin O'Byrne
The only thing I was going to add Xavier is that it is in the restructuring costs that we announced today, the £900m- £1billion includes all the work on Argos stores and all the work on the Sainsbury's portfolio that we anticipate doing in the next three years.

Further answer: Simon Roberts
Great, and then just on your last question, yes absolutely. I mean the decision on counters is a difficult choice for us but one we need to take because we have seen sales on the counters broadly decline by 10% a year over recent years. Customers of course through COVID have been shopping those products in the aisle and we have accelerated the speed with which we are bringing new products into aisles. So we are very confident that whilst we will be closing the counters we can bring in more and more innovation into the aisles for customers.

For example on the fish aisle if you are looking in the fixture today, you can see the range of fresh fish, whole fresh fish and the breadth of species we now have in that fixture compared to three months ago, is a radical shift. So customers are getting the access to the products that they want at more competitive prices and we can substantially reduce the costs in the business, £60 million of cost in wage and shrink and labour that we have been deploying in the counter that we can put back into improving differentiation in our core food offer and you have seen our ambitions and commitment on food innovation this morning. So I hope that reassures you on that point.

<u>Question 5</u>

Sreedhar Mahamkali, UBS
So three questions from my side please. In terms of the capex going into the supply chain project which you call high return. You helpful have given some numbers in financial word they must save, but could you also talk about the potential to improve working capital from them. Are you able to quantify them? If not, can you talk through what that does?

The second one, you talked about 2 percentage point reduction so the cost of doing business, retail operating costs. But why 2 percentage points and how would that look, your total cost of doing business, what you might see as the best in class in the sector when you get there?

And the last one is, Nectar, data monetisation, you talked about accelerating media avenues. Is it just a nice to have, or can it actually drive profits growth? Thank you.

Simon Roberts

Sreedhar thank you. So maybe if Kevin picks up the first part on capex and then I will talk about costs and Nectar.

Answer: Kevin O'Byrne
Yeah on the two big projects we announced today on the Argos store rationalisation and the logistics project, I would anticipate generating at least £100 million of working capital benefit from both of those as we reduce the number of stock locations both in the Argos business and across the Group in total. And that underpins what we have committed to today to have on average £500 million of free cash flow in the years beyond once we have completed our target of at least £750 million debt reduction that we announced previously, for the three years to March '25, delivering on average £500 million a year, part of that is helped by that work in capital work.

Further answer: Simon Roberts
Thanks Kevin. And yes just talking specifically on cost, Sreedhar to you point, so you hopefully see in our presentation this morning, this is a very different level of ambition on costs. So you have seen that in the recent period, although we have been focused on cost saving programmes, the cost of sales ratio has been increasing and we are expecting a clear target to bring that down as you say by at least 200 basis points over the next three years.

And as Kevin has just described, whether that meets supply chain logistics based projects targeting £150 million of reduction over three years or the changes that we have announced in Argos this morning, to reduce the cost to serve by £105 million. Or indeed the point on counters that we talked by £6 million. So we are very, very clear about this. This is a key entry point to being more competitive for customers and investing in the customer offer. So, we are going to bring a very different approach in this area. We are going to be really focused on how we have set internally a really clear plan to deliver a level of cost savings that we are committing to.

And I am very confident that we are already underway with some big programmes of change. And we are going to see those through to make sure we start both the beginning of next year and beyond to deliver the scale and ambition you said.

In terms of why is it that level? Well we think that is a bold and ambitious requirement for us to engage in and this will continue to be the challenge of this industry won't it, how do we deliver for customers a differentiated offer at the same time as being absolutely focused day in, day out at reducing the cost to serve. And that is what we are absolutely setting ourselves to do here. So that is how we are thinking about costs.

Just on Nectar in answer to your question. This is a core part of our strategy and we see real opportunities on Nectar to drive what is a highly profitable model. It gives us at its core, the ability to personalise what we can do for our customers. Now Andrew was asking earlier about what we are thinking in terms of personalisation. Personalising rewards, personalising the way we can offer customers products for them. Of course we have just put Nectar into Argos. We are really pleased with how that plan did, already well ahead of what we expected. We are expanding as you have seen, coalition partners. And then of course Nectar 360 is a part which is marketing a media platform that again we expect to drive significant returns from. So it is all about knowing our shoppers better and Nectar is an absolute core to enabling us to win into food first.

Further question
Thank you. A quick follow-up Kevin, the £100 million working capital, that is by FY22 already or are we thinking FY24 please?

Answer: Kevin O'Byrne
No it wouldn't be by FY22, it would be across that time period. So across the three years as we rationalise the physical locations.

Further answer: Simon Roberts
Maybe a little bit of final colour on this point. If we think about the way the Argos model works today where we have over 500 standalone stores, many of which have extended stock from locations which are full of the ranges of products that we sell today. We are going to over the next three and a half years build a fulfilment network anchored around thirty locations, which means that the level of stock we'll need to service, the volume will be less and it will be close to the point of where customers are.

And on the fee side, as we talk about what we are doing in the new supply chain logistics area, we will be thinking about again how do we particularly focus on those fast-moving elements of the food offer that currently we put away in our depots. And in the future we will look to fast track through to stores again bringing them a level of working capital. So it is one of the key focuses for the business. How do we both drive our return, but also reduce the level of stock in the business to do it.

Sreedhar Mahamkali
Thank you

<u>Question 6</u>

Clive Black, Shore Capital
Morning gentlemen, welcome Simon, wish you all the best mate. A couple of questions from me. First of all, just on the capex, give us confidence or the reasons why you think it can fall back to the circa £600 million level in due course? Because the track record of companies not just in this sector is poor on that front.

And then secondly, could you take us through the deliberations of the Board on the dividends declaration, particularly set against what we think are rather myopic and detached people who seem to think it is not appropriate for supermarkets to pay dividends, especially set against business free rate relief? Thank you.

Answer: Simon Roberts
Clive thank you. And thank you for your comments. Maybe Kevin do you want to pick up on capex and I will talk dividends and the points you made Clive.

Answer: Kevin O'Byrne
Clive the two main reasons we believe we can do it is the areas, the reason we are spending more than we said previously is around the Argos, building the network of 30 locations for stock for Argos as we close the Argos stores. And the logistics, restructuring they are the two big items that are raising the capex. And remember we are not building any big stores which was the big sort of capex spend if you go back a number of years. So hence we are comfortable that the number will come back down to the run-rate that we have said after three years. I think that is probably everything.

Answer: Simon Roberts
And the earlier point I would add is one of a focus and discipline Clive. And as you said, my job and our job is to make sure that every pound of capital we put into the business we invest against high returning projects and we monitor and deliver that deliveryand that is exactly what we were doing. So we are very focused on as Kevin just said, programmes of

fast return that drive either cost now efficiency or in the case of convenience stores, in high returning locations where Sainsbury's is under-represented today. So that is the discipline that we will absolutely bring to this for the reasons that you have highlighted.

In terms of the second point, just to confirm, as you said, the Board deferred the decision on the dividends for last year given all of the uncertainty at the beginning of the year. So this morning we have confirmed the final dividend for last year and just to be absolutely clear, that is in relation to last year's performance. And so we are pleased to confirm that dividend this morning. And also to confirm the dividend for the Interim at the Half Year. You know as you have indicated, the business has worked incredibly hard over the first six months of this year to feed the nation and to provide a service for customers in very challenging times. And I and we think it is absolutely right for the many small shareholders, many of them pensioners, they expect the dividend, they should expect to have received one. So that is where we are on the dividend.

In terms of the broader point in terms of business rates that you raised, a couple of points I would make here. We have long campaigned that we think business rates is an unfair system, particularly in the context of the challenges of retailing on the high street against online. And of course, we talked this morning haven't we about the radical shift to more customers shopping online. And so as we look at what has happened in the first half of this year, we have spent around £290 million in running our business to provide the service we have for customers. And that has been in areas such as supporting colleagues who have had to isolate to home, that has cost us around £70 million in the half. We have spent £110 million making our stores safe and of course there as the lockdown begins today, we will need to go again in that area, the challenges for winter and the Christmas trading period ahead, we shouldn't underestimate the fact that we are going to have to continue to put safety front and centre. We have hired 52,000 new colleagues since the start of the year and we have served just under eight million elderly, disabled and vulnerable customers at home with online deliveries.

So I am really clear about this, the cost of doing business in the last six months, whilst we appreciate the business rates help which has been £230 million in the Half, it doesn't meet the level of costs the business has incurred. And you have heard us say this before, but we will still pay more business rates than Amazon this year despite this situation.

So, our job is to focus on customers, we are very focused on making sure that we continue to do that. We appreciate the Government's help, but we think it is a very different issue to business rates and that is where we are now.

Further question
Well said on that point Simon, but additionally what else has Sainsbury's drawn upon from the Government in terms of tax and the capability to defer tax, people on furlough and other activities that have been widely due around the wider column and moving beyond business rates?

Answer: Simon Roberts
Thank you Clive. To be absolutely clear we haven't furloughed a single colleague and we haven't deferred any back payments. We are appreciative of the Government support, but as I say that has partially offset the cost of doing business. There is no other Government help we have taken in the period.

Clive Black
Thanks Simon and Kevin and all the best.

Question 7

James Anstead, Barclays
Good morning and apologies because I read through your slides, but missed some of the commentary. So if any of these questions have been answered then I do apologise. But going back to the questions on Opex and your target of reducing by 200 bps by March 2024. You have got a slide in the pack this morning showing what looks like a basically a straight line down over the three years. Do you use that, is that just a simplistic piece of drawing or is it broadly what you would expect to see that reduction being straight line rather than backend loaded?

Also you are also showing that Opex sales ratio has been rising in recent years, I wondered if you could talk about what the particular pressures have been that have been driving Opex up?

And then I am afraid it is a bit of a train spotting question, but your lease liabilities I notice actually have risen, sorry noticeably over the last twelve months. And I would have guessed perhaps your lease liabilities would have been coming down generally. I just wondered if you could explain why those have moving in the wrong direction as it were?

Answer: Simon Roberts
Thank you, James, shall I maybe pickup the first couple of questions on the cost plan and then Kevin on the lease at the end.

So just to be really clear, the chart that we put in front of you this morning is the chart we are committed to deliver. We are absolutely clear where we see opportunities to reduce our costs structurally in order to quote the feel as I described to invest in the offer when we need to. So a number of these programmes are already well established and underway. So the supply chain logistics changes that we have spoken of this morning, you will remember we began that journey last year and we are already well down the track of implementing, making that change.

Clearly the Argos programme that we have announced this morning that will begin immediately as we think about the first year and so the programme of rationalising the Argos standalone stores and resetting the cost of certain models in Argos underway and of course the counter decisions that you have heard. So these are three of the programmes that we headlined, but there are many others that sit behind them. And so we are absolutely committed and determined that we will deliver this level of strategic cost reduction as a period as shared in the presentation.

In terms of what is different, I think what is important to signal here is that beyond the £600 million of additional headroom we have committed to, we have to offset a cost number substantially ahead of that given headwind inflation numbers in the business. So we are focused both on the structural cost reduction but equally focused on how we offset inflation because we have a different approach here to deliver both the cost saving reduction we have talked about.

The front and centre in this position is that we will invest faster in improving our offer to customers and improving our return to shareholders as we look to inflect the profit trajectory of the business over the next three years.

Kevin do you want to speak on the lease liabilities?

Further answer: Kevin O'Byrne

Yes James on lease liabilities, we regularly, we extend leases just on supermarkets, the average lease length obviously on convenience and Argos is short. These are generally when we are trying to protect strong sites. And if you look across all our stores where we have for example grocery line in stores, Argos store in stores, over the half you know sales are up something like 18%. So these are strong sites that we are trading from. We also will get a better deal on the rent. So we look at cash first before we look at the sort of accounting if you like. So what you have seen in the period is just a number of lease renewals coming through as we have gone through that programme.

Further question
That's helpful, thank you. Just to follow-up on the current Opex was definitely helpful. But I suppose if you broke the Opex down and I don't expect to get numbers, but what element of Opex has actually been the persistent offenders in recent years in terms of that drift upwards, is it rent or I imagine it might be staff wages? Which are the bits that are being particularly headwinds in recent years?

Answer: Kevin O'Byrne
Yes James, one that springs to mind is rates, I mean rates are actually our rent inflation has not been the biggest issues, our rates inflation for example over the last three years is probably like 7% running well ahead of rent.

Further answer: Simon Roberts
And I think as we think about our strategy update this morning James, one of the key elements of it I would want to highlight is as well as our absolute commitment on costs, this is about focus on discipline in our priorities. And so as we set a really clear course on food first, and as we are clear about the role of our brand outside of food, this is also very clearly about how do we reduce complexing versus how do we bring more focus into the key areas of value creation and in so doing, I think that brings across the whole business an ability for us to be really focused on where we spend our money and frankly where we don't. And so one of the key elements of the re-visit we are taking here is to be absolutely clear on discipline of priorities and where we invest against them.

James Anstead
That's helpful, thank you.

<u>Question 8</u>

Maria-Laura Adurno, Morgan Stanley
Morning, thank you very much for taking my questions. So the first one is on Argos, I was just wondering with respect to the set of Results if you can provide us some comments with respect to underlying profitability?

And the second one is with all the measures that you are putting in with respect to Argos, is there any type of guidance that you can provide us in terms of what would be the reversional leverage that can be derived from these measures?

And then the second question that I had was with respect to the capex increase that you have. I know that in the slides you provided areas in which you would be spending. I was just wondering if you can provide any type of incremental granularity on that? Thank you.

Answer: Simon Roberts

Thanks Maria, okay shall I maybe take the Argos questions and maybe Kevin on capex. So as you know Maria, we don't break out the individual profitability of each of our brands. But what I would say is two things. First of all, as you can look in our statement, sales in the Half in Argos were over 11% and we have attracted two million new customers to Argos in the period. So the momentum in the top line of the P&L we are encouraged by, and of course Argos has played a key role in helping customers live at home to the first six months of this year. So we have strong momentum in the top part of the P&L and that big shift to customers shopping online which really opens up the decision we have taken today to fundamentally change the Argos model. And we shouldn't underestimate the scale of that change to re-wire a new fulfilment network that brings down our costs to serving Argos by £105 million at the end of three years.

And what we are looking to do here is to improve the offer for customers, better availability, better competitiveness where we need to, but reduce the cost to serve such that we can improve the operating margin of the Argos business in what is a clearly competitive market. So that is the way we are thinking about Argos and thinking about what we are doing. And as you have seen, in the changes that we announced this morning will mean that we will close 420 of our Argos standalone stores. That comes on top of other decisions that we have taken, for example, stopping the Argos catalogue. And it really brings to a new trajectory the scale of the integration of Argos into the wider business. You know getting the synergies of reducing operating costs while delivering to customers what they expect from us.

So we are very focused on improving the operating margins in the Argos business, giving customers better value where we need to, and reducing the cost to serve.

Hopefully that gives you some colour on the Argos position. Kevin do you want to speak to capex?

Answer: Kevin O'Byrne

Yeah, well just one other point on the operational leverage. We are talking today about opening up about 300 more locations for Argos customers to shop, whether it is store in stores or collection points. That is obviously giving us great operational leverage across the cost base that we already have.

Just on capex, the two big areas. I guess first of all just building on Simon's earlier point, we are very disciplined about how we allocate our capital. We look at the returns of each project. We have very disciplined reviews of post investment reviews. And we focus obviously on the return and capital. But very particularly on the payback and how quick do we get our cash back. And the big areas that we were talking about increasing is around the Argos restructuring and the need for 30 local distribution centres. We have also increased our ambition on convenience stores and there is a reasonably material investment in reorganising our logistics infrastructure that is part physical. And then a big part of technology as well as we combine stock etc. Does that help?

Further question

Yes, one last question. So with respect to the reinvestment in the proposition for customers on the grocery front. With respect to private labels wouldn't you be thinking differently about the segmentation with in the different subsidiaries and thoughts on this would be appreciated, thank you.

Answer: Simon Roberts

Thanks Marie, just maybe to pull out some of the key trends that we are seeing in the grocery business. You have heard us this morning talk to and commit to a different level of

ambition in terms of our innovation. And really three key areas that we are seeing customers expect more from us, particularly in the areas of meat free for example and meat alternative products, organic, dairy alternatives. And so, it is one of the reasons why very recently we have re-set all of the fresh food departments in our supermarkets. This is the first time we have done this in ten years which was just over three weeks ago. We put 200 new products in these areas.

And this to my mind is a really important element of what we are going to do in putting food first. We are going to be more competitive where we need to be, particularly at the centre of the plate. And we are going to really accelerate the level of innovation in the areas of the offer that customers expect us to be differentiated in. They would be three areas that we are particularly focused on at the moment and the team are working really hard on how we continue to bring more new products as we described this morning.

Maria-Laura Adurno
Thank you very much.

Question 9

Andrew Porteous, HSBC
Morning guys. Just looking, just wanted to ask a question around your cost programme. You talked about the ambition to take 200 basis points out of your operating costs ratio. But I am just thinking if I cast my mind back to sort of September of last year, you talked about an ambition to take out 150 to 200 basis points. And I am just trying to understand what is new this morning or is it consistent with that or incremental? And if it is sort of consistent with it, did that also include the closures of the Argos standalone stores which seem to be a bit of new information this morning as well?

And then also separately if I could ask around Argos, and just could you give us an idea of what gross margins have been doing in Argos, it feels like it has been pretty helpful conditions from a gross margin perspective for that business?

Answer: Kevin O'Byrne
Andrew I mean the cost ambition we are announcing today is higher than when we spoke to you before. First of all it is clearly a larger number. But we have said we are taking out the £600 million of costs and in addition we are going to cover cost inflation. But since we last spoke to you back at the Capital Markets Day, we have got different ambitions for our online business, we have got raised ambitions for volume growth in the business. Both of these things are examples will drive more cost in the business. So we need to take out more cost to if you like stand still and then on top of that we are taking out the £600 million. So, it is a bigger ambition. It is a greater percent of sales and we are very focused as Simon said on it.

And you had a question on Argos margins did you?

Further question
Yeah just trying to understand what the gross margins have been in that business. It feels like it have been pretty good conditions for gross margins in Argos.

Answer: Kevin O'Byrne
Yeah the one comment as you can imagine, given the volume and the sales growth we have had to have less markdown, in order to get some seasonal benefit in the first half with weather as well. Because clearly a lot more sold at the beginning of the season generally has less markdown and a lot more at the end of the season. So the margin well there has been no increase in price if you like, it has been less markdown.

Further answer: Simon Roberts
Yes that is absolutely right Andrew, I think of course also given the demand as you said, we are being more choiceful when we are running promotion as well. So the combined benefit of less mark down and less promotion in the Argos offer, both of those are reponsive imprinted on the margin. And will continue to be selective as to where we invest in promotion in the Argos model.

Kevin O'Byrne
And you will see less participation in Black Friday for example.

Andrew Porteous
Brilliant, thanks a lot guys.

Question 10

Nick Coulter, Citi
Hi, morning to you. Three if I may. Firstly could I ask about the line of sight on the £600 million if you kind of draw back from the individual projects, what proportion is actually identified versus to be identified? And what sort of time frame is within the identified bracket? Is that broadly 18 months?

And then secondly, around the level of inflation embedded within the business. I think you historically referred to around £120 million. It sounds like that is changing due to the channel mix. Is it possible to update that please?

And then also kind of building from the net £600 million to the gross hurdle that you have to achieve, it seems like you have to add in also the online costs, maybe some additional costs to serve in stores as well. But it would be useful to just kind of get your laundry list to get a sense of that gross number.

And then lastly, you have changed the commercial team set-up so it would be interesting to get a sense of, if there is any change in emphasis within the commercial approach, particularly with respect to the promotional strategy? Thank you.

Answer: Simon Roberts
Okay Nick so maybe to your first question if I could come up on that. One of the slides we put in the appendix was just to bring some more colour, Appendix 5, of the cost reduction programmes across the business exactly to your question. And what we wanted to try and do here as best we can is to lay out the key programmes of cost, some of them we have spoken about specifically this morning. And be clear about where we are in delivery and where we are beginning to mobilise. And so if your question was actually of the cost saving over the next three years we are well on the way with establishing and delivering already some substantial cost programmes that we laid out last year at the Capital Markets Day. We are accelerating the ambition against each of those as you heard. And you can also see on that appendix some of the new areas that we will be adding to that programme as well, very much reflecting the fact that we are seeing customers shop very differently and therefore we have got to move quickly to make sure that we are mobilising cost programmes as that change happens. So I hope that Appendix brings some more colour to your question.

Further question
Sorry I don't know if that is in front of me, so is that a half or a third or what is the broad proportion that is identified versus or should be identified?

Answer: Simon Roberts
Well I think if you take the £600 million envelope that we have confirmed this morning, raising our ambition from last year, at the same time as offsetting the headwinds and then three areas we particularly highlighted today, the combination of the counters change. The logistics changes that we are making in the Argos store in store programmes. £150 million in the fulfilments. Sorry £105 million in the Argos change, £150 million in the logistics and £70 million in the counters. That is mid £300 million coming from those three programmes. And then there are substantially in the further programmes on top of that you will see in the Appendix, that will be adding to that programme of delivery over the next three years.

Answer: Kevin O'Byrne
We definitely have work streams that will be more than half of that.

Further question
Okay and that is more than half of the gross or more than half of the net?

Answer: Kevin O'Byrne
More than half of the gross.

Nick Coulter
Okay, super, thank you. And then sorry the inflation 120?

Answer: Kevin O'Byrne
We are not getting into the detail of that, but it is more than we would have said previously because of the raised ambitions and online and because of areas like volume growth in the business. So we have got, we have to deliver substantially more than the £600 million to achieve our target and that is built into our plans.

Further answer: Simon Roberts
And then on your last question Nick, so yeah absolutely, we have announced some changes in our leadership team last evening on the way into our results today. So just to confirm three things we have done over the last period of time. So back in June when I took on the role, we were very focused on clearly how we put customers at the heart of our decisions in what is the time of immense change in the industry. And that was the reason at the time that Mark joined the operating Board very much to bring the voice of the customer into the heart of our decision making. And of course at that point too we brought together our digital and our retail leadership together under CLO, and if we think about the rapid change in the way that customers are shopping to have the leadership of our operations initial in one place going back to the premise of the supermarket, we have got more volumes going out the back of the store, the resources, assets and capabilities in the store and now all led through one leadership line in the business across all of our operations and channels.

And then last evening we announced that in order to accelerate our focus on being food first, and also accelerate our focus on the brands that deliver, we will have two commercial directors going forward, Rhian Bartlett is setting up to lead our food and commercial division. And Rhian joined the business last year. She previously worked for Sainsbury's and she is doing a fantastic job in fresh food today. So Rhian will lead the food commercial deliveries and Mike Luck who joined Sainsbury's 18 years ago on a graduate programme done a wide range of commercial roles across the business and he will be leading the work we will be doing in general merchandise and clothing.

And I am really delighted to the both, Rhian and Mike to be setting up into those new roles. And of course Paul Mills Hicks who made an outstanding contribution to Sainsbury's over 17 years will be working with me into 2021 in an advisory role. Further changes have been

announced in the team, really assessing a course for the team when it delivers the plans that we are talking about.

And then just maybe finishing just to make sure we have answered as best we can your question on our commercial strategy. Three or four things in here I would just pull out. So the key message on value is that we want to continue to bring more consistent value into our offers for customers, trust us to bring value in the areas of the shopping trip at the centre of the place they expect most. And we started that work a year ago, we are accelerating it further in the way that we are talking this morning.

You have heard about innovation and that is becoming really core part of our focus on food. Bringing products to market faster and trebling our ambition in terms of new loyalties. You have heard about what we are doing on Nectar which is all about this personalisation. Personalising how we understand our customers, personalising value and really ensuring that as a result of that we make really well-informed data led decisions about how we serve our customers at a personal level, even better than we do today. And of course, lots of work going on that the commercial team are leading to continue to focus on how we drive our offer to customers to meet the changes in the market.

So optimising focus on food and being really determined about the focus we will bring to that.

Nick Coulter
Thanks guys. All the best.

Question 11

Thomas Davies, Berenburg
Morning all. Three questions from me. Two on the Bank and then one on Argos. I guess in terms of the Bank, first question, how should we expect loan activity to evolve in H2 and beyond? And how do you balance that increase loan activity with the fact that in this current economic environment you would have the revision to more loan losses?

Second of all, I mean there has been lots of focus on the call about the retail business cost savings, but it seems that you made some big savings in the Bank. What big wins are there left in that business for additional cost savings to hit your 50% cost income target?

And then third question, in terms of Argos at the next couple of quarters, what kind of tail wind should we expect from the next generation console launches, given you have probably have the visibility in pre-orders?

Answer: Kevin O'Byrne
Thomas on the bank, clearly the lending, there has been less demand from customers for lending and people have actually been repaying loans as you have seen from the shape of the balance sheet in the first half. And we have been cautious as you can imagine in offering new loans. And we will continue to be cautious in the second half until there is greater visibility. So I wouldn't be expecting to see material activity in the second half as we have got greater visibility of employment trends etc. And I would expect there would be lower demand in any event.

On operating costs, there is still plenty of opportunity as the Jim and the team have focused on.A lot around automation, more paperless, easier to deal with online. So using technology both in call centres and in all the sort of customer interactions. So more to go for there. And then there are other areas like you can always fine tune fraud, you know the cost of

collections etc. etc. So it is detail, detail, detail just going through the operating model and the team are making great progress on it.

Further answer: Simon Roberts
Thanks Kevin and then specifically on the question of Argos over the next couple of quarters. You are absolutely right. So, two things have happened on the launch of the new consoles actually. First of all, we saw the volume come through on the previous console right to the end as customers have been at home more. Frankly getting hold of the console has been key driver whether it be the new one or the one that we had in stock. So we have seen good sales through of the previous version and as you would expect, a very high level of demand for both new launches. And so, as that comes through in the next few weeks, we will see the tailwind of that.

More broadly on Argos, I would just point to, the team have done a fantastic job in our stores and fulfilment operations meeting the scale of demand that we have seen in the first half. And you know Argos has won two million new customers in the period. And we have served customers for the products they have needed at home. And of course we are into a second lockdown starting today and so we see demand into the Christmas period continuing. Of course, it is an unpredictable Christmas trading season, but as customers can continue to collect at store in stores and inside Sainsbury's supermarkets or indeed continue to click and collect in Argos stores, that is what we expect to happen. And we are gearing up and planning for a busy trading period ahead to make sure we can satisfy that demand.

Thomas Davies
Thanks a lot.

<u>Question 12</u>

Rob Joyce, Goldman Sachs
Thanks for having me back. Just keep it to one this time. It is a question that I have had for Sainsbury's for quite a while so would like your take on it Simon. So I think roughly EBITDA pre-rank margins around 7.5% for you guys as a group which is very similar to Tesco in the UK, business which is 50% give or take bigger than you guys. If we add on maybe another couple of 100 basis points from cost savings, it is pretty much industry leading margins. And I was just wondering what is it about the Sainsbury's business that you think lends itself to a structurally higher margin than the rest of the UK peers? Thank you.

Answer: Simon Roberts
Thanks Rob, maybe I will make some comments and then Kevin by all means if you want to add to them. I think to be really clear or as clear as we can be, we expect the cost savings that we are into today to do two things. One, to feel as we described investment in the offer, but also to go to the bottom line as well. So the reason we are confident to commit to an inflexion in our earnings is because we believe we can drive improvement in the core delivery of the proposition, improve volume particularly in food as we talked about, albeit in a very challenging market. And by driving the level of cost saving that we are describing this morning, structural cost saving, we can both invest in the offer but also put some more of that performance to the bottom line and hence be sure that we can deliver the level of profit inflexion that we are describing.

I would just stress the point, this is about improving the offer for customers and driving better returns for shareholders, and that is what we are absolutely determined and confident we will do. Kevin.

Further answer: Kevin O'Byrne

Rob, well the other point I would add is we are structurally advantaged given the customer base we have, given the face of the Group. You know our customers have a higher propensity to trade up when we offer them the opportunity. So that is advantageous just in the margins.

Further question
Okay so essentially gross margin mix?

Answer: Kevin O'Byrne
Yes.

Further answer: Simon Roberts
And maybe just the last point to add Rob, we shouldn't underestimate the level of investment that the business has made in digital data and technology in recent years. And using that data, using that insight to enable us to make really well-informed decisions in terms of how we manage the mix, manage the offer. And so, we are very much going to leverage what we have done in recent years to optimise both the mix and the performance as we go forward.

Rob Joyce
Thank you very much, really appreciate it.

Closing remarks
Simon Roberts

Thank you everyone for your time this morning and thank you for joining us. And I and we will look forward to speaking with you again very soon in the weeks and month ahead. Thanks everyone, speak to you soon.

End