Preliminary Results Announcement

Thursday, 30 April 2020

Kevin O'Byrne
Chief Financial Officer

Good morning everyone and thank you for joining Mike and I for our Preliminary Results Presentation for the year to March 2020.

We hope you are all keeping well and safe just now.

We are clearly in very unusual times and therefore we will run the Agenda slightly differently today.

Firstly I will run through the Financial Results.

Mike will also give some brief words on the past year and then cover Covid 19 and the outlook. Clearly Covid 19 has significant bearing on that. For those listening on the morning of the Results, we are running a Q&A Session separate from this at 9.30 am and for anyone listening later the recording of the Q&A Session will follow on at the end of this Presentation.

Turning to the headline numbers, sales are broadly flat with grocery and clothing growth offset by declines in general merchandise.

Retail profits were down 4% year on year reflecting tough comparatives and marketing investment in the first half, general merchandise weakness and a change in transfer pricing which had the effect of switching around £10 million of profits from Retail to Financial Services. Overall we had a better performance for both Retail and Financial Services in the second half.

Free cash flow generation was strong and included £127 million relating to the sale of stores in the British land joint venture. Non lease net debt reduced by £343 million or 23% in line with our ambition to reduce net debt this year by at least £300 million.

Statutory pre-tax profits of £255 million were up year on year after exceptional items that were lower year on year. The exceptional items were almost entirely non cash and I will cover more on that later.

A couple of things to pull out on this sales movement or sales movement slide. First is the weakness of general merchandise which is the main driver of the supermarket sales decline. Second is the weaker convenience number than you are used to seeing. This reflects fewer

openings in the year but also the store closures that we announced in September at our Capital Markets Day.

Guidance wise you can see the balance of openings and closures anticipated this year. These plans are subject to the impact of Covid 19 and that is particularly the case with Argos.

Looking at the momentum of sales over the course of the year, the key highlights for us has been the customer response to the changes we have made to the value of our grocery offer and the investments we have made in the store of space. There is some benefit from about a week of Covid 19 driven stock piling in Quarter Four, but even without it, it would have been in healthy positive territory. With general merchandise it is important to make the distinction between double digit decline in Sainsbury's stores and sales in Argos which has seen some impact but clearly a better trend albeit not without challenges, particularly in some key categories like toys and gaming.

We delivered a good clothing performance with strong online growth and good full price sales growth.

Picking up on the momentum point, the grocery volume charts are on comparative periods and show the clear progress we have made relative to our competitors over the course of year, although it is fair to acknowledge that Quarter Four was again weak to performance in the prior year.

Argos sales growth dipped below the BRC average over the course of the year reflecting the performance of some categories like toys and games which I have mentioned which are far bigger in the Argos sales mix than the BRC average. Clothing showed a consistently strong performance against a weak clothing market.

The moving parts of the headline profit number are pretty clear. Again the change in transfer pricing arrangements benefited financial services at the expense of retail to the tune of around £10 million. Also we delivered £19 million from lower interest as we continued to reduce net debt and benefit from having paid down some of our more expensive debt instruments regarding to interest costs being £20-30 million lower next year also.

Joint venture income reduced given the British land property sales. Only negligible joint venture income is expected now given this and the fact that Nectar is being fully consolidated.

This chart also draws out the difference between H1 and H2 with Retail in H1 impacted by higher marketing spend and tougher weather comparatives. Also a significant difference in colleague wage inflation in the two halves. And financial services improvement in the second half.

The big headline exceptional number this year is material but 90% of it relates to the property strategy programme we announced in September and is almost entirely non cash. We have revisited the property strategy programme we announced at the Capital Markets Day in September bringing in some additional closures. So now one-off costs are expected to be in the region of £330 million to £359 million of which we booked £296 million in the

year just completed. This compares to an initial expectation of £270 million and again the cash element of this is very limited at only around £50 million. We said of the cash costs of exceptional this year would be less than £100 million and that has been the case coming in at £71 million including the bank and it includes cash costs relating to some exceptional booked to the P&L in the prior year.

Looking at the Financial Services profit contribution in the wider sense that we introduced last year, profits grew by 10% with collective lending growth driving income whilst focusing on capital efficiency. Net income was up £4 million driven by good performances and travel money and banking fees. Impairments also benefited from an alignment of impairment of alignment between Argos Financial Services and Sainsbury's Bank.

Lending wise you can see the early impact of the change in strategy with personal loan balances down year on year and stronger growth in lending linked to our retail customers to the Sainsbury's bank credit card and the Argos store cards. And the increase in mortgages reflects the fact that we didn't stop offering new mortgages until September 2019 and retail deposits increased by 5% to support the growth in the mortgage book. We expect to see our retail deposits reduce as the mortgage book runs off.

It is still early days on the new bank strategy and that is reflected on a cost base which is up year on year. However the headcount chart is a good leading indicator of the changes we have been making as is the success of the Argos Financial Services mobile app and move to a lower cost to serve banking model that will extend across other products. Clearly Covid 19 will have a big impact on the outlook for bank both short-term which Mike will cover later and in terms of five year targets which we will come back to later in the year.

You can see here a step up in capex this year as we accelerated from programmes reflecting in particular our confidence in the store investments we have been making. We continue to guide to £550 million to £600 million of capex in the medium term although again the timing side of this in the year ahead could be influenced by Covid 19.

We are very pleased with the strong underlying cash flow and net debt reduction with net debt excluding leases down 23% year on year. Higher capex was broadly offset by reduced capital injections into the bank.

We made good progress towards our target of £750 million net debt reduction over three years. Mike will talk about the impact of Covid 19 on the outlook later on. On the basis of our base case expectations for the year ahead there is no need to change this outlook, but clearly out of the guidance we have given it carries a bit caveat given the significant uncertainties relating to the development and ultimate impact of Covid 19 on the business.

So in summary, we are very pleased with the strong customer response to changes in our grocery business. General merchandise remains tough. We made good progress on our financial services plans and H2 profit growth was strong and we delivered strong free cash flow and net debt reduction in line with our guidance.

I will now hand you over to Mike.

Mike Coupe
Chief Executive

Thank you Kevin and it is my last Results Presentation in extraordinary circumstances. And can I start by thanking our colleagues who have been absolutely amazing in the way they have adapted to the changes in our business in the last eight or nine weeks.

And as Kevin has already said, I am going to present my part of this Presentation in two sections, first of all I am going to reflect briefly on last year and then secondly I am going to talk about our response to Covid.

So if I turn to slide, we communicated at our Capital Markets Day that our purpose was to help our customers live well for less and that we had a series of priorities starting with the need to be more competitive on price, offering distinctive products and categories to offer personalised and seamless physical and digital experiences to offer fast, friendly and convenient shopping. To drive efficiency to allow us to invest in our business to be a place where our colleagues love to work and we have added in January another objective which is to be a net zero greenhouse gas emitter by 2040. And it is fair to say we have made a lot of progress against the objectives that we set at the Capital Markets Day. And that particularly emissions given the situation with Covid 19. And as we have seen during the year our performance has improved sequentially and certainly our volume share has stepped up and actually grew in Quarter Four. Now it is always difficult to attribute the performance to any particular thing, but we would say it is as a result of combination of a number of the actions we have taken.

If you move onto slide 19 you can see that we have demonstrably improved our overall pricing whether it is against the discounters in the form of Aldi or against our mainstream competitors such as Tesco. And we have done this by launching the 200 items we talked about at the Capital Markets Day, only price point products. Secondly by improving the pricing and commodities, by reducing or holding the price of 2,500 products. And lastly by improving the weight of promotions in our business particularly through our lockdown mechanism. And we are pleased that the Which Magazine actually recognise us as the cheapest supermarket for branded groceries in 2019.

So if we move to slide 20, we have delivered a series of major growth initiatives in 19/20. So we have made 12,500 investments, investing £164 million. We have touched around about three-quarters of our supermarkets, almost half of our convenience stores and around half of our Argos stores. So for instance we have introduced 124 beauty departments, we have put rapid exit and smart shop in 118 stores. We improved Tu clothing in 110 stores. We have put Food to go in 210 of our convenience stores and improved the ambient wage in 250. And we have digitised 256 Argos stores. We have also closed underperforming space and opened a number of new convenience shops and a couple of supermarkets. And we have also actively repurposed our space where we can.

So I will move to slide 21. We have also seen a significant improvement in our customer satisfaction rating. And to take an example of ease of speed of check-outs. As a result of our investment in things like Smart Shop and self-checkouts, we have seen that rating move significantly forward by our customers. And of course more recently, despite the fact that we saw a short-term step down in our customer service during the course of March, we have seen a very significant increase in our CSAT measures during the course of April as a result of our customers response to our response to Covid 19 which I will come back to in a

minute. But overall our supermarket measures have improved year on year in terms of customer satisfaction.

If I talk briefly about our Convenience Business, we have launched a couple of new formats, firstly our on the go format in Mansion House which is proving to be very successful as is our Neighbourhood hub store in Woodhall Spa. We actually saw a strong performance in our Convenience Business growing by 1.3% despite the fact that we closed 27 stores in the year and only opened 13. So a net space reduction.

Groceries online pre-Covid was also growing very strongly. We have seen roughly 7% compound growth every year for the last five years. But of course we have also seen a significant improvement in our overall efficiency. So our peak rates are items fixed per hour as an example have actually improved by over 40% over the last three years and by 14% in the last year. So again post Covid we have seen a very significant increase in the uptake of online groceries from our customers. And I will come back to that in a minute.

So moving onto slide 24 and to talk specifically about our Financial Services. And again at the Capital Markets Day, we laid out our priorities to reshape our balance sheet to simplify our organisation and strengthen our business. And we have made significant progress in this direction although of course there is still a lot to do. So for instance we have stopped mortgage origination, we have improved our margins. As Kevin as already referred to, we have lowered our cost base and we are increasingly focusing our business on building digital propositions not least in other financial services. We have simplified our organisation and we are right sizing our business for its current sales by improving our cost base. We are rationalising product offering and reviewing all of our vendor and supplier arrangements.

And lastly we are strengthening our business through operational resilience, through our conduct and through our capital efficiency and building on our core competencies in customer experiences and digital.

If I move onto slide 25, also we have seen our Nectar business progress significantly in the last year. At the Capital Market Day in October we were just about to launch the Nectar digital proposition and we have seen that now downloaded by four and a half million regular users which is tremendous progress from nothing in October. We have strengthened the coalition in Esso, Sky, Sky store and Argos and we have extended our proposition more widely across our business. And we have also launched Nectar 360 and that gives us the ability to not only use insight in our business more regularly but also gives our suppliers to access information about our customers. And of course when we combine this with Smart Shop it acts as a very powerful tool for our suppliers and ourselves to be able to talk to our customers in real time. And we offer Nectar points more widely across our business both in our stores and in our digital real estate which acts as a currency that can work both within and outside our organisation.

So move to slide 26. It is important to re-emphasise the way that the business has become more and more digital during my tenure. And we have moved the digital sales in 2014/15 from £1.1 billion to in the last year to £6.3 billion and I suspect post Covid it will move a lot higher than that. We have now rolled out Smart Shop into all of our supermarkets and at the end of the year our self participation in our handset stores was around 18%. Now clearly it has moved a lot further forward more recently. And last but by no means least we are joining together our digital proposition and our real estate and increasingly digitising all of our properties whether that is Nectar, whether it is the bank and Argos Financial Services, whether it is Smart Shop and also introducing universal search.

Moving onto slide 27. We have also maintained our focus on reducing our costs. And we have talked about a strategic cost transformation programme not only covering off the cost of inflation, but also further reducing our costs by £400-600 million over a five year period of time. And we are well on the way to executing that plan. So for instance we have completed integrated our operations now. We saw operations, marketing and commercial operations. So the company is now fully integrated. We are already delivering against our property strategy as already talked about and Kevin has already talked about. And we are starting to get on with delivering the other cost transformation projects. So not least in our logistics and supply chain. And you have seen a recent announcement about our work with Blue Yonder to further strengthen and modernise our supply chain as we look forward. So we are confident we have been able to deliver the strategic cost transformation plan despite the challenges that we have in the most immediate future.

So I will move onto slide 28. We introduced our commitment to Net Zero greenhouse emissions by 2040 in January. We think this will become a bigger part of our business and indeed our customers mindset as we look forward post Covid. So as well as reducing our carbon emissions we have talked about minimising our use of water, helping our customers eat healthier sustainable diets, reducing the use of plastic packaging, reducing food waste, increasing recycling and making a net positive contribution to biodiversity. We are also committed to using science based targets and to report progress against these targets every six months.

So moving onto our response to Covid.

We thought we would start by showing you a timeline of how much change has gone on in the organisation in the last 7-8 weeks. And can I start by thanking all of our people, all of our colleagues for the way they have responded to an incredible period of challenge and how flexible they have been. And it is a testament to the culture and the values of organisations to how we have responded to a particularly challenging set of circumstances for both our business and societally more widely.

And we started out with three specific objectives. First of all to feed the nation. Secondly to make sure that we kept our colleagues and customers safe. And thirdly that we set out to support the communities that we serve. So if we just go through the timeline, it shows you how rapidly that we have responded to the challenges put in front of us. First of all starting off with product purchasing limits, then to make sure that we helped our colleagues by first of all colleagues first of all committing to 14 days on full pay if they had to self isolate, 12 weeks on full pay if they were vulnerable or if they were helping vulnerable people. And put in place priority shopping at 22 March. We actually closed the Argos stand alone stores on 23 March. We gave our colleagues a bonus or committed to give our colleagues a bonus for the first trading period of our year as a result of their help and support. We have introduced social distancing measures right across our business. We had most of those in place by 24 March, the day after the Prime Minister announced a lockdown. By 10 April we had increased the number of online delivery slots by almost 50% and actually that was almost doubling of our online volume because of course our customers are ordering more when they ordered online. And we had also contacted 800,000 vulnerable customers as well as donating £4 million to Comic Relief Big Night In.

So moving onto slide 31. What we have done here is laid out for you the sales shape of the various parts of our business and we give you a detailed sales break to how week by week in our R&S from week 50. And as you can see, as you might expect our Grocery business

spiked very heavily particularly in the early part of the year in week one and two. Secondly we saw a peak in our General Merchandise business across the same period of time, particularly driven by Argos, although we saw a slowdown and more recently a slight step up. Our Clothing Business fell to minus 70% at the lowest point, although it has come back a bit more recently. And lastly we have seen our Fuel Business consistently travelling at minus 70% over the last 3-4 weeks. Now I would emphasise that these numbers have actually changed for Easter phasing so we have made sure that we have trade adjusted them, unlike the numbers in our trading statements which give the actual year on year comparison. So it is important to remember these are actually smoothed for the effect of Mother's Day and Easter.

If I move onto our Groceries online business. As we already said, we set out from the very beginning to prioritise elderly, disabled and vulnerable customers and also to significantly increase our online capacity. And we have already referred to the fact that for the last two weeks we have seen the number of slots available increase by almost 50%. And actually because the order sizes are higher than we would normally see, we have almost doubled our online sales as a proportion of our grocery business. So that has moved from just under 8% to almost 15% in the last few weeks.

And the efficiency of the business has also improved because the order sizes are higher. The drop densities, because the numbers of orders are higher and we have introduced click and collect in more of our stores. It is fair to say that the demand still remains high and we are still not able to keep up with all the demand that we have and will continue to look at how we can increase the number of grocery slots in our business and we believe we will get to around 600,000 delivery slots by the end of next week.

If I move onto slide 33. We talked about the fact that at the end of the financial year the average participation of Smart Shop in the stores with handsets was around 18% and you can see from this chart how much that has spiked. So almost a third of our sales are now going through our Smart Shop in the stores that have handsets. And that is of course good for our customers, it makes their shopping experience quicker and safer, but also good for our colleagues because it means less of our customers are going through the checkout and it increases the speed of our overall shopping experience.

If I move onto the impact within Argos, you can see that overall our average weekly sales have actually gone up. And that is even on the back of the fact that we have closed all of the Argos stand alone stores. And you can see how much our home deliveries have grown by 86% over the last few weeks. And by 32% for click and collect. And we have seen roughly 9% growth in Argos since the beginning of the financial year.

So as we look forward, we have talked in our RNS in some detail about our base case, but just to walk you through the various moving parts. We are making an inherent assumption that we will be in full lockdown during all of Quarter One and that effectively means until the end of June. And although we will start to see some of the restrictions being lifted we would expect there would be continued disruption right the way through the first half of our Financial Year so effectively through to the middle of September. We would expect things to go back to more normality in the second half, however we would expect the backdrop to be a weaker economy. And therefore although we would expect the grocery business to remain positive in the first half, we would expect it to normalise in the second half, but we would expect that General Merchandise and Clothing will be down in the lower double digits in the second half of the year on the back of the economy. We would expect the fuel business to

return to something like normality. So those are inherent growth assumptions that we made as far as our base case on our sales outlook is concerned.

If you think about the profit impact, if we look there are three chunks that we have identified. First of all there are a series of higher retail costs. So the costs of 25% absence of peak currently running at 15%, the fact that we have paid a bonus to our colleagues, the fact that we have underwritten twelve weeks absence for our most vulnerable colleagues, obviously significantly increases our operating expenses. That is cost associated with stock clearance, of products that we are not going to sell particularly in our clothing and seasonal ranges. We expect to see reduced tenant incomes and concession incomes as a result of help that we are giving to both our leases and our concessionaires.

We are expecting as a result of sales, weaknesses that we see lower profits in our General Merchandise, Clothing and Fuel Businesses. And of course we would expect an impact as Kevin has already alluded to in our Financial Services Business. So for instance we have closed our travel money. We are issuing a lot less cash because customers are using various other methods to pay. We have also taken some impairments on our balance sheets and would expect reduced customer spend and an increase in colleagues absence. So overall we believe that there is going to be a profit impact in our base case of around £500 million plus. And of course there are a whole series of variables that could alter that in either direction.

So if we move onto slide 37, we have laid out our base case. So first of all we would expect our costs to increase by at least £500 million and that is because of the direct Covid costs that I have already talked about but also the profit impact of certain parts of our business. That will be offset by an increase in our grocery sales and by £450 million of business rates relief. We still however will pay business rates on our offices and distribution centres. So net net in our base case we would expect the impact to be neutral. However I would caveat that by saying there is a high degree of uncertainty and there are clearly scenarios that can go either way and quite significantly either way.

So moving onto slide 38 and looking at the business's liquidity. In all the stress scenarios that we have run we believe the Company is more than adequately funded, in fact we believe that we have got significant financing headroom. So to give you a couple of examples, at the end of March financial year we had £1.45 billion of RCF undrawn at the year end. We have drawn £500 million of that down now and we have put that in our balance sheet for prudence.

We also have our capital weighted towards the second half for obvious reasons because many of the things that we set out to do in the first half will not be done as a result of Covid.

So turning specifically to our Financial Services business, our balance sheet is strong. We have a regulatory capital surplus and significant excess liquidity. And we are confident that our Financial Services Business will not require any capital from the Group.

So coming onto the Dividend on slide 39. We believe that it is prudent for the company to defer the decision on paying a dividend. We believe that there are a very wide range of potential outcomes that currently we do not have full enough visibility on the impact of Covid 19. And this of course will be greater in the latter part of this financial year.

So moving onto slide 40, in summary we take our results for the last year. We had great momentum in our Grocery business, we are coming together as multi-brand, multi-channel

business and we generated very strong cash. So as Kevin has already talked about, we reduced our net debt after leases by £343 million.

We have responded brilliantly to Covid, a great response right across our business supporting our customers, our colleagues, communities and our suppliers. And it shows the strength and flexibility of the multi-brand, multi-channel platform that we have built. And our balance sheet strength is helping support suppliers, tenants and our concessionaires.

As we look out, there are significant incremental costs associated with our response to Covid 19 and a duration of that response is uncertain. But Business rates relief is likely to offset the incremental costs and the weaker general merchandise, clothing and financial services contributions. But our balance sheet is strong, our liquidity is good, but we believe that it is prudent to defer the decision on our dividend.

Thank you very much and we will now open up to questions.

Mike Coupe, Chief Executive Officer

Good morning everyone and, as I hope you are already aware, we are running things a bit differently this morning. So, we pre-recorded a results presentation yesterday which you can find on our website. So, this morning is just a Q&A session relating to the preliminary results and the COVID-19 updates we published this morning, so I won't make any introductory remarks.

Kevin and I are together, but suitably distant, ready to take any questions you have. So, I'll hand back to the operator.

Question 1

James Anstead, Barclays

Good morning. A couple if that's okay; a couple about the Bank. One is you're clearly mentioning a loss for the Bank in the year ahead, and I just wondered, and maybe it's a bit unfair and a bit premature, but can you finesse the wording on that a little bit. Would you expect it to be millions, lows tens of millions, potentially a hundred million? Any extra finessing of that would clearly be helpful.

I wondered as well, it sounds like you're being quite clear, you're not expecting to make capital injections, I presume that bad debt assumptions are key variables there. But I wondered if you could shed any light on how cautious your assumptions are for how bad debts might get and how much worse they might have to get to make injections necessary. So, a couple of questions on the Bank.

And then one more. If you ultimately decide you aren't going to pay a dividend for the year that's just finished, presumably you'd move up your net debt reduction targets in line with the dividend cash you would save by doing that?

Mike Coupe

Maybe if I just start with a general observation, James, and then Kevin will talk more specifically about the questions you've asked.

We've given probably the highest level of disclosure we've ever given and we've been as transparent as we possibly can, and indeed put to you a base case, accepting that there's a high degree of variability of outcome for any number of reasons. And I'm sure you can understand why that is the case. So, it's certainly not guidance, it's a base case. And we think we've given enough background to be able to draw your own conclusions, and indeed make different cases if you think our base case isn't appropriate.

We haven't deliberately broken out the components, but by implication you can get some way towards them. And so therefore we're being slightly more circumspect in being any more detailed than we've been in the announcement. But as I say, I think most of the information you need is actually in the announcement, and if it's not directly in the announcement you can probably infer it.

But maybe if Kevin would want to talk more specifically about the question you asked on the Bank and indeed the dividend.

Kevin O'Byrne, Chief Financial Officer

Morning James. First of all on the Bank, we've run a number of scenarios that we said, and as Mike said, we're not breaking those out between the different business units. But clearly one of the drags in the £500m + number we've talked about that's offsetting the rates and the food performance is financial services; but equally there's impact on General Merchandise, there's impact on clothing, there's an impact on a number of areas as you'd expect, and you can see the assumptions that we've put in the RNS.

Specifically on the Bank, the Bank in all the scenarios we've run, and we've run some scenarios worse than the main scenario that you've seen and we've run some better than the scenario you've seen, in all the scenarios we see the Bank in the current year, under those scenarios, being an earnings challenge and not a cash challenge. So, we don't see in the scenarios we've run that we need to inject capital in the Bank.

And maybe just to give you some context there. The Bank currently has roughly £300m of excess regulatory capital and there's an element of buffer capital, as you're probably aware, that we're allowed to use in times of stress. And so the total there is about £120m of normal capital in normal times, and about £200m of capital that we could dig into in times of stress, so a total of £300m. In simple terms that means the Bank would have to lose more than £300m before we'd have to inject. And in all the scenarios we're running we don't see a scenario where that would happen.

And then even if it did happen the Bank has a range of other options we could look at. We could look at selling assets; we could look at reducing credit balances on things like credit cards; we could be more cautious about future lending which would absorb regulatory capital etc. So, there are other things we could do. Clearly if we did eat into that capital buffer we would have to replenish the stress element of that buffer in time, but you're given a number of years to do that.

So, we don't see a scenario at the moment where we would have to inject capital in the Bank. And if you look at note 21 to the accounts, which is post-balance sheet events, we have run a model post-year end, given the COVID-19 crisis. We've used three employment scenarios you can see in there: a 6% unemployment, an 8% unemployment, and a 10% unemployment, and using a weighted average of those we'd estimate that we'd need to book about £30m of

impairment in the Bank's books this year to allow for that. So, you'd see that coming through in the first half.

The base scenario is a bit more prudent than that, but it's that sort of order of magnitude. So, we're very comfortable with the position right now from that point of view.

Moving on to the dividend question, would we repay debt if we didn't pay a dividend, we don't know at this stage, James. You can see our focus on the last few years has been very clear: focus on generating strong free cash flow, and then use that roughly 50/50 to pay down debt to make the business more financially robust on behalf of shareholders and pay the other 50% to shareholders as a dividend. So, that would remain our focus once we have a greater visibility of what's going to unfold in front of us. And we'd take the right decision at the right time, but it's too early to say right now.

James Anstead

That's helpful, thank you.

<u>Question 2</u>

Bruno Monteyne, Bernstein

Good morning gentlemen. My first question is at the Capital Markets day you quite clearly explained how your somewhat more premium products or unique products, higher margin, more premium customers, really put you at a much better stead in the UK industry – I know I'm paraphrasing; those weren't the exact words. Now, given that we're probably going to go on a quite deep and long recession would you not think that these more premium customers, more premium products are going to actually do the reverse, and actually quite a drag to how you will trade in the next one or two years?

The second question is, so the dividend saved you about £150m of cash, it's taken an extra £500m out of your revolving credit line, so that's £650m of extra cash. Would it be fair that that would be about the size of what you'd think a worst case scenario would be, so a cash outflow of that order of magnitude?

And last, but not least, what I was a little bit surprised within your profit guidance, which seems pretty good being flat year-on-year, was that general merchandising wasn't a bigger drag given that you're expecting double-digit declines. Is that because of the operating leverage and Argos not being so bad anymore like it was in the past because you can reallocate staff from the Argos units to your Sainsbury stores? Thank you.

Mike Coupe

Thanks, Bruno. Perhaps if I take number one and number three, and then Kevin can talk specifically about the cash calculation.

Again, going back to the scenario that we've painted as our sort of base case, we are making an assumption that the grocery business in the second half will return to, in inverted commas, normality. Clearly there are lots of scenarios, and if we enter a recession, as you've described, history would say customers first of all will trade out of eating out into eating in; that generally speaking is good for food retailers. And if anything during the COVID crisis we're seeing that

writ large, that's broadly speaking a trend that is dominating the industries as we are currently trading.

But clearly there are scenarios, if you go back to 2008, where customers will also go beyond that and start trading down. I don't think of any of us know at this stage exactly how that looks. And of course you can make your own assumptions from the information we've given you.

What we have assumed is that we will return to some form of, in inverted commas, normality in our grocery business in the second half. But there are as many scenarios I'm sure that you could paint as we could. We've had a go at modelling that, we've given you a sort of base case, but equally we've given you enough information to be able to make your own assumptions and therefore model your own cases.

We've also been very clear about the GM business in that context. Actually the Argos business, as you would have seen from the trading statements, has traded incredibly well, despite the fact we've closed all of the standalone shops; 9% up in the first seven weeks. We're making an assumption that that will come down, and that if we took the second half that our GM and clothing businesses will be trading down around the 10%, 11% mark year-on-year. Again, you may not believe that, you may think that that's overly optimistic, you may believe that it's overly pessimistic, but that's the assumption that we've made. And clearly that has a consequential impact in terms of the profitability of both the Argos business, the clothing business, and of course the other one that you haven't mentioned is the fuel business, which is equally a drag on the P&L in the current scenario. And again, dependent on where we get with lockdown, we've made an assumption; that assumption may not be right.

On the cash, Kevin, perhaps you can talk more specifically about that.

Kevin O'Byrne

Bruno, just a couple of things on the cash. The first one on the £500m drawdown, we're not actually using that at the moment, we just felt the prudent thing to do was to drawdown that money. So, we still have £1.45bn of unused revolving credit facility in that we're not using it in that we have the money rather than the banks, which we felt was the prudent thing to do in the current environment.

The plan would be on the base case that would get repaid during the year. So, that wouldn't be in the business later in the year and wouldn't be required. We clearly have some upfront working capital demand, for example, paying our 1,500 smaller suppliers immediately, that's about £100m, so there's a number of working capital requirements right now.

The base case doesn't assume, if the base case played out we don't require the £150m from the dividend. The dividend decision has been made not on the base case. The dividend decision has been made because we're seven weeks into a crisis and there is just lots we don't know. We haven't sufficient visibility. And we think the right thing on behalf of shareholders – and it wasn't an easy decision, it was a very difficult decision – but the right thing on behalf of shareholders is to defer any decision at this point until we have more visibility, and that's why we've made that decision.

And then you mentioned about what's the worst case, and frankly the worst case is a lot worse than the base case, as you can imagine. And as part of the year end sign off we do a very rigorous viability review for the next three years, and we have stress tested all sorts of scenarios here, and some of these get an awful lot worse where you say the country's in a

recession for the next three years etc. And they're done purposely just to see is the business financially robust and the answer is yes it is. Even in a persistently high unemployment, very negative situation over the next three years, which we don't expect to happen, but we've stress tested that and we're adequately funded and able to manage through that.

Mike Coupe

To come back to the central point, Bruno, which is we've given you a very high level of transparency, and if you don't agree with our estimated base case then clearly you can model your own scenarios and come to different conclusions. But we've given you our best view of where we stand today, and the assumptions on which we base that.

Bruno Monteyne

Mike, can I just come back on that one second? When you say the base case is for grocery to return to some form of normality in the second half, your sense of normality does that include a recession in the UK or not in the second half?

Mike Coupe

Oh, just an underlying assumption on sales. Clearly there are some mix effects within that. The bigger impact in our view would be on the GM and clothing businesses in a recession. We've been clear again on what assumptions we've made in terms of the impact on sales, and that clearly has a consequential impact on profitability.

But in a recession, depending on the depth of the recession, as I say in the short term at least that can be beneficial to a grocery business and to the mix. In a more deep recession, as you say, there could be an element of trading down.

But we've given you pretty clear transparency and you can draw your own conclusions.

Kevin O'Byrne

Also, Bruno, what we saw on the last financial crisis we saw the grocery business was robust and it was General Merchandise and clothing that were subdued. And clearly, we have a worst scenario, a number of worse scenarios than the ones that we've shared with you, that's the base case, which would see the grocery business might be impacted in a recession. We've played…there's positives and negatives on this. And as Mike said, you can model your own because you know the broad gross margins of the different parts of the business. And clearly the biggest impact on any scenario we're running is what happens at the top line, which I guess is no surprise.

Mike Coupe

And I could also make a very strong case for the fact that eating out of home won't return to any form of normality during the course of not just the first half but the second half of the year.

As I say, we've given you our best estimate of what we think would happen, that's our base case, but we'd also accept that there's a high degree of volatility both ways.

Bruno Monteyne

Thank you.

Question 3

Rob Joyce, Goldman Sachs

Morning guys. Thank you very much for taking my questions. I've got three areas I'd like to look at.

Firstly on the dividend, in your base case scenario if the base case is achieved would you feel comfortable paying the final dividend for FY20 alongside a normalised dividend, around 50% of EPS for FY21, assuming you achieved the base case you've laid out?

Second and third, just squaring a couple of points you've made. I guess on the Argos, the question from people is, Argos going to double digit decline in the second half, for the rest of the year even, even with the first two months being pretty strong, still implies, as far as I can see, the worst ever trading year for Argos, which probably has pretty broad implications for the economy. I'm just wondering, are you seeing anything yet in your underlying business, the measures you might look at there, apart from the headline stuff we're seeing from the government etc, but anything in your own business that would indicate you're going to get to that level of difficulties?

Then finally, on the point about eating out of home, I think it's a very valid point. What's interesting I just note in the April data, if we exclude the week post-lockdown, it looks like your grocery business is trading around +4%. Is that a good read then for the rest of the lockdown period? And wouldn't we expect that to be higher given there's no eating out of home at the moment? Thank you.

Mike Coupe

Just to reiterate the point on the final dividend. We have deferred the decision to pay a dividend, and the Board will review in the light of the prevailing circumstances in October whether or not it would pay a dividend, and what level of dividend it would pay, in November. So you can't imply anything, and we're certainly not making any assumptions that under any scenarios we would pay the money in July. The next time to review that is when the Board reviews the dividend decision at the interims. So, just so we're crystal clear, there is no implication that we would pay anything, and indeed if we did pay something what that something would be.

In terms of eating out of home, again we've tried to be transparent. We're showing you, probably for the first and last time, week-by-week data. Clearly as we see the scenario unfold, we'll have more clarity as to the impact that not eating out has on eating in. And clearly I think we're still in a period of time when our customers are getting used to what the new world looks like, and where that settles down your guess is as good as mine, but we've painted the scenario that we think is not an unreasonable base case. But you'll get the market data in the same way that it's normally published, so that over time I'm sure that you can adjust your models accordingly.

Again, we've been I think sensibly prudent in terms of our view of the economy. I don't think any of us know exactly how it's going to play out. We've assumed, as we've said in the trading statement, the second half will effectively be down 10%+ in our clothing and General Merchandise businesses. And you're right, that will be a pretty difficult set of economic circumstances. But these times are unprecedented, and I think anybody with a realistic outlook would be pretty prudent at this stage, and like all of these things you're better off planning for the worst and hoping that it will be better. But you're right, I mean in the end it's a fairly serious set of circumstances, but I think that's reflective of where the economy will be. I don't know if there's anything you'd add to that, Kevin?

Kevin O'Byrne

The only thing to add is the Argos business has been remarkably robust. The fact that it's a digital business, that we've seen, as you saw in the presentation the slides Mike talked to on slide 34, a massive growth in home delivery, massive growth in click and collect, and where sales are ahead while the stores are closed is remarkable really. So it's a business that's well set up for difficult times, and it has a broad range of products and broad customer appeal. But we're assuming consumer demand will be subdued, and I think everyone would assume that right now, and hence the base case that we've forecast.

Rob Joyce

Thank you very much both. And that is broadly right though, grocery, just doing a straight average of those numbers, is trending around 4% it looks like in April?

Kevin O'Byrne

I haven't done that number.

Mike Coupe

You've got there quicker than I have. To be quite honest, it gets slightly confusing because of the phasing of Easter, which is the other thing. So in our presentation we've effectively seasonally adjusted Easter and Mother's Day. In the RNS you've got a week-by-week tracker which again bounces around all over the place. The last trading week was also a sunny week, which generally speaking helps the business, just to make it doubly confusing. But if that's the arithmetic you arrive at, then I'll just take it as read that that…

Kevin O'Byrne

I think you'd have to also build in the fact that in week one and week two of the year there was massive growth in, but there's going to be a certain amount of stuff in people's kitchen's already and they'll be using some of that. Frankly right now it's pretty hard to forecast next week.

Mike Coupe

All I can say is welcome to our world, Rob, this is what we have to deal with on a week-to-week day-to-day basis. Again, as I say, we've given a high level of transparency in terms of what's happened already, a high level of transparency over the base assumptions that we've used. But it will equally recognise that there's also a high degree of volatility, and there are a

whole bunch of other scenarios that you could play out that would either improve the profitability or detract from profitability in the balance of the year.

Rob Joyce

Fair enough. I appreciate it, thank you.

Question 4

Maria-Laura Adurno, Morgan Stanley

I have two questions. The first one is with respect to the incremental costs that you have announced. If the lockdown was to go beyond your base case, what percentage of those costs would actually not be one-off and you would actually have to again re-spend on top of what you've already announced?

The second question, coming back to your base case around declines and the General Merchandise and clothing business, how much inventory management flexibility do you have? For instance, if you do have an assumption of subdued demand in the second half, do you already have all the orders confirmed and you're not able to actually move away from those? So any qualitative comments around inventory management would also be very helpful. Thank you.

Mike Coupe

Maybe if I just talk a little bit about the first and second, but I'm sure Kevin would also have something to add. Broadly speaking, as a matter of principle we are acting as good corporate citizens, and therefore honouring any of the contracts that we already have in our clothing and General Merchandise business, and taking in any products that have been made for us. There are various aspects of the business, some parts of the business, basically like the grocery business, you buy and sell on a relatively short cycle. But on the long lead time products, typically we're talking about a six month lead time between ordering and delivery. Therefore the actions that we can take to amend our stock requirements will come through into the autumn and into the winter, and obviously the teams are thinking quite carefully about the planning assumptions and we talked again about our base case.

Effectively in our base case scenario there is a reasonably high cost of writing down or selling at a lower price, stock in both our General Merchandise, and particularly our clothing business. So you can imagine, we've had a wave of stock coming into the business, and if that business is trading down let's say roughly 50%, then that stock has to be sold or written off. Certainly that's one of the costs that we've borne in the scenario that we've played out.

Again, we've modelled the scenario in terms of lockdown. We described at a headline level the scenario that we expect to play out, which is effective lockdown until the end of the first quarter, and then some release of the shackles between June and September, and that has an inherent assumption in terms of the costs. I'm afraid I don't think we're going to go any further than that. If you took our assets level as an example, at the peak they were at 25%. Clearly that has a big cost to the business, that's now down to 15%. And we don't really have line of sight as to whether or not that will stay at 15% or drop over the next period of time. So you can kind of see the assumptions inherent in the base case, but I'm afraid I don't think we'll go any further on the costs. I'm just looking at Kevin.

Kevin O'Byrne

The only thing to add, Maria, is the costs there's big store labour costs and logistic labour costs, absence, paying vulnerable colleagues who are off either because they're vulnerable themselves or they're looking after vulnerable relatives, all the extra guarding and cleaning. So the longer this goes on, or if there was a second lockdown, then there would be more of those costs coming into the business. There isn’t a sort of direct correlation between them. But the scenarios we've run that are worse than the base case would assume more of those costs coming into the business should there be an extended lockdown or a second lockdown, etc.

Mike Coupe

The only other thing to add is that there is an inherent assumption that our cost saving programme will have some elements added to it in the balance of this year. Of course again if lockdown continues for longer, there may be some elements of the delivery of the cost saving programme that might come under pressure. But at this point in time we just don't have line of sight on that.

Question 5

Tom Davies, Berenberg

Morning all, three questions from me. Firstly, with the loss absorption, will you be able to operate at a lower CET1 ratio in the longer-term? And given the Financial Services Division pre-COVID was generating little earnings; in a more challenging environment won't that mean that you'll struggle to improve your CET1 fast enough organically so you may need to put cash in?

Second question, just a clarification point from you, Kevin, where you said that you're adequately funded in a worst case scenario. Is that at a Group level or for the Bank?

Then third question is, in terms of wholesale, you announced a wholesale agreement with Aussie grocer, Coles, and you're supplying SimplyFresh stores in the UK on a wholesale basis. Does this represent an entrance into the wholesale industry, and if so, should we factor in some start-up costs associated with this?

Mike Coupe

Maybe if I take the third question, and then perhaps Kevin can reiterate the point we've already made about the no need to inject cash into the Bank, Tom, just so you're clear. On wholesale, we've said for a long time now that we think there are opportunities in wholesaling in the UK. It's a relatively low cost and margin enhancing thing from pretty much day one, so we wouldn't expect any start-up costs associated with that, because effectively we're riding on the back of existing supply agreements with our suppliers, and similarly with the trade that we do overseas. So we already have relationships, as you say, with Coles, with Dairy Farm in Hong Kong, with Redmart in Singapore.

It's certainly part of the business we'll look to develop. It's not a massive earnings benefit in the short-term, although over the long-term you could imagine that it could become a bigger part of the business. It is pretty straightforward to do, we've already built the systems and

distribution infrastructure, it rides on the back of that within our organisation. So there isn't a significant overhead other than a few people in the centre of the organisation associated with supplying wholesale in either the UK or outside the UK. So, Kevin, perhaps you could just reiterate the points on the Bank?

Kevin O'Byrne

Tom, on the bank, just to be clear, we have about a £320m buffer, over £300m as I said, and that's as measured under the PRA's ICAAP process where we look at capital adequacy. Of that £120m we wouldn't need to rebuild, we could absorb that and not rebuild it if we chose not to. The balance of £200m we'd have to rebuild over time. That would just be an agreement with the regulator. As you can see, someone like the Co-op Bank, they've eaten into the buffer and they haven't rebuilt it over a number of years. So given time to rebuild that buffer. So you're right, we'd have to rebuild it in time. But as I say, we'd have to get to a point where if we're rebuilding it, the Bank has to lose substantial amounts of money, and in the scenarios we've run we don't see that happening. That's not to say it couldn't happen, but we've run some stress scenarios of high levels of unemployment for extended periods of time, and we don't see that. And as I say, I'd refer you to note 21 as well in the accounts just to give you more colour on that.

Tom, you talked about worst case scenario, that's at a Group level. We run the viability statement at Group level over three years. I think everyone can take comfort from you can imagine if there was two big discussions around the Board table and Audit Committee table this year, there was viability and there was dividend, and the viability statement got a huge amount of review, as it always does, but it got a particular amount of review this year, and then signed off by EY. Again, you can imagine the audit firms are very concerned about signing off on viability at the moment. So we ran a number of stress tests based on previous recessions going on for the three year period, and then we came at it the other way and said what would it take to stress the business. On both scenarios we got comfortable as a Board that we have sufficient resources to manage the business.

Question 6

Nick Coulter, Citi

Good morning, thank you for taking my questions. Glad to hear you're both safe and well. Three, if I may. Firstly, if I could come back on Argos and Sainsbury's General Merchandise and clothing, more with a view I guess to the year to March 2022, so year two of your year three sign off review. All else being equal how should we view the generic operating leverage in those businesses and what do you think you can do to mitigate any medium-term weakness, given that you have not a decent line of sight but certainly time to adapt to the scenario with regard to buying practices or cost ratios or the like?

Secondly, just on the Bank. Is it possible to get a little colour on current trading for the Bank's fee income and its interest income, just to get a sense to help us with kind of the moving parts in addition to the provisioning? And then also, in absolute terms, maybe what you can do on cost. I guess there's a couple of moving parts within the cost income ratio.

Then lastly if I may, on the dividend. It sounds to me like it's entirely prudent on your part, but I guess there's a very real prospect that the uncertainty or lack of visibility will be just as murky when we get to November. So is there a realistic prospect that you also defer any decision, very justifiably when you get to November as well for the interims? Thank you.

Mike Coupe

Yes, I think perhaps if I take the first and third and then Kevin can talk specifically about the Bank. I mean, on the dividend I think we've been as clear as we can be, we won't pay the dividend in July, and the next decision point for a dividend will be in October, and clearly at that point the Board will review the prevailing circumstances and make a decision that's appropriate and communicate it in the right way.

And I think at this point we can go no further than that, and you can speculate one way or the other, but clearly that's a decision that will be made in the light of what hopefully will be clearer circumstances. But you're also right that I suspect even at that stage there's going to be a degree of uncertainty but the Board will make the appropriate decisions and communicate that to shareholders at the interim.

As far as the scenario planning is concerned, you can imagine that the leadership team has been pretty much 100% on getting the day-to-day sorted out in the last few weeks for, hopefully, understandable reasons. But as I hand over to Simon I'm sure he and the team will be thinking about the very issues that you raise. And I'm sure if you go through the potential scenarios there are lots of things that could play out and indeed, there have been a whole series of fairly real time experiments. In and of themselves each one would probably be quite a significant challenge, but the fact that we've been dealing with them all at the same time obviously gives lots of learning about what the future could look like.

If you take SmartShop in our stores moving to 30% odd of transactions or sales that would be a classic example of something that might have taken three or four years to get to and has happened in the space of less than six weeks. So without being specific about Argos, clothing, or the business more generally there is starting to be a lot of head scratching going on to understand, both the short-term choices that are available to the organisation and indeed the long-term planning horizon and what we may or may not do differently in the light of that. But I don't think it's for me to opine on any of those particular issues. I'm sure in the fullness of time Simon will come to the right choices and will communicate those for the market.

Nick Coulter

But presumably as part of your sign off with you, you kind of had to consider those scenarios?

Mike Coupe

Yes, I mean, as we said, we've laid out a base case, we think we've given you a pretty high level of transparency and we've given you the assumptions on which we've made that base case. So you can apply your version of what you think might happen and the scenarios that might play out, but it goes without saying that there's a wide degree of variability in terms of the potential outcomes and that's why we're not issuing guidance; we are just giving you a set of basic assumptions on which you can build your models and probably the highest level of transparency we've ever given in any set of results. Perhaps if Kevin could talk specifically about the Bank costs?

Kevin O'Byrne

None of what I'm going to say would surprise you about the Bank. We've clearly seen a decreased amount for ATMs, for the cash coming out of ATMs where we get a commission

as people don't use cash and move to contactless for hygiene reasons. Travel money, we've shut all the bureaus, and we would expect that business to be impacted right through the summer which is the peak time for that business, so there's commission income there.

We're seeing a reduced amount, as again you might expect, for new credit cards, personal loans and all the financial services, sort of Argos store card. Some of that will be driven by the fact that stores are closed, because a lot of credit is transacted in the stores and actually online there's less credit contracted in the online journey; so that will be the fact that the 570 odd stores are closed. But all of that is exactly what you would expect, given the current uncertainty, and that's built into our base case scenario, and we've got more negative ones and slightly more positive ones.

And on the Bank costs, we started the plan that we talked to you about after the Capital Markets day in September when Jim joined and put together his new team. Clearly there are big plans around head count, digitising the customer journey, which removes a lot of costs for us internally as customers support themselves. And I think this whole COVID-19 situation will, I think, speed that up if anything and customers I think value being able to do things on a digital platform, rather than having to speak to people now and the time that's involved in that.

And then things like selling to loyal Sainsbury's and Argos customers, rather than going through aggregators where there's a cost involved in that. But a number of other initiatives, and that work has started. You saw on the presentation on slide 11, headcount is down 12%. By February '20 we're seeing people adapting and using the mobile apps as we introduce them. So all those plans are in place and will continue. Inevitably there'll be some delay as there will be in the retail business in some of the cost actions, just because of the COVID-19 disruption. But it's all still to be delivered and will be delivered. The timing may be affected.

Nick Coulter

Super. Thank you, gents. All the best.

<u>Question 7</u>

Victoria Petrova, Credit Suisse

Thank you gentlemen for letting me ask my questions. I have two left. One is on discounters. During Capital Markets day you pretty clearly said that your focus was maintaining market share within the big four while discounters are likely to continue gaining market share in the UK. Recent Kantar data shows that your growth is significantly above the one of Aldi and actually Lidl as well. Can you give a view on that? Are you winning the customers within the COVID environment? Is it location? Is it assortment? Is it anything else? And is there anything to stick?

And my second question is related to any colour on your online grocery sales profitability versus your average grocery profitability? Any colour. I know you wouldn't give the exact numbers, but maybe something relative, how much less profitable it is, what that trend is, is it becoming more profitable than before? Is mix changing in the current environment? Thank you very much.

Mike Coupe

Yes, you're right, in terms of our sort of start point the Capital Markets day would be to maintain our volume share of the grocery market, ex the discounters. And actually if you took our performance in quarter four we did better than that, we actually grew our market share, volume share, in that reported statement. But of course that is now ancient history and what we're seeing, as you describe, is a marked change in customer's behaviour where in effect they are choosing to shop on a needs basis.

Our transaction levels have effectively, well they're not far off halved, but of course that means by implication they're spending more than double what they'd spend on every shopping trip because they're trying to get everything they possibly can in one go. And of course that mitigates towards coming to larger sheds rather than to the discounters, which is what you can see very clearly in the data.

And indeed, shopping locally. I mean there's quite a big step up, as you'd expect, in convenience shops and also local traders which have seen a bit of a bonanza, I think it was 50% up if you look at the sort of local stores data.

I've no idea whether that's going to stick if I'm honest, I mean your guess is as good as mine. But most of these behavioural changes, if they last for a long period of time…if the lockdown lasts for a period of time then they start to become embedded behaviours. So who knows whether it'll go back to where it was, but I suspect it'll be some and some if I was trying to predict the future.

As far as the grocery online business is concerned, you know, the broad metrics are the actual number of slots is up roughly 50% and will continue to grow. The basket size is up roughly 50%, so overall that business has almost doubled as a participation of our grocery business. So accounts are not far off 15% of our total sales in the last week we traded and that's likely to grow because there's still far more demand than there is supply.

It's helpful in terms of physical basket size. The picking efficiency has increased. Clearly more orders means higher drop densities, that's also helpful. And a proportion of the growth of the business is in Click & Collect, which means we're not driving to people's homes, we're only driving into our own car park, which means that the distances are a lot shorter and therefore a lot more efficient.

So in the round that means the business is more profitable. It's not as profitable as customers coming through the stores and buying their groceries and particularly in the way that they're choosing currently to buy their groceries. So we'd still on balance prefer people to come to the shops but clearly in the world that we're in people are obviously taking the opportunity when they can to shop online in their droves. And we'll continue to do everything we can to increase our capacity and to satisfy that demand; which by virtue of that virtual circle that I've described it's helpful on balance for the profitability of the online grocery business. If that helps give you the colour that you need.

Victoria Petrova

Absolutely. Thank you very much.

Question 8

Andrew Gwynn, Exane BNP Paribas

Morning both, how are we doing? I think it's your last event, Mike, so…

Mike Coupe

It is.

Andrew Gwynn

Yes, so I'm not sure how much you're going to miss us but I think many of us will miss you.

Mike Coupe

Oh, particularly you, Andrew

Andrew Gwynn

Yes, well we're going to miss your transparency, ambition, your passion for the business. Your coffee drinking I'm sure, humour and maybe even a bit of your singing, but anyway, I wish you all the best.

Mike Coupe

And that was going pretty well until the last bit, but anyway.

Andrew Gwynn

Yes, so three questions, that seems to be the way, so firstly just on that online shift, I'm just wondering to what extent you would anticipate those supply changes sticking around, because obviously demand is pretty exceptional at the moment. As you mentioned, you'd rather people go to the stores, but would you anticipate post crisis you'd leave all of that store picking process in place?

The second question is just on the rates relief. I was just wondering if there were any scenarios where you wouldn't take the rates relief. Obviously some of the sales scenarios you painted are pretty bearish, particularly around Argos. Are there any circumstances that maybe you'd think it was the right thing to do?

And then the last one, perhaps quite complex, is gross margin. I think it's been described as the magic that we miss, but obviously a lot of moving parts within what people are buying in the stores at present, so in promotion intensity perhaps down a touch, a bit more scratch cooking, a bit less food to go and so forth. So just a little bit of help from the stand of those moving parts. Thank you.

Mike Coupe

Yes, I'll have a go. I'm sure Kevin might want to follow up on all three. Yes, I mean, who knows. I go back to the point I made about discounters, there's clearly a marked change in behaviour,

and if that was to stick around for any length of time it would be hugely beneficial to our organisation, whether it's a shift away from the discounters, larger basket sizes, or indeed, the way that the mix has worked out in terms of online shopping.

Our experience would say that online shopping, and indeed, using things like SmartShop and digital shopping becomes habit if you do it for long enough, and clearly the longer the lockdown goes on the more people get used to shopping for their groceries online the more likely that is to stick. So whether it sticks at the kind of 15% plus levels that we're currently seeing I've no idea, but I suspect it will certainly be higher than the 7%, 8% levels that we were seeing pre crisis. So who knows, but it's going to be at least somewhere between the two but it may well stick at the higher level as people get more and more used to the convenience of online shopping.

On rates relief, clearly we are appreciative of what government has done. We would certainly anticipate taking that rates relief, because we'd also make the point that we would remain one of the largest tax payers in the UK, even with that rates relief. And indeed we would pay higher rates than, for instance, Amazon would, because we still pay rates on our office space and on our distribution warehouses. It's only on our stores and in England, Northern Ireland and Scotland we get the rates relief, the Welsh have decided to continue to charge rates.

So I can't think of any scenarios where we would forego that opportunity and, you know, just to reiterate the point about being good corporate citizens, we've also foregone any opportunity to get recompense for furloughing our colleagues. We're paying very generously if our colleagues are ill, and we haven't taken the opportunity to defer VAT payments. So we continue to act, we believe, in the right way.

As you are no doubt aware, we don't comment on gross margin and won't comment on gross margin, other than to say that you can make some assumptions around the scenarios that we've painted. And clearly the scenarios we've painted, the mix effect you could argue, other than the obvious mix effects between the various big chunks of the business, is broadly neutral, it's the sales impact which is the thing that drives the profitability.

So inherent in our assumption is let's assume a flat gross margin for the various chunks of the business. Clearly in clothing there's a huge amount of markdown going through at the moment which is one of the costs, certainly in the short term. And we've already talked about the potential mix impact of a prolonged recession which I would argue has a potential to be helpful rather than unhelpful in terms of the mix impacts, but your guess is as good as mine, and you can build that into your model if you think our base assumptions are wrong.

Kevin O'Byrne

And the other thing I'd add to what Mike has said on rates, rates it's not optional whereas the VAT and job retention are optional and we've chosen not to take them but the rates wasn't optional. I'd echo everything Mike said about it being a tax that unfairly burdens our sector and we'd welcome the government, as we've talked about for many years, revisiting this after the crisis. And then the other final point is we have closed over 570 stores that are sitting empty and not trading.

Question 9

Xavier le Mené, Bank of America

Good morning gentlemen thank you for taking my question only one actually. You had a Capital Markets day last year and you had a long presentation of your strategy, so I was thinking in the current environment for the consumers it's changing a lot, as you said, and it's difficult to predict, of course, what would be the outcome and the longer term change of behaviour. But is there anything in the strategy that you see you need to potentially accelerate today and are there other parts that you potentially believe are less strategic today?

Mike Coupe

Yes I've already made reference to the fact that this moment in time managing the last seven/eight weeks has been a hell of a thing for the organisation and that's what's been the short-term focus of me and the leadership team. But it's also a good time to be handing over because I'm sure Simon and the leadership team will be looking and addressing exactly the question that you raise. And, clearly on the back of what we are seeing, there are some choices that can be made to accelerate certain things and as you say decelerate certain other things. I don't think it would be right for me to opine on that today and I'm sure when Simon has got his feet under the table and has the time to think about it, both for the short-term and the long-term, he will be talking to you probably at the interims in November about the kind of choices that the business has made in the light of the scenario that's then playing out.

So clearly, broadly speaking, the direction of travel that we set at the capital markets day; the digitisation of the business; the various cost-saving initiatives; the need to continue to invest in the product propositions etc. etc. will all hold true to some extent but clearly there could be a change of emphasis as the new leadership team look forward. So it would be wrong of me to, as I say, opine any further than to say that clearly Simon will be reviewing that over the next period of time and no doubt will talk to you about it at an appropriate moment.

Question 10

Clive Black, Shore Capital

Morning guys. I think as the oldest analyst on Planet Earth just very much wishing you a very long and happy and healthy retirement Mike to be fair to you.

Mike Coupe

Thank you very much, Clive, I appreciate it.

Clive Black

I'm sure you won't be wishing you were doing this for much longer. Just two or three questions please. Mike, in your distinguished career how would you characterise the present economic challenges of retailing? You've been through some big ups and downturns over the years, how do you see this coronavirus crisis for Sainsbury's?

Secondly, in that respect how significant do you think the online activity recently and how much of a strategic shift does that represent, both grocery and non-food, but in that respect the scope for a lot of stores to close in the UK after this crisis?

And then just lastly, one more for Kevin perhaps, just to maybe give a little bit more colour about how robust you think the net debt target in 2022 remains given all the current uncertainty? Thank you.

Mike Coupe

I think on the first point, Clive, it goes without saying that this is unprecedented and not just in my working lifetime but in my lifetime. I think the only thing that gets anywhere near it is the three day week which if you're old enough you'll remember not having electricity for eight hours at a time, which is probably as I say the only scenario that I can think in my lifetime and that goes back to the mid-1970s where we've got anywhere near the kind of situation that we're currently in. And one of the reasons why we're deferring the dividend decision is that I don't think any of us can genuinely currently fully understand the economic impact and the subsequent knock-ons and, therefore, we think it's absolutely right to be prudent. And as I said throughout we've given you a base case but we would give you plenty of cases that have significant downsides and plenty of cases that have significant upsides.

And on your point about what does that mean for retail; again I've said it and I'll repeat it, I think it accelerates many of the trends that were already there. So what might have been happening over a three to five year period: digitisation, move to online, etc. etc. I suspect is going to be quite significantly accelerated, as will indeed the consolidation of certain types of the market, with businesses that might have struggled on for a few more months or years going bust and no longer existing, very sadly.

So your guess is as good as mine but I would say if we look back in let's say a year or twos' time we'd have seen an acceleration of many of the trends that were there anyway in that sense. I'd like to think it's vindicated many of the choices that we've made over the last five or six years. You know you look at things like SmartShop now accounting for over 30% of sales, that wouldn't have been possible even a year ago and that's just a testament to the sort of investment that we've made in our digital and online business. But as I say you're as experienced as I am and you can model many of the scenarios but inevitably that's going to increase pressure on high streets as an example if the trends that we've seen rapidly changing in the last five, six, seven, eight weeks continue for the foreseeable future and beyond.

On debt maybe Kevin can speak.

Kevin O'Byrne

Yes Clive morning. As we've said many times the key financial target for the business is delivering a strong free cash flow. And we use that for two purposes: clearly distributing to shareholders via the dividend and deleveraging the business. The deleveraging is important for us as a management team, it gives us greater financial flexibility, all the more important in the current crisis as you can imagine and we're very pleased that net debt decreased by 23% this year and over £900m in the last four years. And as we decrease debt clearly the equity value in the business goes up so it's good all round.

And so we're committed to the target the issue is timing on the target and clearly we'll see how things play out. And as we get greater visibility then we can come back at the next logical time

to update you with the interims again and just does the timing of the target change but we're committed to the target.

Clive Black

Sorry Kevin to come back just in terms of your base case scenario, for example, is it still feasible to hit that £750m reduction in 2022 or is it something that is very much more likely to be extended out?

Kevin O'Byrne

It's a tricky one to answer because with the base case we could stay on track but it all depends on what happens the following year because clearly it's a three year target. So if we had the base case we could achieve broadly what we would like to do this year but it's difficult to be clear because we don't know what next year would, Clive, if that helps?

Clive Black

Yes okay thank you. Well as someone who remembers cooking toast in front of the coal fire in the early 1970s, Mike, I hope your retirement doesn't take you back to that, and all the best.

Mike Coupe

I hope so as well but at least you remember that and I hopefully agree that's probably the only economic scenario I can think of that gets anywhere near what we're going through at the moment.

<u>Question 11</u>

Andrew Porteous, HSBC

Hi gents and congratulations on a good career for a long time and I wish you very best for the future. Three questions if I may?

First of all around promotions we're seeing at the moment, I think Nielsen was talking about ten percentage points lower promotional participation at an industry level, I was just wondering at an industry level are we seeing a lot of inflation effectively from a lower promotional giveaway at the moment? And also what's happening with suppliers around the funding budgets for that? Are they on hold at the moment? Are they likely to come back later in the year? I'm wondering what discussions you're having there?

The second question was around the supply chain and any signs of stress in that? I'm thinking particularly of the fresh supply chain here, we see articles around labour shortages etc. Are you seeing any signs of distress and does that point to maybe inflation picking up through the summer as we become more reliant on that supply chain?

And then the last one was really around Argos and thinking about peak ordering, and if you could just talk to us, I appreciate it's probably a huge challenge at the moment, but how do you have to think about ordering ahead of peak in Argos and is that happening over the next few weeks and is there a risk that supply becomes self-fulfilling in that if you don't order enough for peak and demands there. How are you thinking about scenarios around that?

Mike Coupe

On the first point it's self-evident that the number one priority that we had was to focus all of our resources on making sure that we could supply all of the base commodities to our customers as quickly as we possibly can. And in that scenario it would be absolutely nuts to carry on promoting in the way that you were previously. Clearly as we come out the other side and we start to see some kind of normality I suspect you'll start to see the cut and thrust, in fact I think we've already seen some of the cut and thrust normal day-to-day activity within the grocery businesses starting to increase.

We haven't seen much change in inflation if I'm honest in terms of the headline rates. We look at inflation effectively at the average item price level, so there's lots of different ways that you can measure inflation. But if you think about the categories that have performed particularly well they've been broadly speaking in the dry goods areas. And therefore in terms of value per item sold that would tend to be on the lower side compared with some of the added value and fresh foods as an example. So we're selling lots of cans of tomatoes, not many packets of ready meals and clearly the ticket price for each one of those items is markedly different, it's like a ten times difference.

So we haven't seen a significant spike in inflation and none of us really know what's going to happen to commodity prices over the next weeks and months, so at this stage I'm not sure I could do anything more than stick with that as an answer.

In terms of supply chain in the end the UK relies on 80,000 migrant workers to pick crops which are now starting to ripen in fields throughout the country. We think the industry, as we see it, has done a reasonable job of mitigating that either through bringing migrant labour in, help from the government, also looking to labour within the UK economy to help. It's probably not quite where it needs to be but it doesn't feel like it was quite as significant as it might have felt a few weeks ago as we were potentially facing down those 80,000 people not being available to pick the crops and all the inherent risks associated with that.

So I'm not saying for a moment it won't be bumpy, there are certain elements of our supply chain, flowers being the one that's come up continuously, which are under pressure but equally we think, and we think more broadly the industry is in a position to mitigate those supply chain stresses. There will be gaps on the shelf in certain categories at certain times but broadly speaking we're returning to whatever normality will look like over the next period of time.

And clearly for the Argos peak as you can imagine, not just within Argos but all of our long lead time businesses, we are reviewing our demand. We are looking at the various planning scenarios and we're making sure that we're making the right decisions in terms of stock for the autumn and winter peaks which broadly speaking we've still got to place orders for and therefore we've got a degree of flexibility. But it wouldn't be a bad scenario to take our base case as the case on which we're planning the business as a start point, plus or minus a few bits here and there. So we've given you a base case that's the planning scenario we're working to. If it was stressier than 10% in General Merchandising and clothing that would give us a stock overhand, but equally the other way we'd run out of stock if the market was more buoyant than that. So that's the planning scenario.

Question 12

James Anstead, Barclays

Thanks for letting me have a second bite of the cherry. I just wanted to add to the various comments about this being your last appearance on one of these results calls. I think it's fair to say your timing hasn't been great, there can't have been many more difficult periods in which to leave the big UK supermarkets given that the growth of the discounters, the growth of online and now we're at a global pandemic to finish off with. But I think all the analysts I'm sure would agree with me in saying three things: one I think you deserve a lot of praise for always looking ahead strategically and not shying away from the big decisions. Also you've always been very keen to engage and debate with the investment community which has been very much appreciated and I'm sure we all wish you success with whatever you turn your attention to next.

It would be nice to think you'd have a relaxing final month to wind down with but I suspect it's going to be one of the busier months in your time at Sainsbury, but the very best of luck with whatever comes next and thanks again.

Mike Coupe

Thanks very much, James, that's very kind of you.

Kevin O'Byrne

James I might add as well because I think we're probably at the end of the questions, I'd like to add on behalf of the whole business our thanks as well to Mike. Mike's knowledge and experience in the industry is unparalleled and many of you would talk about that. But what you often don't see or what you wouldn't see day-to-day is just his commercial judgement, his management style in action and consistently setting the right tone here at Sainsbury's. And Sainsbury's as a business with a really strong heritage for doing the right things and Mike has been an amazing guardian of that heritage. But also at the same time invested hugely in our digital capabilities and set us up really well for the future, which we're very grateful for. It's been very evident during the COVID-19 crisis so, Mike, thank you very much for setting that tone, for looking after the heritage, setting us up well for the future and we will all miss you and wish you all the very best.

Mike Coupe

Thank you. We haven't always seen eye to eye with everybody and we've had many robust debates over the years. Hopefully you've seen that I've always tried to set out to do the right thing and I've put the interests of the company in front of any personal interest and I've tried to do that consistently. And at the centre of this organisation are a core set of values where we set out to do the right thing in what is an incredibly challenging set of circumstances and in some cases quite ambiguous demands. So that's certainly been my personal stance and as I say I appreciate the feedback and I've enjoyed our interactions no matter how difficult they've been sometimes. And I respect the fact that all of you guys have a job to do and we all have a part to play in this very challenging industry but nevertheless very exciting industry. So thank you very much for the kind words.

And actually it's not quite the last time that I'll do this with you because I think we've got the fireside chats so I get to do it all with you all again on Friday. But it certainly will be the last time that I do this kind of results discussion, so thank you very much for the very kind words.

At that point I think we're going to call it a day, so thank you very much everybody.