J Sainsbury plc
2022/2023 Interim Results Presentation
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Presentation

Simon Roberts
Chief Executive Officer

Good morning everyone, and welcome to our 22/23 Interim Results Presentation.

Thank you for joining us today.

I will start with a brief introduction to cover progress against the priorities set out as part of our three-year plan. Kevin will then cover the first half financials, and then I'll go into more detail about our strategic highlights and performance delivery, at what is the halfway point in our three-year plan.

Now, you'll remember that these were the priorities we set out two years ago, in November 2020. Our key value creation pillars of Food First, Brands that Deliver, and Save to Invest, underpinned by being Connected to our Customers and delivering our integrated Plan for Better.

We laid out in April the key focus areas which would underpin our performance delivery over the course of this financial year. We've been relentlessly focused on each of these, and have been delivering consistently against them.

As we navigate the second half of the year, it will be more of the same, with all six imperatives remaining front of mind for me and all of our team.

Now, I'm encouraged by our progress so far this year, and we are delivering for all our stakeholders as a result.

For our customers, we're the best value we've ever been, and we continue to make solid progress in the competitiveness of our offer. Of course, this is more important than ever, during such a tough time for millions of households. We're committed to building the long-term loyalty and trust of customers throughout this period, and importantly, we've strengthened our firepower to help battle inflation, funded by a cost savings programme that helps us invest more than our competitors.

For our colleagues, we continue to take a leadership position in our industry on colleague pay. We've invested £150 million this year to support colleagues, and drive outstanding service. We were the first supermarket to offer a second pay rise in the year in September, and we've announced additional colleague discount and food support for our teams.

For our suppliers, well, we've continued to develop and further leverage strong supplier relationships and the scale benefit from our volume share gains. Of course, we've needed to be flexible, listening and supporting our suppliers, given the challenging macroenvironment. In turn, our suppliers have supported us. I really want to thank them for all their help and commitment, and this is reflected in improved availability we're delivering for our customers.

For shareholders, well, we're committed to improving returns, by creating a simpler, more focused business. As you've seen, profits are significantly higher than before the pandemic, and we are delivering strong cash generation, driving down leverage, and supporting dividend payments.

This slide shows how we are delivering against our strategy for customers and colleagues. We are inflating behind the market month after month, and we are the only full-choice supermarket to have grown volume market share, versus pre-pandemic levels, from the first half of 19/20, and we've grown share again year-on-year.

We're pleased, too, with Argos performance, particularly in Quarter Two, when we significantly outperformed the market, as customers were looking for value and a brand they can trust.

We continue to lead on supermarket customer satisfaction, and we're encouraged that our colleague engagement scores have improved again. This is a priority for us, which I regard as no small achievement in such difficult times. Having the most engaged colleagues is absolutely at our core, in order to deliver leading customer service.

All this is made possible by the scale of our cost savings programme, creating the firepower to invest in price and colleagues, ahead of our competitors.

We are at the halfway point in our three-year cost saving programme that will deliver £1.3 billion by the end of next year – double the run rate of the prior three years.

It is important to stress that a lot of these savings are unique to us. Not least, for example, the benefit of putting Argos stores inside Sainsbury's supermarkets.

Stronger volume performance than competitors is also creating competitive advantage. So, we are improving our competitive position, and mitigating operating profit pressures, which is enabling us to deliver profits significantly ahead of pre-pandemic levels.

I'll now hand over to Kevin, to talk through our first half financials.

Kevin O'Byrne
Chief Financial Officer

Good morning everyone and thank you Simon. I will now cover the financial highlights for the 28 weeks to 17 September.

I'm going to start by looking at sales on a year-on-year basis.

Overall, Grocery sales grew by 0.2% during the first half, despite tough comparatives. We saw sales growth strengthening in the second quarter to 3.8%, as the lockdown comparatives eased, inflation was higher, and customers responded well to the strength of our offer.

We also benefited from warm summer weather, which supported sales in both Grocery and General Merchandise.

General Merchandise sales declined overall across the first half, but we saw growth in the second quarter of 1.2%, with Argos sales up 1.6%.

Alongside the favourable weather, this was driven by the work we've been doing to improve availability and resulted in strong market share gains.

Growth was strong in particular, in consumer electronics and seasonal products.

Clothing sales were down in the first half, reflecting the impact of customers returning to the high street, as COVID restrictions eased. In the second quarter, clothing sales were broadly flat.

In total, H1 retail sales, excluding fuel, were down 1.3% year-on-year, including the impact of higher fuel sales, first half sales growth was 4.4%.

I also wanted to share sales comparatives versus three years ago in order to provide a pre-COVID comparison.

Grocery sales were up over 9% on a three-year basis, driven by sustained higher volumes, post-COVID, as well as inflation.

General Merchandise sales were down 5% versus three years ago, with Argos sales down around 3%, and Sainsbury's General Merchandise sales down nearly 15%. This partially reflects our shift in focus towards more profitable sales, including a reduction in promotional activity and a strategic decision to exit less profitable categories, such as entertainment in Sainsbury's.

Clothing sales were 2.5% higher than three years ago. This was achieved despite a reduction in promotional activity. Full price clothing sales participation levels are significantly higher than 19/20 – 80% this year, versus 64% in the first half of 19/20.

So, total retail sales, excluding fuel, were up 5.9%. Including fuel, first half sales were up 9.2%.

Retail operating profits in the first half were down 9% year-on-year. This reflects the investment we are making in value, the impact of reduced Grocery and General Merchandise volumes post-pandemic, and higher operating costs, partially offset by a higher contribution from fuel.

Financial Services made a profit of £19 million in the first half, which is in line with last year.

Underlying profit before tax was down 8% year-on-year, which represents a 43% increase versus the first half of 19/20.

Finance costs were 9% lower, year-on-year, driven by interest income from higher cash balances and lower interest rates on new leases.

At a statutory pre-tax level, we reported a profit of £376 million. Now, this is down £151 million against the prior year, which included £181 million of exceptional income, relating to the settlement of legal disputes.

As you can see here, we delivered strong retail free cash flow in the half, of £759 million, up 37% year-on-year, with a working capital inflow of £360 million. This inflow reflects higher Grocery sales in Quarter Two, and a more typically strong seasonal working capital position,

seen at this point in the year, and as usual, we would expect this to unwind in the second half.

We were in a net funds position of £361 million at the end of the first half, and we are pleased with this strong delivery. This is the first time we've reported net funds.

We are on track to deliver at least £500 million free cash flow this year, in line with our three-year target to March '25.

The reduction in underlying earnings per share is consistent with the decline in UPBT, and we will pay a dividend of 3.9p per share, up from 3.2p per share last year, in line with our practice of paying an interim dividend of 30% of the prior year's full dividend.

Looking now at Financial Services, where profit was flat year-on-year.

Growth in revenues was firstly driven by a recovery in ATMs and Travel Money, although these areas of commission remain behind pre-pandemic levels.

We also grew interest income, as demand for credit increased, although, again, as you can see, our total credit card and loans book is over £1 billion lower than pre-pandemic levels.

This growth in income was offset by higher impairments and increased costs. Higher impairments were driven by three factors, growth in the loan book, additional provisioning made as a result of more cautious economic forecasts, and the normalisation of arrears levels post-COVID. Overall arrears levels remain low.

Increased costs were driven by recovery of volumes and some operating cost inflation.

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

Restructuring costs of £33 million relate to the programme announced in November 2020 for the structural integration of Sainsbury's and Argos. Our guidance for total restructuring charges for the three years to March 2024 is unchanged, and we still expect a cash outflow of around £60 million this financial year in relation to this programme.

Offsetting this, we booked £30 million of income relating to settlements for overcharges from payment card processing fees, much lower than the £181 million recognised in the prior year, and £35 million of IAS 19 pension income.

As already noted, the first half has been a period of strong underlying cash generation, with retail free cash flow benefitting, as I mentioned, from a more typical seasonal working capital inflow, and higher Grocery sales in Q2.

Free cash flow also includes the cash receipt of a £50 million dividend from Sainsbury's Bank, which was announced at the prelim results in April, and paid in the first quarter of this financial year.

Now, it's worth calling out the, other, line in the table which, in the prior year, primarily related to increased lease additions, from the Highbury and Dragon transaction, where we served notice in the first half of last year to purchase 13 stores, upon the expiry of the leases. We plan to pay for these stores, in March 2023, from cash flow and a term loan.

Excluding lease liabilities, we close the half in a net funds position of £361 million, representing a reduction in net debt of over £500 million from the year end, and a reduction of around £400 million from last year's first half.

Net debt including lease liabilities reduced by nearly £600 million from the year end.

These charts show the strength of our balance sheet position, which is important in the current environment. Our net debt to EBITDA leverage ratio was at 2.9 times at the first half, down from 3.1 times at the year end.

As I've already mentioned, net debt is always lower at the half year. We would expect our net debt to EBITDA position to improve year-on-year to around three times at March 2023. This would be at the top end of our target leverage range that we laid out as part of our capital allocation policy in April.

Return on capital employed is down from year end, reflecting the impact of lower underlying profits. We remain on track with our key metric to increase return on capital employed.

So, overall, we're pleased with our first half performance. The backdrop remains tough, but we're really well placed.

Our volume market share outperformance has been supported by the strength of our financial position and the ongoing delivery of our cost savings programme.

Trading momentum has remained strong in the first few weeks of the second half, with continued volume market share gains. We continue to generate strong retail free cash flow, and expect to generate free cash flow of at least £500 million for the full year.

Looking ahead, we're well placed to deliver through Christmas, and continue to expect underlying profit before tax of between £630 million and £690 million.

Thank you very much for your time. I'll now hand you back to Simon, to take you through our operational highlights, and progress against our strategic priorities.

Simon Roberts
Chief Executive Officer

Thank you, Kevin.

Let's now turn to Food First, the first of our strategic priorities.

There's been a relentless focus, across the business on keeping prices as low as we can at this difficult time for customers. We believe we're in the best place we've been in a long while on value. We will have invested over £500 million in prices over two years by the end of this financial year, and we continue to anchor this value investment at the centre of the plate, in meat, fish and poultry, and fruit and vegetables. This is really working for us.

We have three core platforms of value, as you can see here. First, is Sainsbury's Quality, Aldi Price Match. Here, the focus is on products that customers buy most often, with 240 products in the Aldi Price Match campaign.

Second is Price Lock, where we've added 20% more own brand lines to keep everyday prices low on the core staples. Prices are locked for eight weeks on over 2000 products in this campaign.

Third, My Nectar Prices, which is becoming increasingly popular with customers seeking out Nectar points, and offers, to save money on everyday items. New offers are added every week, as we react to market dynamics and customer needs.

We've shown this chart before. It shows the strength of our value focus. We continue to consistently inflate less than competitors, on the products that customers buy most often, as shown here, as well as on the overall basket. This focus is working. We're driving more volume and more customers into Sainsbury's, and we intend to keep building on this momentum throughout the rest of the year.

Here, we can see our progress on value against our key competitors. We've continued to consistently improve our price position against all of them year-on-year. We've shown particular improvement against Aldi, improving our value index by 400 basis points year-on-year.

As you can see on both these charts, it's all about how we help customers to find value, and then, when they want to, help them to trade up. Sales of economy, own label products were up 11%. We've been gaining spend in this category from nearly all competitors, but with the strength and breadth of our assortment, we are uniquely well placed to win at the other end of the basket as well.

We are seeing great performance in our premium own label tier, Taste the Difference, with sales up year-on-year, and up 13% from 19/20.

We expect to win more spend, as customers trade down from restaurants, and look for treats and meal deals for special nights in, and celebrations with family and friends.

Now, to support that trade up, it's really important that customers recognise the high quality of Sainsbury's products, and you can see here that we are ahead of our competitors, and we're on track to launch 1200 new products this year, with over 600 delivered in the first half. We extended our Summer Edition range, and sales grew over 30% compared to last year.

We're delighted with our delicious, Autumn Edition range again this year, up from 47 products to 82 this year. We continue to balance our assortment by category, as we bring new lines into the ranges, whilst at the same time, we constantly take action on the tail.

So, looking ahead, we're well set up for this Christmas, as customers look for an extra special celebration. We will be launching 300 new Christmas products this year, and nearly half of the Christmas innovation will be in Taste the Difference.

Let's now take a quick look at some of our product innovation over this Summer and Autumn, including some of what's to come this Christmas.

[Video plays]

Simon Roberts
Chief Executive Officer

Moving on to our channels, as you can see from the chart, online orders continue to normalise post pandemic, although the year-on-year decline is slowing. We did a better job than our competitors during the pandemic, making online delivery available to customers who really wanted and needed it. So, as customers have returned to stores, our online sales have declined a little more than the market.

We are encouraged by how this is playing out. We're pleased to see a higher proportion of customers switching back into our own physical stores, than is happening at our competitors, and this is reflected in our overall Grocery market share gains.

We're happy with this balance back to physical stores, but we're also continuing to drive further online efficiencies, and we see further opportunities here, in our store pick model. Drop densities and item pick rates are both significantly higher than pre-pandemic, and item pick rates have improved 4% year-on-year.

We're also pleased with the recovery of our convenience channel. Convenience sales are now 7% higher than they were pre-pandemic, driven by growth in our less urban stores, outside city centres, whilst our smaller, city centre food on the move stores have recovered rapidly and are close to delivering pre-pandemic sales levels.

The chart on the right shows our overall channel performance, and the switch back to our physical store estate.

Our On Demand channel continues to grow, and we are now delivering around 118,000 orders per week, from nearly 700 stores. As customers choose to return to our stores, we're pressing ahead with our significant investment programme, to further improve the store shopping experience, as you can see here.

In fact, we will have touched nearly 90% of our supermarkets this year alone. Prior to October, we finished relaying all our stores, to meet the new High Fat, Sugar and Salt regulations.

We've taken advantage, whilst making these changes to also upgrade our Fresh and Grocery offer in hundreds of stores, rolling out Beauty aisles, investing in checkout technology, and creating destination space for General Merchandise.

So, now that I've talked you through the 'what' of Food First, let's move on, and update you on the proof points of what this is delivering.

This slide shows our relative resilience as customers adapt to cost of living challenges. We've seen less switching to Aldi and Lidl than any of the full-choice supermarkets, and while customers are spending carefully, our customers are dropping fewer items out of their baskets, and trading down less, through product choices.

This is driven by the strategic choices we have made, the demographics of our customer base, our range, and our strong brand position, supported by the geographic mix of our stores.

As you can see here, the trend in customer satisfaction is significantly impacted by inflation, dragging down value perception scores across all retailers. Nevertheless, customer satisfaction continues to be a key point of differentiation for us, and we are maintaining our lead versus all of our full-choice competitors.

You can see this across the four key drivers on the right-hand side of the chart. We continue to lead on availability of items, speed of checkout, quality of products, and colleague availability.

This is the final point on volume market share performance. We showed the left-hand chart at the start of the presentation. We are the only full-choice supermarket to grow or maintain our volume share position, from where we were pre-pandemic, and we also grew volume share ahead of the market, in the second quarter.

Moving on, now, to talk about Brands that Deliver. We're making good progress with the second pillar of our strategy, and I'm encouraged by the progress we've been making across the brands during the half.

Leveraging the full potential in Nectar is all about continuing to acquire new digital Nectar users. Nectar continues to grow, and we've hit our target of reaching 10 million digital collectors. More SmartShop customers are benefitting from personalised Nectar Prices, saving customers on average over £100 a year.

Nectar360 is going from strength to strength, where we work with around 700 suppliers now every year. We previously said that we expected Nectar360 to deliver incremental profits to the business of £60 million to £70 million by March 2026. We now expect this number to be at least £90 million.

In General Merchandise, our objectives were to reduce our cost to serve, and improve profit delivery, whilst delivering a better proposition for our customers.

We're encouraged with the progress now being achieved, as we further improve our focus and capabilities in General Merchandise. Argos profitability levels are significantly higher than pre-pandemic, largely driven by a reduction in operating costs to sales.

Given the challenges last year, we've put a major focus across the General Merchandise business on improving availability, and this is significantly better than last year. We are improving the assortment of ranges, customers are recognising our strong value credentials and we've grown our digital market share in Argos.

To deliver full potential across Brands that Deliver, we need to build each of our brands so that they inspire and really connect with our customers. This slide illustrates some of the things we are doing to develop and accelerate our brand proposition across General Merchandise.

We continue to develop and grow our Tu clothing brand, with our latest Tu & Me campaign really resonating well with customers.

In Argos, we are increasing our premium mix, by securing desirable new brands, such as Smeg, Neff and Mamas and Papas.

We've seen good sales growth in Habitat, as we build this brand. We're particularly pleased with the performance of the new Habitat Kids range, across bedding and furniture, and we're launching an exciting design collaboration with Sebastian Conran, son of Habitat's iconic founder, Sir Terence Conran, ahead of the brand's sixtieth birthday in 2024.

We've seen a strong performance in Argos, particularly in the second quarter, where sales grew by 1.6% year-on-year despite pressures on consumer spending. The favourable summer weather also played to our advantage.

We've been encouraged by overall market outperformance in Argos, growing share in all key categories, as customers have turned to Argos for value.

The chart on the left here shows the key categories that drove this performance. Consumer electronics and technology sales were strong, and the warm summer weather drove seasonal sales of gardening tools, barbecues and outdoor toys.

Sales in bigger ticket items, like furniture, have been challenged, as well as homewares, as discretionary spending patterns have shifted post pandemic.

We remain cautious about spend heading into peak, given the pressures on consumers, but we're increasingly confident that if customers are spending, that Argos is very well placed to benefit.

We're now going to play a short video, to bring to life changes we're making to Argos distribution network.

[Video Starts]

Two years ago, we laid out our Argos transformation strategy, with a key objective of giving customers faster access to a wider range of products.

We are reducing our standalone store estate from 600 stores to around 160. Over 70% of Argos orders start online, and 30% of fast-track delivery orders are delivered the same day, so it's important to have stock in the right place to get to customers quickly.

A key part of achieving this transformation has been through replacing our distribution network, of around 180 larger hub stores, with 30 new local fulfilment centres, which you can see in this video, taking stock out of the system, whilst moving it closer to customers and creating real working capital benefits.

We've now opened 11 local fulfilment centres. They're purpose-built to deal with volume, to stock broader ranges, and enable smarter use of data and voice picking, and allow optimised routing.

In the areas where we've opened local fulfilment centres, we are seeing tangible benefits, with better availability of items on the Argos website, and thousands more product options available to customers, more quickly.

Overall, this half, Argos perceived availability scores have improved six percentage points, and as we make and embed these changes to improve our distribution network, Argos will become even more efficient and synonymous with rapid and convenient access to a wide range of products, with great availability.

[Video Ends]

Moving on to Clothing, we are creating a stronger, more profitable Tu Clothing business. Clothing sales in the half were 2.5% higher than pre-pandemic levels, with our full-price participation remaining significantly higher than in the first half of 19/20, driving a more profitable business. We delivered a record performance in women's dresses in the half, with sales up 40% and we saw a good performance in Back to School clothing sales.

Now to Financial Services. Here is a reminder of the objectives we laid out for the business in September 2019. We're making progress despite a difficult backdrop and we were pleased that the Bank paid its first dividend to the Group of £50 million in April this year. As we've said before, we are focused on developing and delivering Financial Services products for Sainsbury's and Argos customers. Our teams are joined up to deliver these plans and we're delivering this more efficiently with investment in digitisation in particular.

Turning to our third key pillar, Save to Invest, or put another way reducing structural operating cost to fuel investment in the core business. Now we have doubled the run rate of cost savings and expect to deliver over £1.3 billion of savings in the three years to March '24. Eighteen months in we have delivered £730 million of these savings.

Now this is the first time we are talking to a cash target, which is partly to demonstrate the scale of the savings opportunities we have available relative to competitors, but also because much higher operating cost inflation than originally anticipated means that we will not now meet our 200 bps operating cost to sales reduction target by March '24. But let me be clear, we are ahead of the level of cash savings we committed to.

Looking to how we can continue to generate savings, so far our cost savings to date have been mainly driven functionally and focused on savings released from big structural operating model and proposition decisions. Now while these opportunities will continue to play an important role, we've recognised the need to think differently and our focus is now shifting towards driving variable cost efficiency with a greater emphasis on driving productivity and pulling levers end-to-end across the whole business.

Now this slide shows some examples of what we've already delivered to date on our key structural cost saving programmes. We've also made particular improvements in our utilities costs, reducing our electricity consumption by 23% over the last three years, driven by numerous schemes such as rolling out LED lighting to 100% of our stores and fitting aerofoil technology in our refrigeration.

We also believe we're in a good place relative to the industry on our proportion of new to planet energy sourcing. We have committed to the long-term purchasing of renewable energy from new windfarms, which gives us good protection from variable cost inflation. We're also confident that we're in a strong hedging position relative to others on utilities for the balance of this year and into next.

In June last year we launched our Plan for Better commitments and we set out key targets with the three pillars of Better for you, Better for the planet and Better for everyone. We committed not only to setting bold targets, but also to being transparent in our reporting against them.

Now in the half, we set out five Human Rights commitments and added improved animal health and welfare as a key as a key pillar. We've been focused on working in collaboration with other retailers and the World Wildlife Fund to halve the environmental impact of the UK shopping basket by 2030 and you'll hear more on this next week when the World Wildlife Fund publish their impact report.

We're particularly pleased with the progress we're making in tackling food waste. We removed best before dates from 100 more of our own brand products earlier this year, which is estimated to help customers save 11,000 tonnes of food per year. In the year since we launched our partnership with Neighbourly, we've distributed over six million meals to those in need.

So we're now at the halfway point of our three-year plan and here's a reminder of the eight key metrics we set out for that plan. I'm pleased that we're making good progress across the majority of these metrics and of course, we'll update more fully at our Prelims in April.

I'm excited about the momentum that as a team we're building in Sainsbury's. We have a very clear focus and we're executing well against that. Putting more volume through our Food business is the vital lifeblood that not only feeds the economics of the Grocery business, but also supports all our portfolio brands.

So before wrapping up, I want to return to some of the themes I started with. We're now at the halfway point of our plan and we're delivering against that plan. We've got strong momentum and we're proving to be more resilient than our competitors. We're saving more costs than our competitors, offsetting more of the operating cost inflation and we're reinvesting more in our customer proposition and in looking after our colleagues. This is why we're winning volume share.

For our shareholders we're delivering strong cash flows, supporting dividend payments. We're a more profitable business with a stronger balance sheet and this means we're well placed to deliver in this environment and navigate the period ahead. Thank you for listening and thank you for your time this morning.

Question and Answer Session

Operator

Hello and welcome to the Sainsbury's 2022/2023 interim results analyst Q&A call. On the call this morning are Simon Roberts, Chief Executive Officer and Kevin O'Byrne, Chief Financial Officer. I would like to remind analysts on this call if you would like to ask a question please use the reactions button at the bottom of your screen and use the raised hand function. When asking a question please turn your camera on and unmute yourself. We will pause for a few moments for the queue to form.

Our first question is from Andrew Gwynn from BNP Paribas Exane. Please unmute yourself to ask your question.

Andrew Gwynn, Exane BNP Paribas

Hi, good morning Simon, good morning Kevin, how are we doing? Two questions if I can. Firstly, just talking about the control of the P&L, clearly a bucketload going on in terms of

cost inflation, in terms of recycling the cost saving. But I suppose very simply, where did you land versus your expectations in the first half given all that noise?

Then the second one, obviously two key bits of guidance here, so the PBT guidance and then the cash flow guidance. What would cause you to deviate from those significantly? Is there something that you're watching from a consumer metric perspective? Is it simply just a relative performance versus your peer group? Thank you very much.

Simon Roberts

Andrew, thanks. Kevin, do you want to pick up on those couple of questions first?

Kevin O'Byrne

Yes, Andrew, morning. The first half was broadly as we expected. We said that we'd had volume reducing post-COVID in both businesses which we saw. We said we'd invest in food value which we did. We had maybe a little bit more impact from product mix in Argos, there were more electricals in the mix than maybe we would have anticipated. But we had higher cost inflation which we anticipated and that was largely offset by our savings plans, which of course we anticipated. So there wasn't a huge surprise, if you like. On the demand side, probably the demand side in Argos was stronger than we thought in the second quarter, but as I say, we had a mix in there as well. Simon might add something to that.

On the PBT guidance, really it's all around consumer demand. We've got absolute visibility of our costs, as you can imagine, we're fully hedged for the year, we've got – so all that's in the bag. The range will depend on the demand in the final quarter, particularly around general merchandise and what that's at. The other factor that's in there a little bit on our mind is impairments in the Bank and just how will that work out. Clearly a chunk of that is looking forward in the economic models and what IFRS requires us to do, which we'll get greater clarity on in the final quarter as well.

Simon Roberts

Yes, thanks, Kevin. Maybe just a couple of points on the demand side, Andrew. I think looking in the Argos business, I think clearly the self-help actions that we're taking, like availability and range and convenience, are really working. Clearly it was a strong summer from a weather point of view and undoubtedly that gave us tailwinds, particularly in the Argos business, given obviously the strength of the seasonal business there.

I should also just pull out the momentum in food, we've seen momentum. Volumes clearly in the industry are going backwards, but our relative volume performance against others in the second quarter we're really encouraged by. I think the combination of what we're doing, both on value but also on the breadth of the overall offering in food, really play to our advantage there.

Andrew Gwynn, Exane BNP Paribas

Okay, thank you. I'll just come back on the cash though, obviously the guidance is for north of £500 million, but you're substantially ahead in the first half. So should we just take into account you're saying at least £500 million and we'll see where we land? Or is this something we should be aware of in the second half on cash?

Kevin O'Byrne

No, it's at least, Andrew, but bear in mind the first half always is flattered by the working capital and we had the normal – if you went back three years pre-COVID and you looked at our working capital at the half year for each of those three years in what were potentially normal years, you'd have seen £250 million to £300 million of cash flow coming in in the first half because of just the timing of payment cycles and then coming out. So that's a factor in there. It clearly was exacerbated a little bit this year because you got more inflation in the number and we would expect that to largely unwind.

Andrew Gwynn, Exane BNP Paribas

Okay, great. It's been a while since we've had a normal year, but thank you very much, cheers guys.

Simon Roberts

For sure, thanks, Andrew.

Operator

Our next question is from James Anstead from Barclays. Please unmute yourself and ask your question.

James Anstead, Barclays

Good morning, I've got three questions if that's okay. Firstly, I appreciate it's really difficult to come up with any representative way of judging cost savings at the moment, but you've given us this impressive doubling of the run rate in the next three years. I just wanted to be sure, because that seems to be judged off 2021, when obviously there were lots of extra costs relating to the pandemic. Is that adjusted for? I just wonder whether the doubling of the cost savings is entirely the best way of thinking about it. That's the first one.

Secondly, you've also now said you'll have 160 Argos stores by March 2024 rather than 100 because of better rent negotiations. Do you think it stops at 160, or do you think it'll get to 100 but just more slowly? Just interested where that goes.

Then finally, perhaps for Kevin, it's obviously a very good problem to have, £300 million or so of net cash and it doesn't sound likely you're planning in the very short term to start returning that surplus cash, given the guidance for leverage at the end of the year. I just wondered if you could remind us, of other sources of use for that cash in the coming year or so. I know Highbury and Dragon might be part of that answer. Thank you.

Simon Roberts

James, thanks. Why don't I take the cost and Argos question and then I'm sure Kevin will speak on costs, he may also want to come in on the specifics of the COVID costs as well. Just taking a step back on our cost trajectory, you'll remember in November 2020 we said we'd reduce by 200 bps on costs over three years.

What I would say, first of all, is that we're really encouraged with the progress as a team we're making here. These are hard yards taking structural costs out of a business like this and as you can see, in a number of areas we've really delivered against that plan. We're actually a bit ahead of where we thought we'd be at this point in time. If we think about the

key cost areas in areas like supply chain logistics, clearly the Argos transformation, the work we've done on the proposition in food on cafés and counters and then really significant work in our channels on our store operating model.

So really what we're confirming today is this £1.3 billion of costs out of the business to March 2024 reflects the continued scale of that ambition. Whilst, as you say, there was some ups and downs on the COVID costs on the way through the 2021 period, when we look back at what the costs coming out of the business were to 2019/2020 and we look at what we're doing now, we're more than doubling the rate of cost takeout.

Just one other point, James, I would make here which I think is an important one. We've really focused on functional cost savings and on proposition cost savings to this point and very much now we are going to continue to deliver down those paths, for obvious reasons, because they'll be essential. But we're also very much now looking at end-to-end cost savings, productivity savings and also how we drive the operating leverage in the business.

So it's a bold plan, we're mature in our cost savings, we're confident about where we've got to and we can see a lot of opportunity in front of us. I guess the key point on cost, we think we've more cost out in front of us to do relative to our competitors.

In terms of the question on Argos, let's just take half a step back on Argos. We're pleased with the Argos performance in the half, particularly in the second quarter and to Andrew's question earlier, we had some weather help there. But the self-help in Argos that the team have led and availability particularly, and clearly in the cost out in Argos as we reshape the operating model.

I think in terms of the number of stores here, we said at the beginning 160. As you say, we've had some more favourable rent negotiations with landlords. Our objective was always to make sure we have the optimum number of access points for the Argos business and this will mean at the end of the three years we'll have around 1,100 points to access Argos, more than clearly we started with before. Just under 800 standalone stores, 1100 points to access Argos and we've managed to do that through some really strong and effective negotiations from our property team to get more stores in locations where we can serve customers at a lower cost and therefore, continue to improve the economics of the Argos business.

Kevin, do you want to come to the third of James's questions on cash?

Kevin O'Byrne

James, yes, on net cash, it's a great milestone actually. We're very pleased that we got net cash at the end of the half, we haven't had that before and going forward you expect net cash at the end of the year. But I'll remind you of the capital allocation policy that we laid out last year. First of all, invest to strengthen the business, which we're doing. Secondly, solid investment grade, really important and all the more important I think right now, given the world we're facing. So there's more to do on that, we should get to a three times net debt to EBITDA by the year end. We've said our target range is within 2.4 to three times, so a little bit more to do on that so we'll continue to do that.

But we also very importantly said in the meantime we would still pay out a greater proportion of profits to shareholders and we'd go from what was roughly about 53% distribution to about 60% because of our confidence in the cash flow. We know in the end all cash flow is shareholders, so we want to give more of that in the meantime to shareholders. Then after that we'll decide are there things we want to invest in over and above that, or would we return surplus cash to shareholders.

That leads onto your second part, which was the Highbury and Dragon, which as you recall we exercised the option in two different tranches to buy 21 stores back from this structure. You'll recall back in September we were looking at would we sell and lease back 18 different stores to part fund that. In the end, the market wasn't good at the time, the transition didn't go through, and we certainly never want to be or need to be because of the strength of the balance sheet a forced seller at the moment.

So clearly we're not going to sell properties into this market. So we'll fund the 21 stores from some debt and some cash, so you'll see in the post balance sheet events we've put a bridging loan in place. We'll replace that with a term loan and the good news then is net debt doesn't really change that much because we're replacing lease debt with bank debt. But it is positive from a cash flow point of view because the rent we would have paid we'll pay less cash in interest, so we're comfortable with that.

James Anstead, Barclays

That's very helpful, thank you.

Operator

Our next question is from Rob Joyce at Goldman Sachs. Please unmute yourself and ask your question.

Rob Joyce, Goldman Sachs

Morning to you two, thanks for taking the questions, I've got three. In the outlook statement you reference being well placed into next year. Just looking at consensus, it looks to have around a flat EBIT margin in the retail business next year versus maybe down 40, 50 this year. Just wondering if that seems consistent with your comments on being well placed and where you see costs.

Second one was just a follow-on really, Kevin, thanks for the comments on Highbury and Dragon. Just to understand, for those of us still using old money, in terms of the impact on net debt pre-leases what do you think – I think the purchase price was just over £1 billion from what I've seen from Supermarket REIT. So if you could help us understand that and maybe also just tell us what the expected rental savings would be, that would be really helpful.

Then the third one was just you referenced volume quite a lot in the release. It does look from the external data, not specifically for you but that market three-year volumes took a bit of a downturn in September. Can you just help us understand how your three-year volume momentum has been in September and into October? Thank you.

Simon Roberts

Thank you. Maybe Kevin, if you take the outlook and the net debt and then I'll take the volume question.

Kevin O'Byrne

Just starting with the Highbury and Dragon one, we'd envisaged taking out – you'll see we took a bridging loan of £575 million. The transaction net is probably about £700 million that we need, so we'll put a loan of that size in place. Whether we need it all or we'll do some

from cash we'll play that, but let's say it's £575 million, so you'd add that to the pre-lease debt and then we'll then eat into it over the next few years. So at the most it'll be £575 million, probably be a bit less.

The rent saving, had we done the 18 stores depending on the agreement, £45 million to £50 million of rent, so the interest on that will clearly be materially lower, so that's good from that point of view.

As far as being well placed into next year, I thought we might get a few questions on next year and as you can imagine there's a limit to what we can say. But we're very aware it's a tough backdrop, it's clearly too soon to be very specific. We do our budgeting processes after we get Christmas trading, so we'll come back and give you more detail as we enter the year.

But there are some things we do know and some things we don't know. We know it's a rational market at the moment and we can see people behaving in a rational way. We know we've got momentum from the plan and the actions that Simon laid out in the presentation, so we're in a good position with the underlying momentum in the business. We know we've got a mature Save to Invest programme that's delivering and we have clear line of sight of future savings.

There are areas, while inflation – we also know there's going to be more inflation clearly next year, particularly in labour and utilities, but we have some visibility of that. So we're 75% hedged for our utilities for next year and we've clearly got some visibility and a view on labour. So we kind of know what we're dealing with to a large degree there, although still lots of other uncertainty.

What we don't know, of course, is the level of demand, which is why we do our budgeting process after Christmas and closer to the financial year end and that's the big unknown. But overall we think that everyone's facing that demand question, so we think we're relatively well placed without being in any way complacent, because it's a pretty – it's a tricky environment out there and we're making decisions literally day by day, as you can imagine.

Simon Roberts

Yes, thanks, Kevin. Then let's just come to volume specifically, Rob. So clearly as you say, volumes in the market clearly are down, we know that. The key point that I'd really want to emphasise here is our relative volume to others, as you've seen, through the half has been strong. Also our relative volume to the full-choice supermarkets compared to pre-pandemic, as you've seen, we're the only one that's growing. So the context is really clear. We can see customers putting less in the basket, we can see some trade down happening and as you describe, as inflation has picked up into the autumn those forces have accelerated.

What I would say and one of the things that clearly we're very focused on is the fact that we're seeing less switching to the discounters. We're seeing that continue as we come out of the half. Our basket sizes are holding up better relative to our competitors and we're seeing a bit less trade down too. I think those three components in what clearly is a very challenging set of market dynamics at the moment, we're really focused on those because in the end they're the test as to what extent our focus on value on our food offer is really working.

Clearly no complacency in that, it's going to be a competitive period up to Christmas. I think we're going to see the market behave rationally, but clearly as customers are absolutely seeking value everyone's going to respond to that. So our strategic focus on value, on making sure customers trust the price on the shelf in the basket and that we not only help

customers manage as they trade down but also take opportunities to leverage our mix as well.

That's why one of the key points I wanted to just emphasise today, we're seeing that trade down, we're seeing customers shop in to Own Brand for sure. But we're also seeing customers trade up and you saw the Taste the Difference performance up 14% on three years and you can see what we're doing at the top end of the mix to really leverage that.

If it's helpful, just a word on GM, because I think clearly we've had a strong quarter 2 in the Argos business, some self-help's really driven that, the weather's been helpful. But for obvious reasons we haven't seen yet the start of the real build towards Christmas. I think if there's one big area of uncertainty on our minds it's just to what extent consumer spending will really pull back. We'll only really get our first feel of that over the next three or four weeks, once we get towards the end of November.

Rob Joyce, Goldman Sachs

Very helpful, thank you, both. Just a follow-up, just to help us understand the magnitude since the summer and the sort of volume fall-off, are we talking a percentage point or so? If we think volumes are down minus-one or they're now running at minus-two or whatever the number is on a three-year basis, can you give us any understanding of how that's – magnitude and trending?

Simon Roberts

It's not a significant shift, Rob. I think as the inflation cycle picks up, clearly customers are responding. We look very closely at the relationship between inflation up and volume in the basket. One of the things I would just draw attention to that I think we're seeing in our demographic and geographic mix, is as inflation has gone up we're seeing a bit less impact on the volume dropout than others. I think that's a function of both the demographics of the Sainsbury's customer, but also the predominance of our geography base as well.

Rob Joyce, Goldman Sachs

Thank you.

Operator

Our next question is from Clive Black at Shore Capital. Please unmute yourself and ask your question.

Clive Black, Shore Capital

Morning, gentlemen, thank you for the questions, as everyone else has said. I wouldn't just mind asking a few questions about consumer behaviour and sentiment, so it's a single question with three parts. First of all, how do you see consumers viewing the differential in price between proprietary brands and private label? This is something they're talking about and noticing and maybe your own thoughts about how that differential has changed in recent months, noting one or two major branded operators have actually expanded margins recently.

Secondly then, some of your competitors have spoken around consumer behaviour, things like end of month versus midmonth, use of cash. I'd just be interested in the anecdotal of how you're seeing shoppers actually operate in your stores.

Then lastly, just a slightly broader piece, have you seen the shoppers' interest in ESG matters, which you talked about in your presentation, Simon, adjust as times become more difficult? Thank you.

Simon Roberts

Thanks, Clive. Well let's get right into the heart of how customers are really behaving, to your question. I think on the first point, just to emphasise and we all get this, don't we, it's really tough out there and customers – and I said at the Q1, customers are watching every penny. I think whatever we felt then, double plus double what it's feeling like now. Literally every product selection at the shelf edge, customers are watching every penny that they spend. I think that's playing out in this shift towards own brand.

I think it's evident when you stand at the shelf of the own brand products and you look at branded products, they're broadly half the price and customers are making choices based on that very clear value decision. We're seeing the shift to own brands and we're seeing customers on those everyday stables they buy week in week out: cereals, canned and packaged products, household products, making those choices. The thing that we're very focused on, we've got a very strong assortment in Sainsbury's, it's something we're very proud of, we think it's a point of difference.

At each of our product tiers the teams have been doing a lot of great work to make sure our own brand product base is very strong, both at the main tier but also, as I describe it, the premium tiers as well. So I think we're going to see this trend continue. I think customers are going to buy into more own brand products as they see their relative quality and value and it's something we think we're well set for.

In terms of consumer behaviour as we head towards Christmas, I think it's very clear, as you say, customers are looking to spread the cost of Christmas out. They started to shop earlier and that was both a function of when they're getting paid, so month ends have become more important and we've been gearing up to take advantage of that.

We saw in the general merchandise business, for example, early buying of things like Christmas gifts and Christmas decorations way earlier than normal, as customers look to try and bring some of that spend forward. You can see in the market data how month end particularly has become a real planning point for customers. We've seen that at the end of October, we'll see it at the end of November, I'm sure, and we'll see it as we go ahead.

Specifically, just in terms of in the Argos business. You know one of the things about the range in Argos, clearly is we sell a whole bunch of products that help customers save energy. So we've seen a huge increase in the amount of energy saving products. Whether that be electric blankets, whether that be air fryers, whether that be airers. You know and we've had very good availability to be able to really take the opportunity of giving customers access to those products.

Look, I think as we look ahead, as I said earlier to James' and Rob's question, it's really hard to call the GM demand for Christmas yet. I think we're not going to know that really until the end of November. But it's inevitable, isn't it that the impact of just how tough it is, is going to play through. The question is to what degree. We think the value in the Argos brand, particularly, should be helpful to us and the momentum we've got and availability is clearly important too.

Then just on your point on ESG, Clive. Look, I think let's really talk about what customers are talking about. They're talking a lot about plastic. You know plastic and the amount of plastic in food packaging. We went through a pandemic where everyone wanted to see products covered again, for obvious reasons. It's a big focus for us. We're very focused on how we take as much plastic out of our product base. Working very closely with a number of key supply chains in how we do that. Because these are big structural, as you know, changes that need to happen over a period of time.

Then the other big area of focus for us has been food waste as well. We've taken best before dates off a further 100 of our products where there's no compromise on quality. We're doing everything we can to bring down food waste and also help customers to bring down their own food waste too as they look to make the most of every penny on food that they spend.

Clive Black, Shore Capital

Then just by way of follow up to that, Simon, you say customers are counting every penny. Do you sense there's a risk, if that's the right term, that coming into Christmas we'll see people maybe really prioritise food and beverage as something related to experiences, which may lead to very weak gifting or artefact demand?

Simon Roberts

Well, look I think, as I say it's early to see on the gift side. But I think it's inevitable people are going to prioritise their spend. I think they're going to prioritise their spend actually on food and beverage at home. You know I think we've got a World Cup just before Christmas for the first time. I think you know that's going to be a big at home occasion. I think people are going to want to buy food and beverages to drink and enjoy at home with family and friends. We're gearing up for that.

You know there's a lot of focus on the cost of living, on watching every penny. But I think customers will look to want to treat themselves this Christmas, particularly in food. That's why our focus as a business on Taste the Difference is going to be a really key part of our Christmas plan. Customers are going to want to enjoy themselves this Christmas but in a way they can afford. So we've got 300 new, as you've heard, Taste the Difference products, a big focus on innovation.

So helping you to enjoy Christmas in a way you can afford it. Same with the World Cup. We're seeing spend in restaurants really come off the last few weeks as customers spend more time and make their budget stretch further at home. We're gearing up for all of that.

Look, on the GM side, I think it's inevitable spend on gifting will be less. But it will be on the kids and it will be on making sure that there's great value and experience in the gifts that people buy. You'd expect me to say this, we think we've got a really strong range of products to do that.

This time last year availability was a big challenge in general merchandise. This year we're in better shape. So as customers pull their spend earlier, we've got to be ready to make sure we can serve them and help them when they want to shop.

Clive Black, Shore Capital

Well I hope you're set up for Wales to beat England in the World Cup and not be too shocked when Iran beat England as well. All the best.

Simon Roberts

I couldn’t possibly comment on those predictions Clive. Thanks.

Clive Black, Shore Capital

Thank you.

Operator

Our next question is from William Woods at Bernstein. Please unmute yourself and ask your question.

Simon Roberts

Good morning William.

William Woods, Bernstein

Good morning Simon, good morning Kevin. Thanks for taking my question. Two please. The first one is just as part of the Food First Strategy, you've obviously continued to kind of underinflate the market to improve relative price perception. Do you think that this continues to be necessary? Do you have kind of a relative pricing level in mind that you're looking to get to?

Then the second one is just on kind of H2 margins. Obviously H2 should be seasonally stronger in terms of profitability. Would you expect the same this year, even if demand is weaker and should we still see those kind of better margins?

Simon Roberts

William thanks. Well look let me pick up your first question on Food First and where we are on value. Kevin can perhaps help us on the second half margins. Look, I mean a fundamental principle of our Food First Strategy was to improve the competitiveness of Sainsbury's. Look, clearly, as you can see in our results today, that's really working for us. It’s working in improving our relative volume market share performance compared to others. It’s working in building the trust and loyalty of Sainsbury's customers in the value offer that we have and in the broader product offer that we have.

So we’re really clear it’s a key part of our strategy and as you know our cost programme and the work we’ve been doing on our negotiations with suppliers are a key part of our self-help to underpin that. That being said, we think this market will continue to behave rationally. We want to make sure that we present our offer competitively within that context. So we’ve said before and I’ll say again, we would expect to inflate 1% to 2% behind the market. But we'll focus our value investment into those parts of the shopping basket that really matter to customers.

We were clear up front that centre of the plate really matters. Meat, fish and poultry, fruit and vegetables. As we’ve deployed our value investment, £500 million over two years into these areas, it’s really working for us. Because it’s giving customers confidence that if I can buy those items in my shopping basket at even better value than I thought, then I’ll shop the rest of the store.

That shopping the rest of the store is really important. Because of course we've got this assortment in Sainsbury's that we're really proud of and customers really want to buy into. I've talked about Own Brands today, I've talked about Taste the Difference.

So our focus on value is win the centre of the plate, inflate behind the market in a market that we think is rational. Use our cost saving programme to continue to be able to drive that strategy forward. Kevin.

Kevin O'Byrne

William, on the H2 margins. We would anticipate year on year that we will have lower margins in the general merchandise business, largely. That's a mixture of rate and demand and obviously they interact. Because if demand is lower than we expect, we'd expect people maybe would try and trade a bit harder and then we'll see rates up. You know it will be in the mix there and we'll be able to tell you more about that after we've gone through it. But that's our working assumption year on year, which probably isn't a surprise.

William Woods, Bernstein

Understood, thank you.

Simon Roberts

Thanks William.

Operator

Our next question is from Xavier Le Mene at Bank of America. Please unmute yourself and ask your question.

Simon Roberts

Good morning Xavier.

Kevin O'Byrne

Morning.

Xavier Le Mene, Bank of America

Thank you, good morning, two questions if I may. Just on Price Match actually, can you comment where you are with Price Match and sharing some colour about the performance you've got. So the percentage that you said, is it increasing year on year on what you're supplying going forward?

The second one just technical but what's the impact of Fuel on your retail profit actually?

Simon Roberts

Okay, thanks Xavier, let me pick up Price Match and Kevin might want to speak on fuel. Let's try and answer your questions for you as best we can.

So look, on Price Match, it's a key part of our value platform, as you know. This is a very mature programme for us now and as I said in the presentation this morning, it's really

working for us. So 240 products in our Price Match. One of the elements that I would really draw attention to is the fact that our Price Match is very geared to fresh food.

When you look at what we're doing here it's all about meat, fish and poultry, it's all about fruit and vegetables, it's all about dairy. The products that customers buy in high volumes regularly. The key component of our Price Match focus is that when customers look at these products at the shelf edge, or online, every time they shop, they get real confidence that our price is parity with Aldi and Lidl. That's a really important point for us to make and it's really working for us.

So 240 products today you'll see us as we head towards Christmas, make sure we maintain the strength of our competitive offer. And the volumes in those categories where we have anchored the Price Match clearly have increased as we put more through Price Match. Kevin.

Kevin O'Byrne

Just, yeah on fuel Xavier, it's a category is performing well for us, we're pleased with the performance. We're gaining share against the supermarkets and against the majors and we're growing volume, so that's really good. We think of it as one category among a range of categories. It's interesting, the industry has moved away from incentivising fuel. You see fewer promotions in fuel than you would have seen in the past to incentivising food, largely. Which again, isn't a surprise, I guess, given the pressure of people's wallets as we said.

If we put it in the scale of things, you know it's similar to sort of frozen food in our business as far as sort of category contribution. It's performing well and it's helping us balance the better value that we're giving customers across the range.

Simon Roberts

Just Xavier, just last point just to help on your question on Price Match. As I said over 90% of the volume of Price Match is in Fresh categories, just to really emphasise the point about where all the investment's going.

Xavier Le Mene, Bank of America

Thank you so much.

Operator

Our next question is from Sreedhar Mahamkali from UBS. Please unmute yourself and ask your question.

Sreedhar Mahamkali, UBS

Yeah, hi, good morning Simon.

Simon Roberts

Hi Sreedhar.

Sreedhar Mahamkali, UBS

Thanks for taking questions. Sorry, my video isn’t working, apologies. A couple of questions. First one, I think Simon you said you've got a good picture of costs. You said 75% hedged on energy, good view on wages et cetera. You've also talked about significant ambition in cost saving.

As you look forward into next year, do you see these cost headwinds, that you clearly have a pretty good idea of. Will they be playing a draw as you’ve stepped up cost savings, do you think? Or is that not quite how we should think about? That's the first one.

Secondly, going back to GM, you've talked about very different profitability profile at Argos and GM. A couple of short questions there. Can you talk to any contribution to profit in GM in the first half? Did you grow profit from GM in the first half? For the full year and into next year, how strongly is GM profit contribution tied to sales versus self-help? I know sales is always important but I'm just trying to distinguish how the model worked historically versus how it is working now. The point you made about leverage being a very different dynamic now, especially at Argos.

Simon Roberts

Sreedhar, thank you. Okay, well let me start by just trying to give you a greater sense on the cost and then Kevin, let’s talk about the GM margin. So just taking half a step back here. As Kevin said, I think look, it’s too early to talk about next year and I think, as you’d expect me to say, we need to wait for the outturn of this year. Because you know a lot could happen between now and the beginning of next year.

But that being said, you know I just want to emphasise, we believe we're in a strong position for really three reasons. The first is we have a mature cost saving programme now. As you know we started this over two years ago now. We’ve been very focused as a team on structural cost out of our operations and on opportunities that we think we have in front of us that others either don’t have or have already exercised against.

So first point to make is that we think we’ve got a lot to go at here. Second point to make is that we’ve got clear visibility, as you've indicated, clearly in utilities, in energy costs. But also in labour costs as well. As Kevin said earlier, we’re fully hedged in energy this year. We’re 75% hedged next year, we’ve clear line of sight clearly as to where that hedging is and what we’re also seeing in terms of our plans on labour costs as well.

So I think that visibility is enabling us to plan for what we need to have in place next year. Look, clearly operating cost inflation is bigger, you know much bigger next year than we’ve seen before in those areas. But we can see the direction of travel and we can see the cost plans we need to have in place to make sure we’re on the front foot here.

I think look, the other point to make is that our momentum in cost saving we think is strong and we’re clear about how we’re going to continue to accelerate it.

Then just moving on to the Argos point before handing to Kevin. Look, you know I think the Argos costs programme, Cost Transformation Programme, and you know I would broaden it to Customer Transformation Programme, we’re really encouraged by. You know you can see the performance in terms of our relative market share improving. We’re taking costs out of the Argos business but we’re also growing market share as we do it.

You know, as you know, as we've effectively deployed heart and lung transplant on the Argos distribution and fulfilment model, we've been able to improve our customer metrics. Therefore that operating leverage in the Argos business is here to stay. Because we've structurally taken so much cost out of the business.

Kevin in terms of our GM margins, anything you want to add?

Kevin O'Byrne

Yeah, Sreedhar, I'll just draw your attention to Slide 34 in the pack which just shows what we've done with the cost base and the operating profit. We're pleased with the performance in the first half of Argos from a profit point of view. It's growing versus '19/'20, it's down versus last year – as we'd expect – with volumes down and, of course, costs out are critical.

Another little anecdote for you. You know, we started when we bought the business we had about 725 stores. Today we have about 725 stores with 415 of them – 414 of them, are in our own stores so effectively rent and rates free, so you can see a massive focus on cost. We've also had a big, big focus on margin discipline we've talked about before, which is very important, but, of course, sales clearly are critical in any retail business. There's an element of fixed costs that we will always have, so we need to hit the sales.

There's a combination of all those things, but real cost discipline, real margin discipline and then driving sensible sales behind that.

Simon Roberts

Thanks Sreedhar.

Sreedhar Mahamkali, UBS

Thank you.

Operator

Our next question is from James Grzinic from Jeffries, please unmute yourself and ask your question.

Simon Roberts

Hello James.

James Grzinic, Jefferies

Yes, good morning team, hi, good morning. I had a couple of questions. The first one is on – just really on cost, on hedging on utilities. Can you perhaps help us? Because, of course, we might have visibility, but the level may not be good depending on where spots will be next year. So, can you help us understand at what levels you are hedged for most of next year?

Secondly, still on costs, we've seen one of your peers introducing the £11 level for starting wages, you're talking you're well covered on next year on labour. Can you perhaps help us understand – yes, I think you are £10.25. Where are you thinking you're going to be settling next year on wages?

I guess, thirdly, where do you think the mix of margin will develop next year, given what you said on fuel, what you're saying in terms of consumer behaviour? Perhaps, to summarise it, I guess, if you give us a sense of where you think OpEx inflation will be for your cost structure next year, gross of the costs saved of course. Thank you.

Simon Roberts

Okay, let's try and navigate through all of those questions. So, I mean, look, I think we've given you as much as we can give you on hedging, but Kevin, let me just…

Kevin O'Byrne

Yes.

Simon Roberts

…check with you on that, I'll then cover wages and let's come back to the next of your questions.

Kevin O'Byrne

Yes.

Simon Roberts

Anything else on hedging?

Kevin O'Byrne

Yes, James, we're inevitably going to disappoint you with our answers here, as you can imagine.

James Grzinic, Jefferies

I expected that.

Kevin O'Byrne

But, look, on hedging, we've hedged, we believe, relatively well, clearly we're not going to give the rates because that would be competitively sensitive. Our utilities will cost more next year than this year because clearly you just need to look at the price curves. But the important thing is we have visibility, we kind of know what we're dealing with and therefore we can take actions to offset it.

One thing I would say, you know, coming into next year we'll have about a third of our electricity will be long term contracts for wind and solar – mostly wind, vast majority wind – so that does help us. These are contracts that we've signed, some of them a number of years ago, some of them more recently, so that gives us an underlying chunk of our electricity; we're a big electricity user, as you'd imagine, so that's helpful.

That's probably all I was going to say…

James Grzinic, Jefferies

Sorry, Kevin, can I just ask you a follow up on that point, so if you can help us further. If we think about your total energy costs, how much is electricity, is it 50/50?

Kevin O'Byrne

No. The electricity will be a bit more – will be more than gas, but we'll have a third of that, as I say, we get from the electricity usage from New to Planet.

Simon Roberts

Thanks Kevin. Okay, let's talk on wages then, James. So, look, I mean I think just take half a step back and then the look ahead. Look, clearly as you know, we've taken a leadership position in the industry on colleague pay, we feel very strongly about it. Our teams have done – and continue to do – a brilliant job serving customers and you can see that playing out in our continued strength of service performance. I think it's no accident, we want to really focus on supporting our teams, particularly at the moment when the cost of living challenges are really impacting everyone.

So, that's why we made a second pay increase this year, we were the first to do it. You will remember at the beginning of this calendar year we were the first to announce our move to our new rates in March and then we've gone again in September. So, your question looking ahead, I think this is clearly an industry wide issue, everyone is looking at how they're going to be handling pay rates going forward, as I've just indicated. It's one of the things we've been thinking about and planning for, for a long period of time.

When we think about our labour costs – you know, we talked earlier in the year – around £4 billion of our costs are in labour and so it's one of the first things we clearly look at in our planning of costs. I'm not going to share with you now our plans on colleague pay into next year, but I would say we've clear visibility of our plan, we've been planning for it. When I talk about our cost saving programme, I would just come back to three components of that. Structural cost out, we're ahead of where we expected to be at this point in time and so as we play forward, those benefits are now in our costs stack.

Secondly, we're very focused, as a team, on productivity in our operations. Now, clearly lots is happening about how customers are shopping differently. For example, more customers are self-checking out, are digitally checking out, that's helping us to really look at our productivity in our operations. We're seeing less customers shopping online than we saw certainly at the height of the pandemic and even at the start of this year, so as more customers come back into store, that helps the economics of our operations.

You can see in our presentation today we've actually won – or attracted back – more of our customers into store than our competitors, our fulfilment costs come down as we do that. So, the reason I draw attention to that is there's clearly a lot of inflation in wages but there's also a lot of operational self-help and customer behaviour change that's in our planning for how we think about that.

Then, look, specifically on next year – and apologies for the repeat on this – I think the position that we see here is it's just too early to call the components of next year's outlook yet. We'll learn a lot over the next few months, but I would just come back to, again, the three fundamentals which is we've got a lot of good momentum in the business. We're really focused, as a team, on our performance and on our delivery of profit performance particularly; you can see that in the rate of our profit accretion since '19/'20 in the first half.

We've got a real focus on our cost saving and transformation programmes, they're on track and in some areas they're ahead and we've got clear line of sight of what we're doing on the next phase of those programmes.

So, the outlook has got a lot of challenges in the macro, but we think we're well placed to navigate those.

Kevin O'Byrne

James, just maybe just to give you a little bit more help on the last question. It's roughly 80/20 electricity/gas but to some degree a little bit academic because we're hedged on both and obviously, they're very linked, the price of gas feeds into electricity.

James Grzinic, Jefferies

Thank you, that's very helpful, thank you.

Simon Roberts

Thanks James.

Operator

Our next question is from Nick Coulter at Citi, please unmute yourself and ask your question.

Simon Roberts

Hello Nick, good morning.

Nick Coulter, Citi

Morning gents. Morning. As ever, thanks for taking the questions. Apologies, I have three, and maybe I could go one by one to ease the process.

Firstly on energy, would you be able to share the broad rate of inflation that you've seen on utilities or energy in the first half just to kind of give us some anchor to the debate. Then, I guess, a quick supplementary on that, on the nature of those long-term contracts, are they fixed or are they index linked? How do they work please, thank you.

Kevin O'Byrne

On that, Nick, I mean, no, we won't share, unfortunately. We just think it's giving too much information to start breaking down our cost base that we've incurred on utilities. Those contracts tend to be between 10 and 15 years and largely fixed.

Nick Coulter, Citi

Okay, great, thank you.

Secondly, on – I know the demand environment is febrile but how have you planned your Argos inventory for peak please? Obviously you were talking to high single digit sales declines for the year at the start of the year, there's clearly inflation in the mix, there's better availability, easier supply chain. So, how should we think about how you're approaching

peak from an inventory perspective? It would be great to get your thoughts on the dollar impacts coming down the track in general merch as well. Thank you.

Simon Roberts

Maybe I'll just pick up on inventory and Kevin, I'm sure, will want to add to this. I mean we think we're in good shape, Nick. I think – look, obviously a lot of interest in the market on the relativity of stock positions in general merchandise retailers globally over the last period of time. I would say that one of the things that we've been very focused on as a team is the rigorous management of our stock. Making sure we've got real line of sight as to where it is, what's on shore, what's off dock, how we're prioritising fast moving product within our range.

One of the features of our improvement in availability has been our improved processes and how we've been managing this across our logistics and supply chain and commercial teams. So, I think no complacency in anything I've said there. Clearly we're pleased with our market share growth in general merchandise, you can see through the first half how that's built. That's built off the back of both weakness in last year's numbers, some improved weather, but, importantly, structural improvements in how we're managing availability.

Of course, it's one of the key points of focus for us to make sure that we're stocking effectively to our forward plan. So, as we look at how we're trading, the momentum we've started the second half with, we think we're in solid shape here.

Nick Coulter, Citi

Are you kind of risk on or risk off? Are you, kind of being conservative and willing to miss sales or how are you approaching peak? How do you think the industry is set up for peak, because clearly Walmart and Target weren't set up appropriately.

Simon Roberts

Yes, well we think we're well set up for peak. I'd never over – be complacent about that. These are difficult times, as you say, but we're in a strong place. We've got stock where we need it, we're geared up for actually some of the unique characteristics of the pre-Christmas build. We've spoken about a World Cup coming just before Christmas, obviously a Black Friday where customers are going to want to really buy into products this year and really get value, and so all of our plans have taken into account the best view we can see.

For obvious reasons – as you'd expect me to say – what the top of customer demand is and what the bottom of that, we'll find out over coming weeks, but we're well prepared for it.

Kevin O'Byrne

Yes, and just to build on that point about the dollar. Clearly we don't know if we've got it right and we'll tell you after Christmas but we're also mindful that there's good stock and bad stock. There's some stock if we're buying it now, and we've bought it on old dollar rates -t o come onto your next question – if we had to winter it and sell it later, that'd be fine. There's other stock that clearly deprecates in front of your eyes and you wouldn't want lots of it around, so, we'll play all that, as you can image.

Just on the dollar hedge, no impact on the dollar, no impact for this year as you could imagine because we'll have bought forward. For next year, more than half of the dollars we need for next year we think we've bought, can't tell you what the rate is but you can imagine it's comfortably above what is in the marketplace right now.

But another point it's probably worth making – because I think people assume that if the dollar goes down that affects Argos profitability – it may affect Argos profitability but not in the way I think people think. Because, clearly, it'll affect the cost of the product and therefore it'll affect the cost that we're selling it at but – like everyone in the market - we'd have to adjust the pricing versus the dollar. If we're hedged a little bit better than others, than we can be more competitive for longer, so that's good. But where it will affect, of course, is demand.

So, as the dollar weakens and prices go up, it will affect demand. The good news is that freight is going down – so that's helpful in the marketplace – and we're seeing where we had freight inflation we'll have deflation in freight so that's helpful. So, in the mix I think the real question will be what will it do to demand.

Nick Coulter, Citi

Yes, no I think that's fair. Again, just a quick one on Nectar360, which looks like a real bright spot and sounds very encouraging. Are you able to share a profit figure for the half, please, or some sense of how you're going through that curve to the raised target.

Simon Roberts

Yes, as you know I'm going to say, we don't split out Nectar profitability specifically on its own, but – to your first point – we're really encouraged with the progress on Nectar and Nectar360. As you've seen in the half, we've gone through our 10 million first target for digital Nectar collectors. Actually, the platform of Nectar360, we're really encouraged with how that's building. I think, from a macro perspective, as we see the cost of advertising in the market really pick up, I think more and more is the opportunity to use Nectar360 as a way of directly reaching, in a personalised way, customers.

So, you've seen that we've upgraded our expectations in terms of profitability over the next period of time and that's just a function of the fact we're now working with over 700 suppliers. Momentum is really picking up; our team are doing a fantastic job in this area to really build out our capability.

Nick Coulter, Citi

Brilliant. No, looks good, thank you.

Simon Roberts

Thank you.

Operator

Our final question is from Victoria Petrova at Credit Suisse. Please unmute yourself and ask your question.

Simon Roberts

Hello Victoria.

Kevin O'Byrne

Hello Victoria.

Victoria Petrova, Credit Suisse

Thank you very much, I'll be quick. Hello, hello, thank you. My first question is if we look at your cost savings versus extra costs, is it fair to assume that you're saving around £250 million per annum this year and next year probably and are running at around £260 million, £275 million, maybe £280 million extra costs, with a similar split to your competitors, when we look at labour versus energy, is it fair to assume? Any comment would be extremely helpful.

My second question is, do you expect underlying profit before tax to be up or down next year?

Thank you. It's worth a try.

Simon Roberts

Look, I've tried to give – no, it's clear Victoria. Well, look, I hope we've given you as much clarity on the shape of our cost program and I guess just maybe before passing to Kevin, on the relative scale of our cost saving program compared to other listed retailers that have similarly put their cost saving target out, you can see the scale of what we're doing over three years at £1.3 billion compared to what we were doing before, more than twice the rate. You know that inflation is clearly higher in the business than we had before but it's the fact we have the cost saving opportunities in front of us still to go at that we don't think others have in the same way that we think is a very important underpin of the size of this cost ambition.

I'm not sure we can do a lot more to break it out in any more detail but Kevin.

Kevin O'Byrne

It's clearly more material, I think, Victoria if I picked up your question right. It's more than £400 million in the year.

Victoria Petrova, Credit Suisse

Thank you. That's very helpful. Thank you very much.

Simon Roberts

Thanks Victoria.

Kevin O'Byrne

Thanks Victoria.

Simon Roberts

Okay, well look if there are no…

Operator

That was our final question, so I will now hand back over to you, Simon, for closing remarks.

Simon Roberts

All right. Well thank you very much everyone this morning for joining us. I hope the presentation was useful. It's been great to hear your questions this morning. Thank you for all your interest and we look forward to catching up with you over the next few weeks. Thanks again for your time. See you soon.

End