FLASH REPORT

Sainsbury's (LSE: SBRY) 2Q17 RESULTS: SALES DECLINE WORSENS, COMPS MISS CONSENSUS

1) **The UK's second-largest grocery retailer, J. Sainsbury, reported 2Q17 comps down 1.1%, trailing the consensus of (0.8)%. Total sales were down 0.4%.**
2) **Total sales growth and comparable sales growth both recorded a sequential weakening from 1Q17, while rivals Tesco and Wm Morrison are reporting strengthening performances.**
3) **Newly acquired Argos posted sales up 3.0% in total and up 2.3% on a comparable-store basis.**

2Q17 RESULTS

Like most UK companies, British supermarket retailer J. Sainsbury reports profit data only at the half-year and full-year, and updates on sales growth each quarter.

For the 16 weeks ended September 24, Sainsbury reported total sales down 0.4% and comparable sales down 1.1%, both excluding automotive fuel. Comps trailed the consensus estimate of (0.8)% recorded by S&P Capital IQ. The figures marked a sequential weakening from the 0.3% total sales growth and 0.8% comparable sales decline of the first quarter.

Across 1H17, total sales fell 0.1% and comps were down 1.0%.

The weakening performance and negative comps equate to a worsening performance versus major listed peers, Tesco and Wm Morrison: Tesco's latest UK comps for 1Q17 were +0.3%, and marked the second consecutive quarter of positive growth; Wm Morrison's latest comps for 2Q17 were +2.0%, and marked the third consecutive quarter of positive growth.

We see two possible reasons behind Sainsbury's underperformance:

1) The major grocers are fighting over a diminishing share of the pie, as discounters Aldi and Lidl steal ever more share; as Tesco and Morrison grow sales due to improved propositions, one or more of their competitors will lose out.
2) Sainsbury has long benefitted from the limited geographical overlap between its store base and those of Aldi and Lidl; as the discounters put down new stores in underserved areas, such as the southeast, the threat to Sainsbury grows.

The figures above exclude the newly acquired Home Retail Group.

Sainsbury completed its acquisition of Home Retail Group, the owner of general merchandiser Argos, on September 2. In its second quarter to August 27, Argos posted sales growth of 3.0% and comps of 2.3%, a sequential improvement from total growth of 2.6% and comps of 0.1% in the previous quarter.

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NON-FINANCIAL METRICS

CEO Mike Coupe said that Sainsbury's comp decline was driven by food-price deflation, and that the retailer grew transactions on a comparable basis and recorded total volume growth. Here are some other takeaways:

- The company made further price investments in the second quarter, including in everyday food products such as fresh vegetables and frozen foods.
- Sainsbury grew general merchandise sales by 4% in the quarter.
- Its clothing business gained market share, as measured by Kantar Worldpanel, but sales declined in a weak market and against demanding comparatives from a year earlier. This was reportedly the first ever quarterly decline in sales for Sainsbury's clothing range, and this reflects the current exceptional weakness of the UK apparel market. Sainsbury launched a premium "Tu Collection" womenswear range in the quarter.
- The grocery chain added a net one new supermarket and nine new convenience stores in the quarter, taking its network to 602 supermarkets and 783 convenience stores.

HOME RETAIL GROUP ACQUISITION

As noted above, Home Retail Group's acquisition was completed in the quarter, bringing the 839 stores of Argos into the group. Given this substantial store base, analysts are anticipating a raft of store closures to cut costs, with opportunities for the group to open replacement Argos stores in larger Sainsbury supermarkets. The company said it has already opened 15 Argos stores in Sainsbury supermarkets, and this total will reach 30 by Christmas this year.

In addition, Sainsbury plans to open up to 200 integrated collection points in its stores by the end of the year; these will bring together collection services for its own general merchandise and clothing, eBay purchases, Argos purchases and DPD parcel deliveries.

OUTLOOK

The company offered no guidance in its statement. For FY17, the consensus among analysts is for GAAP EPS of 25 pence, versus 23 pence in FY16. Analysts expect the company to grow total revenues by 8.6% to £25.5 billion, helped by the mid-year acquisition of Argos, which generates around £4.1 billion in sales. The consensus is for EBIT to fall 5.0%, but net income to climb 4.8%, according to S&P Capital IQ.

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