

## Sainsbury's (LSE: SBRY) FY17 Results: Growing Scale Fails to Prevent Disappointing Erosion of Profitability

**Figure 1. Sainsbury's FY17 Key Metrics**

	FY17	FY16	YoY Change
Revenues (£ Mil.)	£26,224	£23,506	11.6%
Gross Margin*	6.2%	6.2%	4 bps
SG&A/Sales*	4.6%	3.6%	99 bps
Operating Margin	2.4%	3.0%	(56) bps
Underlying Diluted EPS (Pence)	20.4p	22.8p	(10.5)%

\* Sainsbury's includes some selling and general expenses within cost of sales rather than SG&A.

Source: Company reports/Fung Global Retail & Technology

- **Sainsbury's reported that group sales were up 11.6% in the year ended March 2017. Revenues were boosted by the acquisition of general merchandiser Argos as well as by growth in clothing and general merchandise, implying meaningful declines in Sainsbury's grocery sales.**
- **Despite the company's increased scale, operating profit fell by 9.2% and missed the consensus estimate. Lower comparable sales, investment in its offering and cost inflation eroded operating margins.**
- **In turn, underlying diluted EPS fell by 10.5%, but was in line with consensus.**

### FY17 Results

Sainsbury's, the UK's second-biggest grocery retailer, reported topline numbers that were slightly ahead of consensus and EPS that was in line with consensus. Nevertheless, it was a weak year for the group, whose scale had been boosted by the acquisition of Argos in September 2016. The figures below relate to the combined entity.

- Group revenues were up 11.6%. Argos contributed 14.5% to group revenue growth, while negative comps at Sainsbury's, declining fuel sales and the disposal of pharmacy operations dragged on topline results.
- Operating profit tumbled 9.2%, and missed consensus. Operating profitability was impacted by lower comps, unspecified "investment in the customer offer" and cost inflation.
- The company said that retail underlying operating profit fell by 1.4%. This measure excludes financial services.
- Underlying diluted EPS fell by 10.5%.

The Sainsbury's grocery chain saw comps excluding fuel fall by 0.6% in FY17, with such comps down 1% in 1H17 and down 0.1% in 2H17. Total online grocery sales rose by 8% and convenience-store sales rose by 6%. The company noted that the trend of consumers buying groceries across channels and formats "place[s] pressure on volumes" in its supermarkets.

The Sainsbury's chain grew general merchandise sales by "over 2%" and clothing sales by "over 4%," implying meaningful declines in its grocery sales.



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Argos comparable sales were up 4.1% in 2H17 (1H17 comps were not declared, as Argos was not acquired until 2H17). Argos contributed £3.11 billion of sales (including VAT) and £77 million of underlying profit before tax. To provide fuller information, the company said that Argos made a loss in the pre-acquisition first half, and that its full-year profit contribution would have been £45 million.

**Outlook**

In FY18, Sainsbury's expects group underlying profit to be higher in the second half, due to the consolidation of the first-half Argos operating loss (put simply, the chain makes its profits at Christmas), the annualization of FY17 price investment and the recent step-up in cost inflation.

In FY18, the company expects cost inflation in the 2%–3% range and efficiency savings of around £145 million. Sainsbury's says it remains on track to deliver savings of £500 million over three years by the end of FY18, and that it is developing plans to deliver a further £500 million in cost savings over the three years beginning FY19. The company expects depreciation and amortization of around £700 million, an increase of around £70 million, as a result of the consolidation of a full year of Argos.

The company reported a reduction in net debt and high levels of liquidity in FY17. Net debt was £1,477 million at year-end, down £349 million in the year.

For FY18, analysts expect the company to grow revenues by 7.7%, but for EBIT to fall a further 1.7% and for underlying diluted EPS to decline by 4%.



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