Financial review

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Sainsbury's has made good progress in the challenging economic environment, reflecting the ongoing development of its offer and increasingly universal appeal, and continuing to deliver its growth strategy, whilst benefiting from a strong and robust balance sheet.

Sales (including VAT) increased by 5.7 per cent to £20,383 million (2008: £19,287 million). Underlying profit before tax improved by 11.3 per cent to £543 million (2008: £488 million). Profit before tax was down 2.7 per cent, at £466 million (2008: £479 million), impacted by the non-cash investment property fair value movements of £(124) million (2008: £nil), partially offset by £57 million profit on property disposals (2008: £7 million). Underlying basic earnings per share increased to 22.1 pence (2008: 19.6 pence), up 12.8 per cent. Basic earnings per share were down 13.1 per cent, at 16.6 pence (2008: 19.1 pence) as a result of the non-cash, investment property fair value movements (which are disallowable for tax purposes). A final dividend of 9.6 pence per share has been recommended by the Board (2008: 9.0 pence) making a full year dividend of 13.2 pence per share, up 10.0 per cent year-on-year (2008: 12.0 pence).

Summary income statement for the 52 weeks to 21 March 2009	**2009 £m**	2008 £m	Change %
Sales (including VAT)[1]	**20,383**	19,287	5.7
Sales (excluding VAT)	**18,911**	17,837	6.0
Underlying operating profit	**616**	535	15.1
Underlying net finance costs[2]	**(89)**	(45)	(97.8)
Underlying share of post-tax profit/(loss) from joint ventures[3]	**16**	(2)	n/a
Underlying profit before tax	**543**	488	11.3
Profit on sale of properties	**57**	7	n/a
Investment property fair value movements	**(124)**	–	n/a
Financing fair value movements	**(10)**	(4)	(150.0)
One-off items	**–**	(12)	n/a
Profit before tax	**466**	479	(2.7)
Income tax expense	**(177)**	(150)	(18.0)
Profit for the financial period	**289**	329	(12.2)
Underlying basic earnings per share	**22.1p**	19.6p	12.8
Basic earnings per share	**16.6p**	19.1p	(13.1)
Full year dividend per share	**13.2p**	12.0p	10.0

1 Sales (including VAT) were adversely affected by the reduction in the standard rate of VAT from 17.5 per cent to 15 per cent, effective from 1 December 2008. Sainsbury's estimates that this diluted sales growth by circa 30 basis points in the full year, with 40 basis points in quarter 3 and 80 basis points in quarter 4.
2 Net finance costs pre-financing fair value movements.
3 The underlying share of post-tax results from joint ventures is stated before investment property fair value movements and financing fair value movements.

Sales (including VAT) and space

Sales (including fuel) increased by 5.7 per cent to £20,383 million (2008: £19,287 million) through good like-for-like ("LFL") growth and new space. The 5.7 per cent growth includes a (0.7) per cent dilution caused by the timing of Easter in 2008 and 2009, which was more than offset by a 0.9 per cent contribution from net new space. LFL sales (including fuel) were up 5.5 per cent, which reflects in part the impact of higher fuel prices and improved fuel volumes.

Sales (including VAT, including fuel) for the 52 weeks to 21 March 2009	**2009 %**	2008 %
Like-for-like sales *(Easter-adjusted)*	**5.5**	4.4
Removal of Easter adjustment[1]	**(0.7)**	0.3
Net new space (excluding extensions)	**0.9**	1.1
Total sales growth	**5.7**	5.8

1 Like-for-like sales growth has been Easter-adjusted for comparative purposes. 2008 included two Good Friday trading weeks and one Easter Sunday trading week. 2009 included one Easter Sunday trading week only.

LFL sales (excluding fuel) were up 4.5 per cent, of which 0.5 per cent was contributed by extensions. This LFL growth was slightly above Sainsbury's medium-term planning assumption of between three and four per cent, and reflected continued improvement throughout the year, with LFL growth of 3.4 per cent in quarter 1, 4.3 per cent in quarter 2, 4.5 per cent in quarter 3 (4.9 per cent VAT-adjusted), and 6.2 per cent in quarter 4 (7.0 per cent VAT-adjusted). Online sales increased by over 25 per cent and now represents a £500 million annualised business.

Sales (including VAT, excluding fuel) for the 52 weeks to 21 March 2009	2009 %	2008 %
Like-for-like sales *(Easter-adjusted)*	**4.5**	3.9
Removal of Easter adjustment[1]	**(0.8)**	0.4
Net new space (excluding extensions)	**1.0**	1.4
Total sales growth	**4.7**	5.7

1 Like-for-like sales growth has been Easter-adjusted for comparative purposes. 2008 included two Good Friday trading weeks and one Easter Sunday trading week. 2009 included one Easter Sunday trading week only.

Net new space (excluding extensions) contributed 1.0 per cent to total sales growth (excluding fuel). Sainsbury's added a gross 665,000 sq ft of new space (net 512,000 sq ft after disposals and closures), which represents a gross increase of 4.1 per cent (net 3.2 per cent) since the start of the year. Sainsbury's opened 13 new supermarkets during the year, including two replacement stores, and completed 21 supermarket extensions and 13 refurbishments. In the convenience estate, it opened 16 new stores, disposed of 57 stores, as announced in March 2008, closed one store and refurbished four stores.

Store numbers and retailing space	Supermarkets Number	Supermarkets Area 000 sq ft	Convenience Number	Convenience Area 000 sq ft	**Total Number**	**Total Area 000 sq ft**
As at 22 March 2008	504	15,495	319	696	**823**	**16,191**
New stores	13	266	16	40	**29**	**306**
Closures/disposals	(2)	(50)	(58)	(103)	**(60)**	**(153)**
Extensions/refurbishments/downsizes	–	360	–	(1)	**–**	**359**
Reclassifications[1]	(13)	(97)	13	97	**–**	**–**
As at 21 March 2009	**502**	**15,974**	**290**	**729**	**792**	**16,703**
Memorandum						
Extensions	21	346	–	–	**21**	**346**
Refurbishments/downsizes	13	14	4	(1)	**17**	**13**
Total projects	**34**	**360**	**4**	**(1)**	**38**	**359**

1 Following the recent review of the convenience mission, 13 stores previously classified as supermarkets will now operate under the convenience fascia.

In March 2009, Sainsbury's announced the acquisition of 24 stores from the Co-operative Group, of which 19 are expected to operate as supermarkets. These stores are all expected to be converted in the first half of the year and will be slightly earnings-dilutive in 2010, with the more significant impact in the first half. Gross space growth of 5 per cent is expected in 2010, weighted towards new stores following this acquisition. Net new stores are expected to contribute 2.0 per cent to total sales growth (excluding fuel) in 2010, weighted more towards the second half.

Underlying operating profit

Underlying operating profit increased by 15.1 per cent to £616 million (2008: £535 million) reflecting the good sales performance and a 26 basis point improvement in underlying operating margin to 3.26 per cent for the year (2008: 3.00 per cent). The rate of improvement was consistent across the first half and the second half. Sainsbury's has driven operational gearing from higher sales volumes and the delivery of cost efficiency savings which have offset over 75 per cent of total cost inflation as well as supporting sustained investment in the customer offer. Sainsbury's expects cost inflation to be at the higher end of its medium-term expectation of between two and three per cent in 2010, offset by a similar level of savings as in 2009.

Underlying operating profit for the 52 weeks to 21 March 2009	2009	2008
Underlying operating profit (£m)[1]	**616**	535
Year-on-year operating profit growth (%)	**15.1**	24.7
Underlying operating margin (%)[2]	**3.26**	3.00

1 Underlying profit before tax from continuing operations before underlying net finance costs and underlying share of post-tax results from joint ventures.
2 Underlying operating profit divided by sales excluding VAT.

Sainsbury's Bank joint venture ("JV")

Sainsbury's 50 per cent equity share of Sainsbury's Bank's post-tax profit amounted to £4 million in the year (2008: £(3) million loss). The underlying banking business has driven increased profitability through a rise in net interest income, strong cost control and tighter risk management which has resulted in a reduced charge for bad debts. Sainsbury's Bank has imposed tighter lending criteria and attracted more diverse sources of income. It has a strong and well-capitalised balance sheet.

Profits from the Sainsbury's Bank JV are expected to show a small increase in 2010 as it continues to invest in growth.

Property joint ventures

On 26 March 2008 Sainsbury's invested £274 million to create a 50:50 JV with British Land. This securitised property JV holds 38 of Sainsbury's most important stores. The results of the JV have been equity accounted since inception and Sainsbury's share of underlying post-tax profit in the year is £9 million. The investment has been financed largely by the sale of mature assets with no further development potential, at broadly similar yields.

Sainsbury's share of underlying post-tax profit of its 50:50 JV with Land Securities, established in November 2007, was £3 million for the year (2008: £1 million profit). One additional property was sold into the JV during the year, bringing the total number of properties within the JV to five.

Profits from both the British Land JV and the Land Securities JV in 2010 are expected to be similar to those recorded in 2009.

Further to the establishment of the British Land JV, Sainsbury's now accounts for investment properties held within its property JVs at their market value as determined by professional valuers at each reporting date. The difference between the fair value of an investment property at the reporting date and its carrying amount prior to re-measurement is included within the income statement but excluded from underlying profit in order to provide a clear and consistent presentation of the underlying performance of Sainsbury's ongoing business for shareholders. Any profit or loss on properties sold out of the JVs once developed will be recognised within the income statement but will be excluded from underlying profit.

At 21 March 2009, non-cash investment property fair value movements of £(124) million (at the half-year: £(36) million) have been recognised within the share of post-tax losses from JVs in the income statement, reflecting Sainsbury's 50 per cent share. These fair value movements are broadly equivalent to a valuation of the properties at an average yield of 6.2 per cent.

Underlying net finance costs

Underlying net finance costs increased by £44 million to £(89) million (2008: £(45) million) which reflects £30 million lower net return on pension schemes and £21 million higher net interest costs due to increased level of average borrowings, partially offset by £7 million higher capitalised interest.

Under IAS 19 'Employee Benefits', there have been significant movements in the pension charges in 2009 compared to 2008. These have resulted in a reduction of £30 million in the net return on pension schemes, of which £19 million is due to an increase in interest on pension liabilities and £11 million is due to a lower rate of return on pension assets. At the level of underlying profit before tax ("UPBT"), the impact of this reduction in net return on pension schemes is mitigated by a £25 million reduction in service costs charged to operating profit. The net impact of these changes was therefore a £5 million reduction in UPBT compared with 2008.

Interest cover, excluding the net return on pension schemes, was 5.8 times (2008: 5.9 times).

Sainsbury's expects underlying interest costs excluding the net return on pension schemes to reduce by around £25 million in 2010 (from £(113) million in 2009) with lower interest rates on the Group's inflation-linked debt outweighing the impact of a small increase in average net debt.

Underlying net finance costs[1] for the 52 weeks to 21 March 2009	**2009 £m**	2008 £m
Interest income	**28**	29
Net return on pension schemes	**24**	54
Underlying finance income	**52**	83
Interest costs	**(156)**	(136)
Capitalised interest	**15**	8
Underlying finance costs	**(141)**	(128)
Net underlying finance costs	**(89)**	(45)
Net underlying interest costs excluding net return on pension schemes	**(113)**	(99)

1 Finance income/costs pre-financing fair value movements.

Property disposals

The Group recorded a profit of £57 million on the sale of surplus properties during the year (including eight supermarkets where no further development was achievable, sold at an average yield of 5.2 per cent). This compares to a £7 million profit in 2008.

Taxation

The income tax charge was £(177) million (2008: £(150) million), with an underlying rate of 29.1 per cent (2008: 30.9 per cent) and an effective rate of 38.0 per cent (2008: 31.3 per cent).

The underlying rate is lower than last year due to a reduction in the statutory rate of corporation tax from 30 per cent to 28 per cent on 1 April 2008 and the resolution of a number of other items. Disallowable depreciation amounted to £73 million in 2009 (2008: £71 million).

Despite the reduction in the statutory rate, the effective rate is higher than in the previous year due to the £(124) million non-cash investment property fair value movements, which reduce profits, but for which no tax relief is available.

Underlying tax rate calculation for the 52 weeks to 21 March 2009	**Profit £m**	**Tax £m**
Profit before tax	466	(177)
Less: profit on sale of properties	(57)	21
Add: investment property fair value movements	124	–
Add: financing fair value movements	10	(2)
Underlying profit before tax	**543**	**(158)**
Underlying tax rate (%)		**29.1**

Sainsbury's expects the underlying rate of tax in 2010 to be broadly in line with 2009.

Earnings per share

Underlying basic earnings per share increased by 12.8 per cent from 19.6 pence in 2008 to 22.1 pence in 2009, reflecting the improvement in underlying profit after tax attributable to equity holders.

The weighted average number of shares in issue increased by 19.8 million due to the vesting of share option schemes during the year. However, the total number of shares for calculating diluted earnings per share decreased by four million in the same period, through the exercise or lapse of share options.

Basic earnings per share were down 13.1 per cent, at 16.6 pence (2008: 19.1 pence) as a result of the non-cash investment property fair value movements (which are disallowable for tax purposes).

Underlying earnings per share calculation for the 52 weeks to 21 March 2009	**2009 pence**	2008 pence
Basic earnings per share	**16.6**	19.1
Profit on sale of properties, net of tax	**(2.1)**	(0.4)
Investment property fair value movements, net of tax	**7.1**	–
Financing fair value movements, net of tax	**0.5**	0.2
Other one-off items, net of tax	**–**	0.7
Underlying basic earnings per share	**22.1**	**19.6**

Dividends

The Board proposes a final dividend of 9.6 pence per share (2008: 9.0 pence), which will be paid on 17 July 2009 to shareholders on the Register of Members at the close of business on 22 May, subject to approval. This will increase the full year dividend by 10.0 per cent, to 13.2 pence per share (2008: 12.0 pence per share).

The dividend is covered 1.67 times (2008: 1.63 times) by underlying earnings, in line with Sainsbury's policy of providing cover of between 1.50 and 1.75 times.

The proposed final dividend was recommended by the Board on 12 May 2009, and as such, has not been included as a liability as at 21 March 2009.

Net debt and cash flows

Sainsbury's net debt as at 21 March 2009 was £(1,671) million (2008: £(1,503) million), an increase of £168 million from the 2008 year-end position. The increase was driven primarily by core capital expenditure, weighted towards the first half of the financial year, the investment in the British Land JV, and increased outflows for taxation and interest.

Summary cash flow statement for the 52 weeks to 21 March 2009	**2009 £m**	2008 £m
Cash generated from operations	**1,206**	998
Net interest paid	**(118)**	(97)
Corporation tax paid	**(160)**	(64)
Cash flow before appropriations	**928**	837
Purchase of non-current assets	**(994)**	(986)
Investment in joint ventures	**(291)**	(31)
Disposal of non-current assets/operations	**390**	197
Proceeds from issuance of ordinary shares	**15**	43
Capital redemption	**–**	(10)
Proceeds from/(repayment of) borrowings	**165**	(36)
Net dividends paid	**(215)**	(178)
Decrease in cash and cash equivalents	**(2)**	(164)
(Increase)/decrease in debt	**(157)**	46
Other non-cash movements	**(9)**	(5)
Movement in net debt	**(168)**	(123)
Opening net debt	**(1,503)**	(1,380)
Closing net debt	**(1,671)**	(1,503)

This was partially offset by improved operational cash flows and disposals of £393 million.

Sainsbury's expects year-end net debt to increase to between £(1.7) billion and £(1.8) billion in 2010, following broadly the same profile as in 2009 with cash outflows weighted towards the first half.

Financing

Sainsbury's seeks to manage its financing by diversifying funding sources, configuring core borrowings with long-term maturities and maintaining sufficient stand-by liquidity.

Sainsbury's core funding is represented by two long-term loans entered into in March 2006 and secured over a portion of its property assets. The amortising loans comprise £1,130 million due 2018 and £872 million due 2031. During the year Sainsbury's also entered into a new £150 million bilateral bank loan maturing in May 2015. Short-term funding is maintained through two committed revolving credit facilities: £400 million due February 2012 and £163 million due May 2011. At 21 March 2009, there was no outstanding balance under these facilities (2008: £nil).

Since the year-end Sainsbury's has renewed its £35 million loan, due May 2009, at a level of £50 million and extended its term to May 2012. Additionally, it has put in place a new £50 million credit facility, maturing May 2012.

Capital expenditure

Core capital expenditure amounted to £863 million (2008: £850 million) in the full year, which included £386 million on new store development (2008: £308 million) and £385 million on extensions and refurbishments (2008: £424 million). During the year, a number of freehold properties of existing trading stores were acquired, in line with Sainsbury's plans to buy freeholds of trading sites where it believes there are potential long-term development opportunities. This expenditure totalled £392 million (2008: £168 million), including £274 million on the British Land JV. This expenditure has been offset by proceeds of £393 million in relation to property disposals (2008: £219 million).

On 4 March 2009, Sainsbury's announced the acquisition of 24 stores from the Co-operative Group. The financial impact of this acquisition is not reflected in the financial statements. Completion on these stores, of which only one store is awaiting OFT approval, commenced in May 2009.

Sainsbury's expects capital expenditure for 2010 of between £800 million and £900 million. This will bring its three-year expenditure to £2.5 billion, in line with the guidance provided in May 2007.

Capital expenditure for the 52 weeks to 21 March 2009	**2009 £m**	2008 £m
New store development	**386**	308
Extensions and refurbishments	**385**	424
Other – including supply chain and IT	**92**	118
Core retail capital expenditure	**863**	850
British Land JV investment	**274**	–
Acquisition of freehold properties	**118**	168
Proceeds from property transactions	**(393)**	(219)
Net capital expenditure	**862**	799

Working capital

Sainsbury's has continued to manage working capital carefully and cash generated from operations includes a year-on-year improvement in working capital of £167 million. This has been achieved through improved management of trade cash flows, supported by the growth of Sainsbury's supply chain financing platform, whilst reducing stock days.

Summary balance sheet

Shareholders' funds as at 21 March 2009 were £4,376 million (2008: £4,935 million), a reduction of £559 million, primarily as a result of the deterioration of the pension surplus into a deficit, which reduces net assets by £588 million. Gearing, which measures net debt as a percentage of total equity, increased to 38 per cent (2008: 30 per cent) as a result of the pension surplus moving into deficit.

Summary balance sheet at 21 March 2009	**2009 £m**	2008 £m
Non-current assets	**8,425**	8,010
Inventories	**689**	681
Trade and other receivables	**195**	206
Cash and cash equivalents	**627**	719
Debt	**(2,298)**	(2,222)
Net debt	**(1,671)**	(1,503)
Trade and other payables and provisions	**(3,040)**	(2,825)
Retirement benefit (obligations)/assets, net of deferred tax	**(222)**	366
Net assets	**4,376**	4,935

Pensions

The retirement benefit obligations as at 21 March 2009 have been calculated on a consistent basis with the previous year, with updates provided on market-based assumptions.

As at 21 March 2009, the present value of retirement benefit obligations less the fair value of plan assets was a deficit after deferred tax of £(222) million (2008: a surplus of £366 million). The movement into deficit mainly reflects the change in asset values in the year, in line with market performance.

Sainsbury's is currently commencing its 2009 triennial funding valuation, which will provide an updated estimate of funding obligations, for which the statutory completion date is June 2010.

Pensions at 21 March 2009	**2009** **£m**	2008 £m
Present value of funded obligations	**(3,610)**	(3,668)
Fair value of plan assets	**3,310**	4,171
	(300)	503
Present value of unfunded obligations	**(9)**	(8)
Retirement benefit (obligations)/assets	**(309)**	495
Deferred income tax asset/(liability)	**87**	(129)
Net retirement benefit (obligations)/assets	**(222)**	366

Change in Accounting Reference Date

Sainsbury's will change its accounting reference date from 28 March to 20 March with effect from 2010, and will report its 2010 results for the 52 weeks to 20 March 2010. This change is to ensure that each half-year and full-year results includes one complete Easter period, and to avoid any volatility that might otherwise be caused by the variable timing of Easter.

Updated Pensions Accounting in 2010

The financing element of IAS 19 'Employee Benefits' pensions accounting generates significant volatility in the income statement. In line with the way in which external commentators and other companies view and prepare accounts, Sainsbury's will be removing the IAS 19 financing element from its UPBT in 2010.

The 2010 IAS 19 service charge (included in operating profit) will remain within UPBT. The charge in 2010 is expected to be similar to the £(53) million cost in 2009.

For reference, the effect of this accounting change on UPBT for 2009 and 2008 is shown below:

Impact on UPBT of pension accounting change for the 52 weeks to 21 March 2009	**2009** **£m**	2008 £m	Change %
Reported UPBT	**543**	488	11.3
Less: IAS 19 financing element	**(24)**	(54)	(55.6)
Revised UPBT	**519**	434	19.6
Reported underlying basic earnings per share	**22.1p**	19.6p	12.8
Revised underlying basic earnings per share	**21.2p**	17.5p	21.1

Underlying profit before tax will now be defined as: profit before tax from continuing operations before any profit or loss on sale of properties, investment property fair value movements, impairment of goodwill, financing fair value movements, IAS 19 net return on pension schemes and one-off items that are material and infrequent in nature.