# Proposed Sainsbury's and Asda merger

# Introduction

In the past decade, how and where customers shop has changed fundamentally.

Following the 2008 recession, real wages have declined and customers increasingly look for – and find – greater value from retailers. Changes to lifestyles, size and diversity of households plus developments in technology mean that people expect quality and greater convenience, at ever lower prices.

People shop more frequently and buy less in supermarkets, a trend which is increasingly enabled by technology. These changes have led to the rapid growth of new entrants in the UK grocery market, including competitors with leaner cost structures such as Aldi, Lidl, the bargain stores and disruptors such as Amazon.

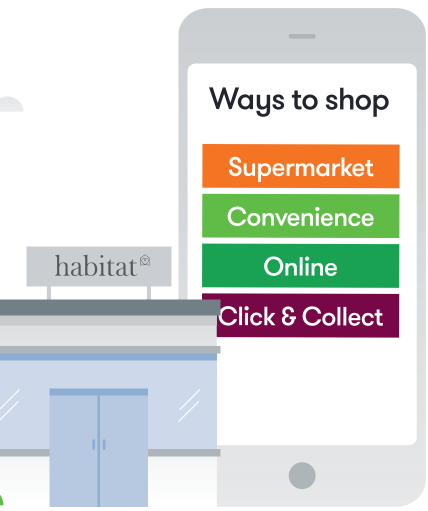
Boundaries between shopping formats, channels and missions are increasingly blurred and there is intense competitive pressure from at least nine household names: Tesco, Sainsbury's, Asda, Morrisons, Aldi, Co-op, Waitrose, Lidl and M&S.

Both Sainsbury's and Asda are working hard to respond to these changes – reducing our own cost bases so that we can lower prices, while preserving what customers value from each brand. But to continue meeting customer demands now and in the future, we must combine forces.

Our merger will unlock significant cost savings, a large proportion of which will be passed directly onto customers through lower prices. These cost savings will not only make us more competitive on price, we will also be able to invest more in value, quality, range, service and convenience for our customers.

# Contents





habitat
Ways to shop
Supermarket
Convenience
Online
Click & Collect


Sainsbury's
ASDA

# 1. Fast changing customer habits and competitive market forces

## a. Customers demand value, increased quality and convenience

Since 2010, customer perceptions of the quality in Aldi and Lidl have increased significantly. This has brought them in line with the quality perception of traditional supermarkets, while improving their low price offer and perception.

Customers have different perceptions of the Sainsbury's and Asda brands, but the challenge for each business is similar: to remain competitive, each business needs to reduce prices on key everyday products while continuing to deliver the quality, range and service that customers love and expect.

## b. Blurred lines across shopping formats, channels and missions

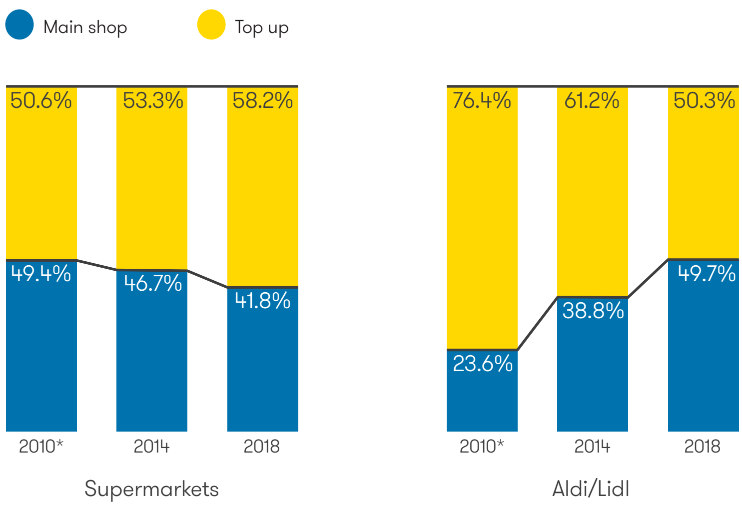
The way people shop has evolved dramatically.

They shop more often, across more grocery retailers[1] and increasingly switch between stores and online. The proportion of spend on 'main shop' is declining, with 'top up' shops growing. On average customers now shop for grocery 3.9 times per week[2].

Medium-sized stores now cater for 'main shops' and customers are increasingly choosing the discounters for this. The proportion of spend at discounters (who operate predominantly medium-sized stores) for main shops is now higher than in traditional supermarkets[3].

At the same time, online grocery shopping has grown and now accounts for 6% of the market. This will steadily increase, forecast to grow ahead of all other formats between 2018 and 2023 . Online delivery (including click and collect) provides our customers with additional convenience. Physical stores constrain online grocery sales as customers see no clear boundaries between the channels. Customers who shop online at Sainsbury's or Asda (and other grocery retailers in the UK with multi-channel offerings) can get their shopping delivered from their local store and pay the same price (plus a delivery charge) as someone who has visited the store in person.

### % spend on Main shop vs Top up in Traditional Supermarkets and Aldi/Lidl (Kantar Worldpanel)




Source: Kantar Worldpanel

1 For example, Shoppers visit an average of 11.7 stores across 4.56 channels per month, IGD, Retail and Shopper Trends (Q4 2018), page 12
2 Based on Nielsen Homescan data for the period ending April 2018 for UK total grocery (Copyright © 2018, Nielsen), retailers included: Tesco, Sainsbury's, Asda, Morrisons, Waitrose, Aldi, Lidl, M&S, Co-op
3 Kantar Worldpanel, based on Kantar channel definition for "supermarket".
4 Online grocery sales are forecast to grow ahead of all other formats between 2018 and 2023 IGD, UK Channel Opportunities report (June 2018).

## c. Intense competitive pressure

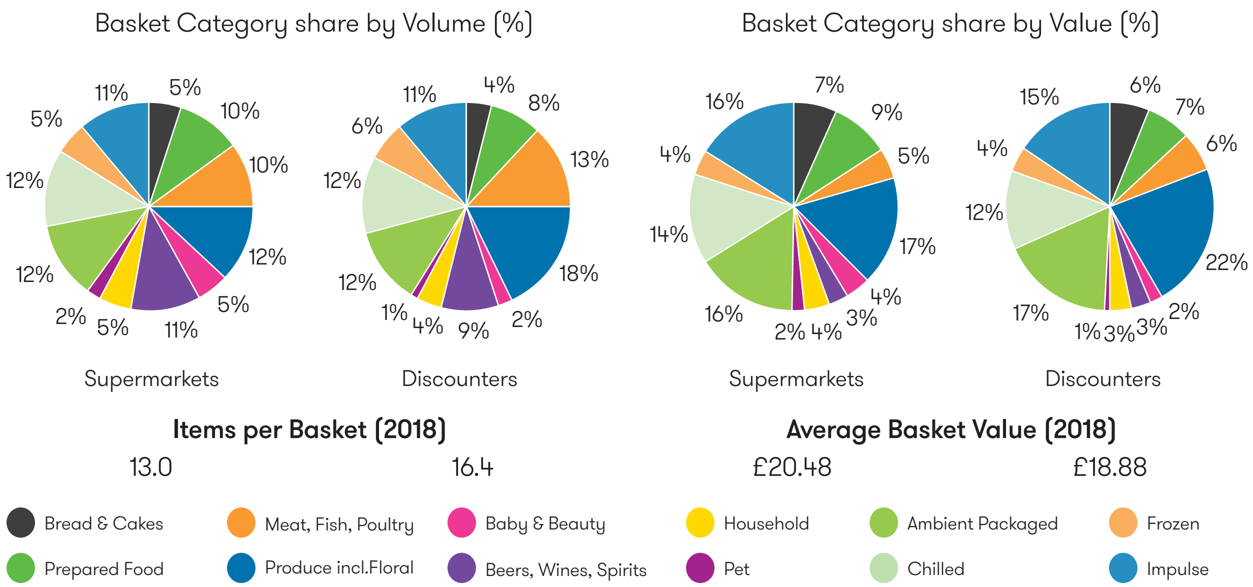
The UK grocery sector is highly competitive and dynamic. Sainsbury's and Asda are significant players but are not particularly close competitors relative to an array of traditional, disruptive and newer rivals.

The emergence of Aldi and Lidl as mainstream competitors has driven a profound change across the UK grocery sector. Aldi and Lidl have disrupted the UK market and continue to do so:

- Their reinvented retail offer combines convenient locations and high quality (including fresh and premium) products with the lowest prices in the industry. They have therefore redefined what "value for money" means, putting increasing pressure on traditional retailers to offer lower prices.
- Their product range serves customers' 'main shop' needs and has made them more attractive to all customer demographics. This makes them an equally compelling threat to both Sainsbury's and Asda.
- The investment they have made to reposition their customer offer has driven a significant increase in sales intensity per square metre: Aldi is nearly three times more productive per square metre than it was in 2010; Lidl is nearly twice as productive.
- Building on this success, they have embarked on an aggressive store expansion programme. Aldi and Lidl have opened approximately 650 stores since 2010 (the equivalent of a new store opening every 4-5 days over 8 years) and are projected to open another 480 stores by 2022. This would take their total combined store base to over 2000[5].
- The result is that over the past five years, both Sainsbury's and Asda – alongside other traditional retailers – have lost significant market share to Aldi and Lidl's[6] long-standing and new stores across all local markets.
- The average basket size at Aldi stores has more than 19 items in it, larger than any of the traditional grocery retailers (of which Asda has the largest average basket at 16 items).[7]
- The composition of baskets at Aldi and Lidl are very similar to those at the traditional grocers, as shown by the Figure below.

Intense competition continues between Sainsbury's, Asda, Tesco, Morrisons, M&S, Waitrose and Co-op – and their individual responses to Aldi and Lidl only serve to intensify that rivalry. For example, Tesco is the largest player in the market and enjoys significant cost advantages due to its scale. Even Tesco is having to be bold to compete: in addition to its acquisition of Booker, it has announced a buying alliance with Carrefour and recently launched its own discount chain, Jack's. Other traditional retailers are likewise investing and responding in their own ways.

### Basket comparisons – Supermarkets vs Discounters[8]




5 Aldi and Lidl store opening figure for 2018-2022 from IGD Data centre, 5 March 2018. Aldi plans to open 130 stores in the UK over the next two years, creating 5,000 jobs and taking it closer to its target of 1,000 stores by 2022. It also expects to beat its 2022 target and has publicly stated that it intends to have 1,200 stores by 2025 (see "Aldi vows to take on Jack's as UK sales top £10bn for first time", The Guardian, 1 October 2018, available at: https://www.theguardian.com/business/2018/oct/01/aldi-sales-exceed-10bn-for-first-time-in-uk-and-ireland).

6 Kantar Worldpanel.

7 Aldi press release, 2 October 2018, available at: https://www.aldipresscentre.co.uk/press-releases/view/614; Based on Nielsen Homescan data for the period ending April 2018 for UK total grocery (Copyright © 2018, Nielsen).

8 Based on Nielsen Homescan data for the 52-week period ending 28 July 2018 for the UK total retail market (Copyright © 2018, Nielsen), Supermarkets based on sum of Tesco, Sainsbury's, Asda, Morrisons, Waitrose and M&S (excludes Co-op); Items per basket and average spend based on Kantar Worldpanel.

# 1. Fast changing customer habits and competitive market forces continued

## c. Intense competitive pressure continued

The impact of this competitive pressure is shown clearly in the changes in market shares since 2011:

### Kantar Total Grocery Market Shares 2011 to 2018

| Brand | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018* | % change from 2011 to 2018 |
|---|---|---|---|---|---|---|---|---|---|
| Tesco | 27.3% | 27.3% | 26.8% | 25.8% | 25.3% | 25.2% | 24.6% | 24.5% | -2.8 ↓ |
| Sainsbury's | 15.0% | 15.0% | 15.0% | 14.7% | 14.6% | 14.2% | 13.6% | 13.5% | -1.5 ↓ |
| Asda | 14.9% | 14.7% | 14.5% | 14.5% | 14.0% | 13.2% | 12.7% | 12.7% | -2.2 ↓ |
| Morrisons | 11.5% | 11.2% | 10.8% | 10.4% | 10.2% | 10.0% | 9.6% | 9.6% | -1.9 ↓ |
| Aldi | 2.0% | 2.5% | 3.1% | 4.0% | 4.7% | 5.3% | 6.0% | 6.3% | +4.3 ↑ |
| Co-op | 5.9% | 5.6% | 5.4% | 5.2% | 5.1% | 5.2% | 5.0% | 5.0% | -0.9 ↓ |
| Waitrose | 4.1% | 4.3% | 4.5% | 4.7% | 4.9% | 5.0% | 4.9% | 4.8% | +0.7 ↑ |
| Lidl | 2.3% | 2.4% | 2.6% | 3.1% | 3.6% | 3.9% | 4.4% | 4.6% | +2.3 ↑ |
| M&S | 3.1% | 3.1% | 3.2% | 3.2% | 3.3% | 3.5% | 3.5% | 3.5% | +0.4 ↑ |
| Iceland | 2.0% | 2.1% | 2.1% | 2.1% | 2.1% | 2.2% | 2.2% | 2.1% | +0.1 ↑ |
| Others | 12.0% | 11.6% | 11.8% | 12.1% | 12.0% | 12.2% | 13.4% | 13.4% | +1.4 ↑ |

Source: Kantar World Panel Total Grocery Share.

The Competition and Markets Authority (like its predecessors, the Competition Commission and the Office of Fair Trading) has consistently taken the view that competition in UK grocery retailing is "*fundamentally local*".[10] Grocery is a clear example of the CMA's general approach to retail mergers, whereby retailers take account of local competition when making decisions – including those made at a UK-wide or "national" level.

There is no separate "national" issue that is not derived from an analysis of local competitive pressures, and which cannot be remedied by a package of local divestments.

Aldi and Lidl now have a combined volume share of 20.5% in fresh food and 16.6% in packaged food.[9]

9 Based on Nielsen Homescan data for the 52-week period ending 28 July 2018 for the UK total retail market (Copyright © 2018, Nielsen)

10 See Competition Commission, Groceries Market Investigation, para 4.135; cf. Tesco/Booker, para. 6.24,

## d. Future disruption to the market

We expect the competitive landscape to become even more competitive.

Technological advances have already helped to disrupt the grocery sector. For example, businesses like *Hello Fresh* deliver meal kits to homes and the takeaway sector has become a new threat, with companies like Uber Eats, Just Eat and Deliveroo expanding at pace. All of these meals are meals that customers are no longer buying from supermarkets. When UK market leader Just Eat was promoted to the FTSE 100 last year, it was worth more than Sainsbury's.[11]

Amazon is significantly expanding its presence in the UK grocery sector, working with Morrisons to offer a wide range of ambient, fresh and frozen products as part of its Amazon Pantry, Amazon Prime Now and Amazon Fresh offer. The acquisition of Whole Foods in 2017 gave Amazon a platform for further expansion in the UK, both online and through physical stores. The acquisition was widely perceived as evidencing Amazon's long-term commitment to expansion in the grocery sector.

Amazon has clear ambitions to expand further into in-store grocery:

"The US giant has hired property agents to search for up to 200 sites for Amazon Go, a new convenience store using cutting-edge technology to dispense with the need for checkouts. Meanwhile, it is also understood to be considering an offer to snap up a large block of bigger stores to expand Whole Foods in the event that regulators force Sainsbury's and Asda to sell supermarkets to their rivals as the price of their proposed merger."[12]

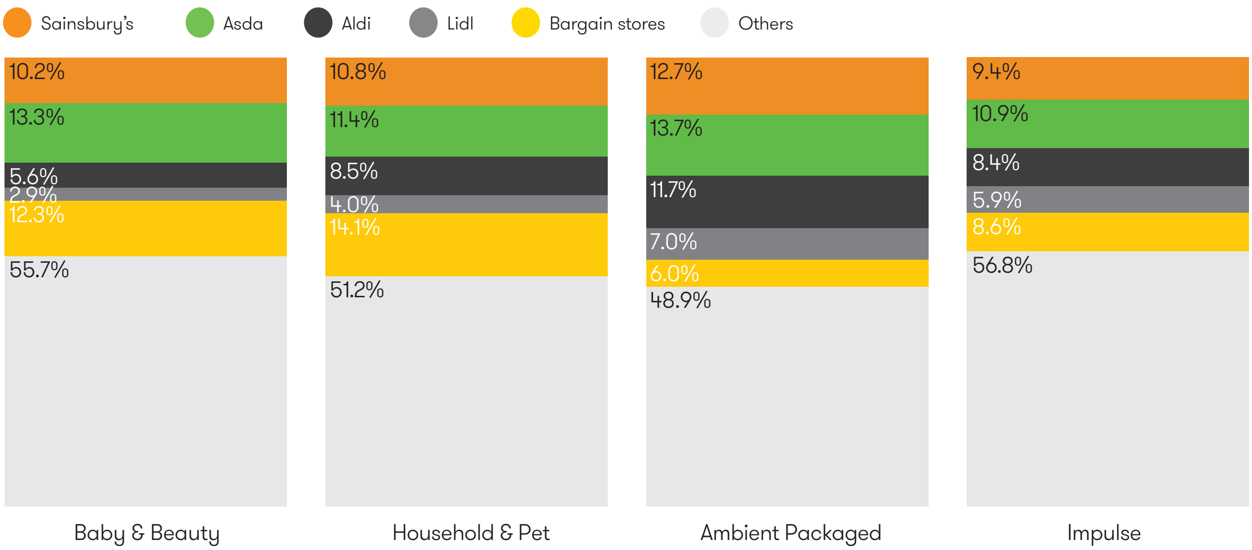
"The potential for Amazon Go is extraordinary … The tech will be difficult for other retailers to replicate and the convenience of it is hugely enticing for shoppers, who just want the retailer to get out of the way."[13]

While new players emerge, established retailers continue to expand significantly. Bargain stores such as B&M and Home Bargains now have volume market shares similar to Asda and Sainsbury's in categories including baby and beauty, household and pet, ambient packaged food and impulse food. They are also growing significantly in fresh and frozen food as well as rolling out significant amounts of new space. B&M has opened more than 200 stores in the past five years and has an ultimate store target of 950.[14] Home Bargains now operates over 500 stores, with an ultimate target of 1,000 UK stores.[15]

Sainsbury's and Asda both operate traditional, large supermarkets which have significant fixed costs. These cost bases mean that we face challenges remaining sustainably competitive and responding to both competition and customer expectations. These costs are also rising faster than volume is growing in the market due to a combination of rents, business rates and labour costs. These increases do not apply to all rivals in the same way.

Both businesses have successful ongoing cost reduction programmes, but there are structural limits to how far we can adapt our costs without adversely impacting the customer experience.

### Nielsen Value and Volume by Subcategory FY 201718 w Bargain Stores[16]




11 The Guardian, Just Eat £5.5bn valuation: online takeaway company now worth more than M&S, 29 November 2017. See: https://www.theguardian.com/business/2017/nov/29/a-bigger-slice-of-the-pie-just-eat-enters-ftse-100-with-55bn-valuation

12 Sunday Times, Amazon primes its technology to invade the high street, 28 October 2018. See: https://www.thetimes.co.uk/article/amazon-primes-its-technology-to-invade-the-high-street-9tc2q5w80.

13 Ibid, from GlobalData analyst Patrick O'Brien

14 "B&M Retail to open yet more stores as it defies inflation worries", Telegraph, 25 May 2017, available at: https://www.telegraph.co.uk/business/2017/05/25/bm-retail-open-yet-stores-defies-inflation-worries/

15 "Discount retailer Home Bargains founder takes home £1m", The Telegraph, 21 October 2018. See: https://www.telegraph.co.uk/business/2018/10/21/discount-retailer-home-bargains-founder-takes-home-1m/

16 Based on Nielsen Homescan data for the 52-week period ending 10 March 2018 for the UK total retail market (Copyright © 2018, Nielsen).

# 2. Customers

Sainsbury's and Asda are both working hard to respond to the changes in customer behaviour and market forces. But to continue to improve quality, service and range while lowering prices, we must combine forces.

Our proposed combination will create the buying and operating cost savings necessary to lower prices and to further invest in our business.

We are committed to reducing prices on everyday items by around 10%. While we cannot publish details of our pricing strategy for commercial reasons, we commit to lowering prices on a wide range of household staples that customers buy week in, week out. We are confident in the ability of the combined business to deliver the cost savings we have outlined and, given how competitive this market is, we have to invest in lowering prices for our customers, otherwise they will shop elsewhere.

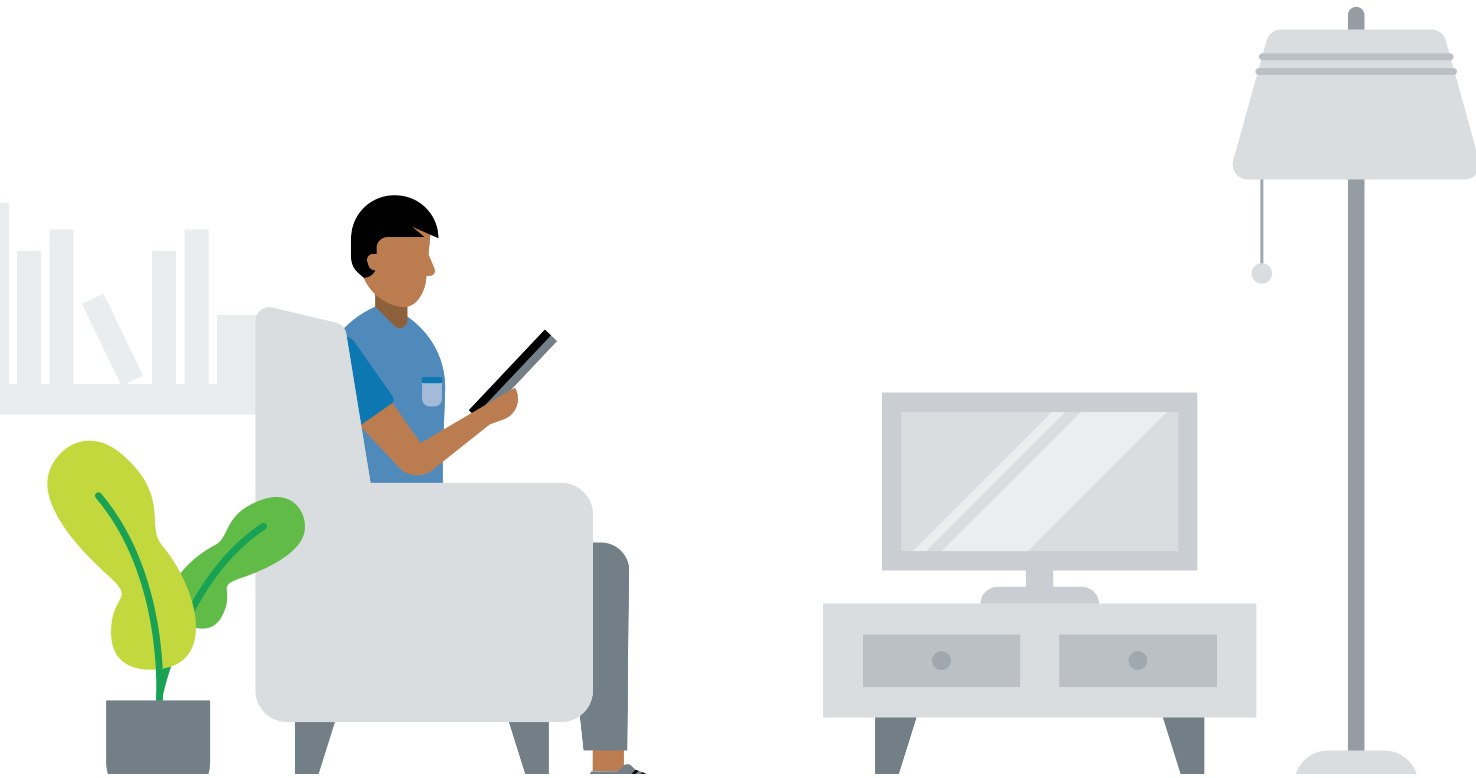
Sainsbury's and Asda are two distinctive brands. We will maintain and invest in the combined business to ensure we keep what customers already love about each distinctive brand – and add to it. For example, customers will benefit from the rollout of Argos in Asda stores, giving them access to a greater variety of products that can be collected or delivered the same day.

And by continuing to operate a complementary network of more than 2,800 Sainsbury's, Asda and Argos stores, we will help ensure they maintain their crucial place within the fabric of local communities up and down the country.

Our proposed merger is fundamentally pro-competitive. We expect it to stimulate greater competition from our rivals, leading to a dynamic and market-wide strengthening of competition that benefits UK customers.

**'We are committed to reducing prices on everyday items by around 10%.'**

**'We will maintain and invest in the combined business to ensure we keep what customers already love about each distinctive brand.'**



# 3. Suppliers

We believe our combination provides an opportunity for suppliers, particularly our small and medium-sized suppliers and farmers. Our small and medium-sized suppliers are critical to Sainsbury's and Asda offering new and distinctive products, which are highly valued by our customers. Sourcing from small suppliers and farmers will remain at the heart of our offer.

The synergies do not rely on store or distribution centre closures or on reducing the prices we pay to our smaller suppliers. Our supplier base is highly concentrated, with a small number of large — often multinational — companies accounting for the vast majority of what we buy. Sainsbury's top 50 suppliers account for over half of all food and grocery purchasing and 24 suppliers account for around one third of Asda's sales. These multinational suppliers are active across multiple countries and channels.

The basis for our merger is to harmonise buying terms across both businesses. Currently, Sainsbury's and Asda pay large suppliers different prices for identical products. By converging on the same lower price, we will secure considerable savings. We think this is fair and customers will benefit.

The suppliers from whom the majority of the harmonisation benefits flow already have substantial bargaining power, and already offer these prices to either Sainsbury's or Asda pre-merger. There is no credible evidence to conclude that suppliers will materially increase their prices to other retailers; the opposite is more likely to occur.

Both Sainsbury's and Asda have built strong and often long-standing relationships with suppliers. Put simply, we have no wish or incentive to harm our suppliers or to prevent the very innovation sought by our customers. We simply want to ensure that we are both charged the same fair price by suppliers.

Sainsbury's and Asda both have impressive track records of working with suppliers to make their businesses work more efficiently and reduce their costs. Following the merger, we will be able to strengthen our relationships with smaller suppliers even further:

- We can help them reduce their costs by making their business work more efficiently by serving one, larger business
- We can combine the ingredients our own-label food producers use when they create products for each business, reducing manufacturing costs and maximising purchasing volumes

Like the other major retailers, Sainsbury's and Asda are already bound by the Groceries Supply Code of Practice (GSCOP) and Groceries Code Adjudicator (GCA), ensuring our suppliers are treated fairly.

The topic of regulation is something for the government to consider, but as it stands there are large parts of the food industry whose dealings with their suppliers are not covered by the GCA. We would support major suppliers being held to the same fair trading practices with their suppliers as retailers are held to with theirs. This could be achieved by extending the GCA's powers through direct regulation of suppliers, not by extending the current framework to suppliers of our suppliers.

Sainsbury's Dairy Development Group (SDDG) is a good example of where Sainsbury's works closely with its farmers to support them. Our cost of production model absorbs the risk of changes in the – often volatile – prices of feed, fuel and fertiliser. We review these every three months to ensure that every one of our 244 farmers receives a fair and sustainable price for their milk. We also offer a bonus for health and welfare improvements to incentivise ongoing investment and progress.

Asda's Pathfinder schemes are about strengthening relationships with its key producers and suppliers. They provide farmers on key primary protein lines like dairy and lamb with support for innovation and access to the very best production techniques. They also provide a forum to share best practice and the ability to access market information and receive technical input from Asda, all at no cost to the farmer.

# 4. Colleagues

Sainsbury's and Asda are employers where colleagues love to work, offering industry-leading benefits and sharing strong culture and values.

We will not close any stores as a result of the merger. If the CMA requires us to sell any stores, the regulator will insist that those stores are only sold to a party willing, able and committed to running them as a going concern and sufficiently resourced to ensure maintenance of strong competition in any local market where a divestment is required.

At a time where jobs are threatened across the retail sector, the proposed combination is good news for our 330,000 colleagues, offering them more security and a greater breadth of career opportunities.

Customer service is a key point of differentiation for us and can only be delivered by happy and well-incentivised colleagues.

Sainsbury's and Asda are committed to training and developing colleagues so that they realise their full potential and rise to be the business leaders of tomorrow. By bringing our businesses together, we will be able to provide more training and promotion opportunities for colleagues across the Group.

We take our obligations to our current and former employees very seriously. The combination will provide additional security to members of the Sainsbury's defined benefit pension scheme. It will deliver greater security through:

- A stronger balance sheet, resulting in lower leverage
- An improvement in the freehold/leasehold mix, due to Asda's freehold property profile
- Significant cash generation potential to improve our de-leveraging profile, and an investment grade credit profile upon completion

Walmart will retain responsibility for the Asda defined benefit pension scheme.

## Integrating Argos

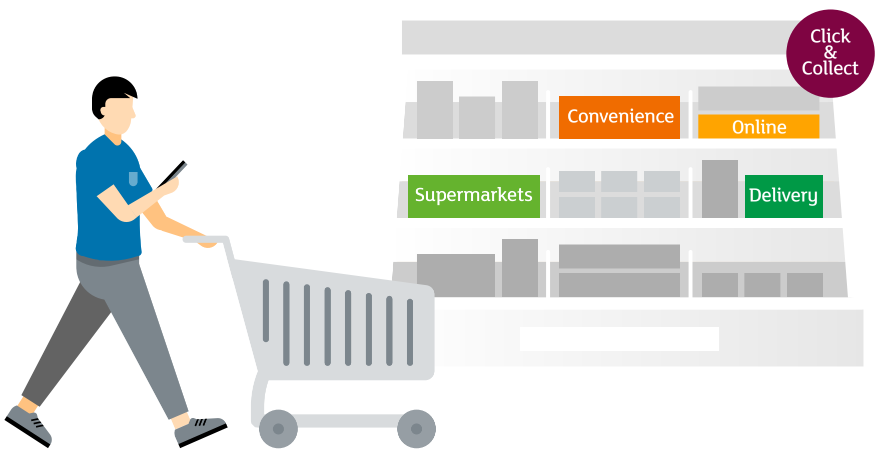
Since 2016, Argos has been integrated into Sainsbury's.

When combining with Argos, we made a three-year commitment to:

- Deliver £160m synergies
- Create 1,000 net new retail roles
- Open 250 Argos stores in Sainsbury's supermarkets
- Keep the Argos HQ in Milton Keynes open

Just over two years in, we have:

- Delivered £160m synergies ☑
- Created over 1,000 new retail roles ☑
- Opened 251 Argos stores in Sainsbury's supermarkets ☑
- Kept the Milton Keynes HQ open and invested more than £10m refurbishing it ☑
- Removed Under25 colleague pay and increased all colleague pay to above the National Living Wage ☑



# 5. The broader economy

The combined business would create a stronger and more resilient business in the UK. A business that would provide local jobs, pay UK tax and reduce prices for customers.

## Office locations nationwide

We will retain the Sainsbury's head office in London and the Asda head office in Leeds, alongside our existing office locations in Edinburgh, Manchester, Coventry, Milton Keynes and Lutterworth. This makes strategic sense given the three core UK retail talent pools are based on the M62 corridor, the Midlands and in London.

As a UK PLC, the combined company will be subject to the highest standards of corporate governance. The UK exchequer will benefit from us being one of the largest taxpayers in the UK, supporting the national economy as much as we support local communities by contributing to the cost of local services through business rates.

Sainsbury's is the 62nd[18] largest company in the FTSE100, but it is the seventh largest tax contributor in the UK[19].


18 Based on London Stock Exchange, FTSE100 Index, as of 13th November 2018. See: https://www.londonstockexchange.com/exchange/prices-and-markets/stocks/indices/summary/summary-indices-constituents.html?index=UKX

19 PwC 2017 Total Taxes Contribution survey

# Creating a dynamic new player in UK retail

## Shopping habits are changing

And the pace is accelerating



## Bringing together trusted brands

To create a more competitive and resilient business

Sainsbury's
ASDA
Argos
Sainsbury's Bank
George.
Tu
habitat

### Best possible fit

Shared colleague culture and values

Highly complementary store locations and sizes

Sharing technology developments

### Key facts

**330,000** Colleagues

**£51bn** Revenues

**2,800** Stores

**47m** Weekly transactions

## Benefits for...

### Customers

**c. 10%**
Aim to reduce the price of everyday items

**Better**
Quality, ranges and more flexible ways to shop

### Colleagues

**Opportunities**
In larger, more resilient group

**Further security**
For pension holders

### Small suppliers and farmers

Opportunities for growth and more efficient supply chains

### Shareholders

**£500m**
Net synergies*

**Double digit**
Earnings per share growth**

**Stronger**
Balance sheet

### The UK economy

One of the largest employers and taxpayers

**£2.1bn**
In tax in 2017/18

**inc. >£1bn**
In business rates

* post price reinvestment
** by second full year post completion