

Notes to the financial statements

29 Financial risk management

The Group's activities expose it to a variety of financial risks including liquidity risk, credit risk and market risk.

Funding and financial risk management are managed by a central treasury department in accordance with policies and guidelines approved by the Board of Directors. The risk management policies are designed to minimise potential adverse effects on the Group's financial performance by identifying the various risks and setting appropriate risk limits and controls. The Finance Committee of the Board of Directors has responsibility for approving specific financial transactions. The Treasury Committee, chaired by the Chief Financial Officer, regularly reviews risk positions and monitors performance. The Group Audit Committee oversees management compliance with risk management policies and reviews the adequacy of the risk management framework in relation to the risks faced by the Group. The Group Audit Committee is assisted by Group Internal Audit who regularly review the Group's risk management controls and procedures.

The Group only uses derivative financial instruments to hedge exposures arising in respect of underlying business requirements and not for any speculative purpose.

Treasury operations in respect of Sainsbury's Bank are managed separately through Lloyds Banking Group, the Group's joint venture partner.

Liquidity risk

The Group's operational cash flow is largely stable and predictable, reflecting the low business risk profile of the food retail business. Cash flow forecasts are produced regularly to assist management in identifying future liquidity requirements.

The Group's liquidity policy requires that it maintains committed funding to cover cash flow requirements over an 18-month period. This is achieved by structuring core debt with long-term maturities, pre-funding operational cash flows and maturing debt obligations and maintaining a portfolio of committed standby credit facilities.

Core funding is mainly comprised of two long-term loans entered into in March 2006 and secured over property assets held in two subsidiary companies. The loans comprise £1,130 million with a legal maturity of April 2018 and £872 million with a legal maturity of 2031. During the year the Company also entered into a £150 million loan maturing 2015 and a £35 million bank loan maturing May 2009.

Short-term and seasonal funding is sourced from the wholesale inter-bank money market where interest is charged at various spreads over LIBOR. The Group also maintains a £35 million net overdraft facility under which debit and credit balances of the various subsidiary accounts covered by the facility are netted for the purpose of charging interest. The table below includes the gross overdrawn balances within this facility and the offsetting cash balances under this arrangement are included within cash and cash equivalents (see note 27b). Interest arising on any net overdraft balances is charged at a margin above bank base rate.

For standby purposes the Group maintains a £400 million committed revolving credit facility maturing February 2012 and a £163 million committed revolving credit facility maturing May 2011. Interest on drawings under these facilities is charged at margins above LIBOR. There are £nil drawings under the committed facilities as at 21 March 2009 (2008: £nil drawings).

The table below analyses the Group's financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the tables are the contractual undiscounted cash flows or an estimate in respect of floating interest rate liabilities.

Group	Less than one year £m	One to two years £m	Two to five years £m	More than five years £m
At 21 March 2009				
Notional overdraft	28	-	-	-
Borrowings				
Bank loan	35	-	-	-
Secured loan due 2018	85	85	224	1,221
Secured loan due 2031 ¹	53	54	170	1,239
Term loan due 2015	13	12	37	175
Loan notes	8	2	-	-
Obligations under finance leases	3	3	9	177
Trade and other payables	2,487	-	-	-
At 22 March 2008				
Notional overdraft	118	-	-	-
Borrowings				
Secured loan due 2018	86	85	256	1,276
Secured loan due 2031 ¹	52	53	170	1,302
Obligations under finance leases	3	3	9	188
Trade and other payables	2,272	-	-	-

Company	Less than one year £m	One to two years £m	Two to five years £m	More than five years £m
At 21 March 2009				
Notional overdraft	8	-	-	-
Bank loan	35	-	-	-
Amounts due to Group entities ²	3,540	1,139	118	952
Other payables	10	-	-	-
At 22 March 2008				
Notional overdraft	88	-	-	-
Amounts due to Group entities ²	3,761	1,135	113	946
Other payables	10	-	-	-

Assumptions

- 1 Cash flows relating to debt linked to inflation rates have been calculated at projected RPI.
2 Cash flows relating to debt bearing a floating interest rate have been calculated using the prevailing interest rates at 21 March 2009 and 22 March 2008.

The table below analyses the Group's net settled derivative financial instruments into relevant maturity groupings based on the period remaining from the balance sheet date to the contractual maturity date. The amounts disclosed in the tables are the net contractual undiscounted cash flows.

	Less than one year £m	One to two years £m	Two to five years £m	More than five years £m
At 21 March 2009				
Commodity contracts				
Outflow	7	-	-	-
Interest rate swaps on secured loan due 2018				
Inflow ¹	(2)	(2)	(7)	(11)
Other interest rate swaps:				
(Inflow) ¹ /outflow	(2)	(2)	(4)	6
At 22 March 2008				
Interest rate swaps on secured loan due 2018				
Outflow ¹	-	-	1	1
Other interest rate swaps				
Inflow	(1)	(1)	(1)	(7)

Assumption

- 1 The ten-year swap rate at 19 January 2009 has been used to calculate the floating rate cash flows over the life of the interest rate swaps shown above (2008: 19 January 2008).

The Group holds commodity contracts, for which the outflow figures in the table above have been calculated. The commodity contracts are at fair values prevailing at the reporting dates. At 21 March 2009, £5 million relating to these financial instruments has been recognised in equity.

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The table below analyses the Group's gross settled derivative financial instruments into relevant maturity groupings based on the period remaining from the balance sheet date to the contractual maturity date. The amounts disclosed in the tables are the contractual undiscounted cash flows.

	Less than one year £m	One to two years £m	Two to five years £m	More than five years £m
At 21 March 2009				
Forward foreign exchange contracts – cash flow hedges				
Outflow	120	22	–	–
Inflow	(142)	(22)	–	–
At 22 March 2008				
Forward foreign exchange contracts – cash flow hedges				
Outflow	134	4	–	–
Inflow	(137)	(4)	–	–

The Group holds foreign exchange forward contracts, for which the inflow figures in the table above have been calculated by translating the foreign currency forward commitments at spot exchange rates prevailing at the reporting dates. At 21 March 2009, £17 million relating to these financial instruments has been recognised in equity (2008: £2 million).

Credit risk

The Group's exposures to credit risk arise from holdings of cash and cash equivalents, derivative financial assets, deposits with banks, investments in marketable securities and trade receivables (note 17).

The Group deposits surplus funds on the wholesale inter-bank money markets with approved banks or into pooled money market funds. The Group's credit policy limits investments to banks or liquid securities which carry minimum short-term credit ratings of A1 from Standard & Poor's and P1 from Moody's Investors Service or, in the case of money market funds, AAAM from Standard & Poor's and Aaa from Moody's Investors Service.

The table below analyses the Group's cash and cash equivalents by credit exposure excluding bank balances, store cash and cash in transit:

Counterparty	Rating	2009 £m	2008 £m
Financial institutions – Money Market Funds	AAA/AAa	410	300
Financial institutions – Money Market Deposits	A1+/P1	28	11

During the year there were no breaches of deposit limits and management does not expect any losses from non-performance of deposit counterparties.

Interest rate swaps and foreign exchange contracts are used by the Group to hedge interest rate and currency exposures. The table below analyses the fair value of the Group's derivative financial assets by credit exposure.

Counterparty	Short rating	Long rating	2009 £m	2008 £m
Interest rate swaps	A1/P1	A/A2	19	–
Interest rate swaps	A1/P1	A+/Aa2	37	–
FX forward contracts	A1+/P1	–	4	4
FX forward contracts	A1/P1	–	18	–

Market risk

(a) Currency risk

The Group is exposed to currency risk principally on future inventory purchases denominated in currencies other than pound sterling, primarily euros and US dollars but also Hong Kong dollars, Polish zloty, Australian dollars and New Zealand dollars. The Group also has limited exposure in respect of recognised foreign currency assets and liabilities.

The Group's risk management policy seeks to limit the impact of movements in exchange rates on Group income by requiring anticipated foreign currency cash flows in US dollars and euros to be hedged. The future cash flows, which may be either contracted or un-contracted, are hedged on a layered basis between 80 per cent and 20 per cent using forward contracts.

The Group has limited exposure to currency risk on balances held on foreign currency denominated bank accounts, which may arise due to short-term timing differences on maturing hedges and underlying supplier payments.

A 20 per cent change in the value of the US dollar versus sterling at the balance sheet date with all other variables held constant would have increased or decreased post-tax profit or loss for the year by £2 million (ten per cent change 2008: £20,000), as a result of gains or losses on translation of US dollar cash balances and US dollar denominated trade payables and receivables.

A 20 per cent change in the value of euro versus sterling at the balance sheet date with all other variables held constant would have increased or decreased post-tax profit or loss for the year by £1 million (ten per cent change 2008: £500,000), as a result of gains or losses on translation of euro cash balances and euro denominated trade payables and receivables.

Movements of this magnitude in the other currencies noted above would have an immaterial impact on both the income statement and equity.

(b) Interest rate risk

The Group is exposed to interest rate risk on its portfolio of interest bearing borrowings and deposits. The Group's interest rate policy seeks to minimise interest expense and volatility by structuring the interest rate profile into a diversified portfolio of fixed rate, floating rate and inflation-linked liabilities.

Inflation-linked cash flows arising on the Group's long-term borrowings remain an effective source of diversification within the liability portfolio, a hedge of the Group's revenues as well as a means of reducing balance sheet risk. These cash flows arose as part of a general refinancing exercise undertaken in March 2006.

(i) Fair value sensitivity for fixed rate instruments

The Group holds £1,130 million of fixed rate debt (2008: £1,159 million), of which £211 million (2008: £602 million) has been swapped into floating rate debt with interest rate swaps. The remaining £919 million (2008: £557 million) portion of fixed rate debt is recorded at amortised cost and a change in interest rates at the reporting date would not affect the income statement.

(ii) Cash flow sensitivity for variable rate instruments

The £211 million portion of fixed rate debt swapped to floating rates (2008: £602 million) and the associated interest rate swaps have been designated as being in a hedging relationship. The interest rate swaps and the gain or loss on the hedged item attributable to the hedged risk are recognised at fair value through profit or loss.

The two movements in fair values on the underlying fixed rate debt and the interest rate swaps largely offset one another in the income statement. A change of 200 basis points in interest rates at the balance sheet date would have increased or decreased post-tax profit or loss by £3 million (a change of 100 basis points 2008: £4 million) representing the increased cost of the floating rate leg of the swaps.

For the year, the fair value movement in the interest rate swaps has resulted in a credit to the income statement of £35 million (2008: £25 million). The fair value movement in the underlying fixed rate debt has resulted in a charge to the income statement of £35 million (2008: £25 million). The net movement is a credit to the income statement of £691,000 which represents the ineffectiveness on the hedging relationship (2008: £282,000).

At the balance sheet date the Group held the following interest rate swaps not in a hedging relationship; a notional value of £256 million (2008: £75 million) of fixed rate borrowings into floating rates of interest and a notional value of £391 million (2008: £nil) of floating borrowings into fixed rates of interest. Interest rate swaps not held in a hedging relationship are recognised at fair value through profit or loss. An increase of 200 basis points in interest rates would have decreased post-tax profit or loss by £3 million (2008: £4 million). A decrease of 200 basis points in interest rates would have decreased post-tax profit or loss by £7 million (2008: £10 million) represented by a movement in the fair value and interest rates for the year.

For the year, the fair value movement in the interest rate swaps has resulted in a charge to the income statement of £6 million (2008: £4 million).

(iii) Cash flow sensitivity for inflation-linked variable instruments

The Group holds £872 million of inflation-linked debt (2008: £867 million) which is recorded at amortised cost. A change of 100 basis points in the RPI at the balance sheet date would have increased or decreased post-tax profit or loss by £6 million (a change of 50 basis points in the RPI 2008: £3 million).

(iv) Cash flow sensitivity for term loan due 2015

The Group holds £150 million of borrowings and associated swaps where the variable rate coupon is subject to a cap and floor. A change of 100 basis points in the coupon would have an immaterial impact on the post-tax income statement taking the loan and swaps as a whole.

(v) Fair value sensitivity for available-for-sale assets

Included within available-for-sale financial assets is £90 million (2008: £105 million) relating to the Group's beneficial interest in a property investment pool. The net present value of the Group's interest in the various freehold reversions owned by the property investment pool has been derived by assuming a property growth rate of 2.8 per cent per annum (2008: 2.8 per cent) and a discount rate of ten per cent (2008: ten per cent), (see note 15).

A change of 0.8 per cent in the assumed rate of property rental growth to 2.0 per cent and 3.6 per cent, holding other assumptions constant, would result in values for this asset of £77 million (2008: £90 million) and £103 million (2008: £121 million) respectively. A change of one per cent in the discount rate to nine per cent and 11 per cent, holding other assumptions constant, would result in values of £103 million (2008: £121 million) and £79 million (2008: £92 million) respectively.

Commodity risk

The Group is exposed to commodity price risk on its own use consumption of electricity, gas and fuel.

The Group's Energy Price Risk Committee seeks to limit the impact of movements in commodity prices on Group income by requiring forecast purchases of power and fuel be hedged.

The Group uses financial derivatives to hedge fuel exposures on a layered basis using contracts for difference. A 20 per cent change in the fair value of the commodity price at the balance sheet date would have increased or decreased the cash flow equity reserve by £2 million.

The Group hedges electricity and gas exposures via forward purchases under flexible purchasing arrangements with the relevant suppliers.

Capital risk management

The Board's policy is to maintain a strong capital structure consistent with the size and nature of the Group. The Group's current credit ratings comprise a Corporate Family rating of Baa3 from Moody's and a Corporate Credit rating of BBB- from Standard & Poor's.

The Board monitors a range of financial metrics including return on capital and gearing to measure the efficiency of the Group's capital structure, the returns for shareholders and benefits for other stakeholders.

The Board has a policy to maintain the underlying earnings cover for the ordinary dividend at a minimum of 1.50 times and to grow the dividend cover over time to between 1.50 and 1.75 times.

From time to time the Company purchases its own shares in the market for the purpose of issuing shares under the Group's share option programmes. Outside of this practice the Group does not have a defined share buy-back plan.