TRANSCRIPT

Tesco Plc Half Year 2014/15 Earnings Presentation

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PRESENTATION

Richard Broadbent - ***Tesco PLC - Chairman***

Good. Well, welcome, everybody. Welcome to Tesco's interim results, a bit later than usual for reasons that you're aware of. Is everyone in; everybody back okay?

I'm Richard Broadbent, as many of you may know, and I'm absolutely delighted to introduce Dave Lewis on my left, our Chief Executive, and Alan Stewart the Chief Financial Officer. These are the people who are going to take Tesco into the future, and I can't say how pleased I am to be here -- that they are here.

I'm going to begin with just a few words and then I'm going to hand over to Dave and Alan, because I think it's probably them you want to hear from more than me, but I will begin by saying a few words just to provide context and background.

It's about two years and 10 months since I took this role, and in that entire time Tesco has been, and indeed still is, a company in transition. That wasn't a complete surprise when I arrived. I knew that. But it is a very substantial transition. It reflects obviously a set of internal business and cultural issues. It reflects a radically changing external market.

And notwithstanding the fact that over that two and a half or so years, notwithstanding the fact that we took a series of quite substantial business initiatives, it became evident some time ago that more radical steps needed to be taken.

I'm not going to bore you with a list of those, but you saw quite recently the fairly tough decisions we took on capital spending, on the dividend; and the actually much less tough decision, but probably most important decision, to bring in an entirely new senior management team.

That decision, of course, was the key one, because to bring in a completely new management team rather than just a person may give you some indication of how the Board was seeing this Company at that point.

Now having said all that, the events of late September were obviously not foreseen. Alan is going to deal with the details of the investigation. I'm not going to go through it in detail. I will say two things about it; the two key points, if you like, I think.

Perhaps first and most importantly, the issue about the mis-statement of expectations has now been scoped. The Deloitte report verifies a mis-statement of expected trading profit of GBP118 million in the first half of the year, and GBP145 million in relation to earlier years, a total of GBP263 million.

The report also confirms that almost all this mis-statement is down to timing, rather than the validity of receipts. These are two key and important conclusions.

And the report now and all its relevant files have been passed to the Financial Conduct Authority, the FCA, who are conducting an investigation, as they announced I think earlier this month. And because of the outstanding investigation by the FCA, and this may become I'm afraid a slightly repetitive point, because of that investigation, we can make no further comment at this stage about how these events came to pass.

It's very, very important that I make it clear, if it's not obvious to you, that the issues that have come to light are a matter of profound regret, I mean to me personally and to the Board. And I'm not going to do more than say that, because not withstanding that fact, notwithstanding this deeply disappointing issue, the most important thing now is the business; and the business continues to face challenges at difficult markets and intense competition, and our focus has to be on the future.

It's absolutely right that Dave and Alan are now reviewing all aspects of the Group in order to improve its competitive position and deliver sustainable returns. That's why the Board asked them to join us. And I'm completely confident that they're going to move quickly and effectively in this respect. And I want to make it clear again that in that process, consideration is going to be given to all options that increase flexibility and value for shareholders as well as to customers.

And what is most important now for the business is stability and orderly process. The Board's immediate focus is on ensuring that we can complete the transition to the new team, who are before you today, and that new and far-reaching business plans are put in place to take the business forward and put in place quickly.

These plans will mark a new beginning, a new phase for the Company, and it's completely appropriate at the point that we reach this new phase I can now begin to prepare the ground to ensure an orderly process for my own succession. And I do that, and it's my decision, because it reflects the principle in my view of accountability on behalf of the Board. It will help draw a line under the past for the Company. It absolutely demonstrates what this Company stands for. And it also reflects my own personal view of the responsibility of people in positions such as mine to recognize that when events take place, never mind how or what, just events, there is accountability and it is important that it is acknowledged. And that is why I am going to begin that process for my own succession.

Thank you.

Having said all that, I'm now going to hand over to Dave to deal with the rest of the presentation.

Dave Lewis - ***Tesco PLC - CEO***

Good morning. What I'm going to do now is in the next half an hour between Alan and myself is I'm going to set up a little bit of an introduction; give you a couple of thoughts that I'd like to share with you that will form some of the things we're going to talk about today, but also will form some of the conversations that we're going to have together over the next years.

I will then lead into a -- it will be a natural segue into the commercial investigation, and I will introduce, but Alan will take you through what it is we've actually done.

And we'll share with you the detail, as Richard said, on how with the help of Deloitte's we've got to the what here. We won't be able to speculate about the how or the why but we will be very clear with you about the what.

Alan will then share with you the detail of the first-half results, and then I'll come back and I'll share with you some of what I consider to be our immediate priorities and some of the things that you can expect to see from me and the team in Tesco in the next weeks and months.

Seven weeks in. Thought I'd start here. Right? People ask me lots of questions about this. I've known Tesco for 27 years, and I've known it to be a fantastic business. I've worked with it around the world in many, many capacities, and when I was invited to become involved with Tesco, it was a chance not to be missed.

I'm not at all naive about some of the challenges that Tesco faced when I said I wanted to come, and maybe it may have got a little steeper in the last couple of months, but it doesn't take away what a phenomenal business Tesco is.

When you look at the scale, when you look at the reach, when you look at the capability, when I look at the expertise, and most of all I have to tell you and I'll share more of this as we go through the next hour or so, the passion that I feel inside the business, Tesco has everything it needs to be successful into the future as well.

We'll change some things. We will change some things. And I'll share a little bit of that with you. But just remember, if you want to know something about this business, just think of this fact in the UK. Every second, every single second, we serve 66 people.

Our reach, our connection with, our potential engagement with customers in the UK and in the markets we serve around the world is unparalleled. The opportunity for me and my team to add something to that engagement, in the way that we relate to our customers is the opportunity that we should all focus on in Tesco. I can change the business around that, but actually, that engagement, that reach, is just unparalleled.

What have I been doing in the first seven weeks? I've been asking lots of questions; some naive, some probing, some very pointed. But I've been doing an awful lot of listening. A bit of advice I was given early in my career when I went around Asia was, remember, you have two ears and one mouth, and if you use them in those proportions you'll be fine.

There's a lot, a lot to understand about a business like Tesco, but it's interesting when you look at the business through the eyes of a customer. So what I've been doing over the last seven weeks is spending an awful lot of time in store, an awful lot of time around the business talking to colleagues. The answers to our business opportunities are there in the colleagues that already exist.

And I have to tell you, the reaction, the reception, the energy that I feel inside the business, despite the issues that we've had, is just incredible, absolutely incredible.

So whilst I'm very clear about some of the issues that we have, I'm also as clear about the energy and the passion that exists within the business, and I've felt that in the seven weeks that I've been here.

I thought I would do, if you don't mind, and this comes to two thoughts, which are going to have an impact on how we'll talk to each other over the years ahead, is I've got a couple of perspectives on history and a couple of perspectives on competitive advantage I thought I would share with you.

The first is history. Right? So as somebody who's had a bit of a marketing career early on in my professional career, history is really very important to me; so a strong study of history. Anybody who is responsible for managing any brand might appreciate what I'm about to say.

When any brand is made great -- there's a principle called brand archeology. When you take over any brand, go back into its history and find out what it was that made the brand great, because actually, whatever the brand does, there's something always in its DNA that made it great. And when you study -- when I study the history of Tesco and you look for that DNA, it's actually quite easy to see.

Tesco has always been at its best when it's been the champion for customers. Whether it was Cohen and challenging things like retail price maintenance, whether it's MacLaurin and its checkout and the relaunch that happened then, or dare I say it was [Terry] and it was Clubcard. That was all about being the champion for customers.

So when I look at history, I look at history through the lens of let me understand the genetic DNA of this business and let me think about what it is that the modern expression, the modern activity of a business can be against that DNA.

Now I say that to you because everybody I meet always wants to talk to me about the history. I get huge amounts of questions about where did Tesco go wrong. Was it 2007? Was it 2009? Was it this decision? Was it that decision? I get lots of that and I understand it. And I will use history to guide the actions of Alan and myself.

Everybody makes mistakes. You learn more from your mistakes than you do from your successes. We will do that. But actually, I won't engage in lots of questions about what it was that were good or bad decisions. What I will engage in when it comes to history is what part of the genetic DNA of this business is relevant to how it is we want to take it forward.

So it's important that you know that from me because that's the bit of history that I respect and it's the bit of history that actually is going to focus us going forward.

The other thing you should know about me a little bit is I'm a big believer and studier of competitive advantage. We were talking about this in the coffee outside.

One of the things -- why did I put this here? Because, again, everybody asks me when are you going to reveal your strategy; which date will it be revealed? And I do get it. Trust me, I'm not -- I do get it. But I tell you, I was struck. In deciding to come to Tesco, you do your due diligence and you read around, and the amount of things I could find in public review.

And I know that when businesses get under pressure there's a pressure on someone like me to tell you what it is I'm going to do. But actually, this industry is incredibly competitive. Small differences really do matter. And so the things that you need to understand from me is, actually, I want my strategy to be felt first by customers, and then I'll come and explain it to you as to why it is we did it. And it's important that you appreciate it that it's that way around. Okay?

So I will come. I will make the investment case for Tesco for you. I will. And I will always explain to you what we've done and why we've done it. But, please, don't expect me to come and tell you what I'm going to do in a highly competitive industry before I do it. Okay? I've seen it; I understand it; I know how we got there. But you need to know that that's something I'll bring into the business.

Having said that, let's move very quickly, because obviously, the seven weeks have been impacted greatly by the commercial investigation, commercial income investigation. And what we're going to do now is I'm going to basically take you through what happened and Alan will share with you the content of that.

So preparing for our results presentation on September 19, I got a call from Adrian, who happens to be sitting in the front row, to tell me that we'd received a paper, an internal paper. Adrian is our general counsel with a very purple tie on in the front row. And the internal paper said that we've had a commercial issue, a potential commercial issue of GBP246 million.

There then ensued a very intense weekend where we took that information and we started to interrogate to see whether that was the case; a whole series of crisis meetings, ourselves with the auditors, with the PLC brief, and we did an initial data capture.

The crisis teams were formed over that weekend and we included Freshfields as we started to investigate, and we appointed Deloitte's. And we put in together some business continuity planning, as you would expect.

It's at this point, and I do want to say this, it's at this point that I gave Marc Bolland a call. And I gave Marc Bolland a call and I woke him up very early in -- I think he was in New York and I woke him up. And I said to him, Marc, I need your help. And I asked if he would, having consulted Alan, whether he would be prepared to release Alan early because I had an issue in Tesco. And I tell you that because I publicly want to thank him because at some inconvenience to himself, he did agree to that, and it shows the mark of the man that he was prepared to. So I'm eternally grateful to him for that. And as a result, Alan joined that week.

And it's at that point that in the way of English relay teams, I'm going to hand over to Alan to take you through the rest of the investigation and then on to the results.

Thank you.

Alan Stewart - ***Tesco PLC - CFO***

Morning, everybody. Before I get into that, I'd just also like to say how when Dave spoke to me over that weekend, my first and immediate statement was I have to be there. And I'd also like to thank Mark for releasing me because I understand the reasons why I was held offside. But I equally would like to thank Mark for allowing me to be here, because this is a critical time for Tesco and it was critical for me to be part of it and to assist Dave and Richard and the rest of the team in it.

So I joined four weeks ago, and the first day in the office I was there as the work streams were kicked off. We had a number of work streams which were launched, and you can see them set out on the slide. This was a crisis such as many companies face; not always the same issues, but crisis management. And we kicked it off very efficiently, very quickly, and with a great degree of insight to me as to how Tesco reacts as a business and reacts very, very well when it's under pressure and when things need to be done.

So we launched that off. You can see there all of this -- the streams we had. There were two streams that we were trying to get to; two answers we were trying to get to at this stage. The first was, what's the size of the issue; and the second was the how and the why. Now as Dave has said, we're not going to be able to get to the how and the why, but we set out trying to achieve that.

Things moved very quickly though, because in the next week, on October 1 the Financial Conduct Authority launched their investigation, and immediately it became clear to us that the how and the why were questions which, much as we'd like to answer them, they weren't going to be answered by us. And that's where we are today, and that's where we will be I suspect for some time.

We also started the triage process there, which I'll come on to. Two weeks of intense activity working with our internal audit, working with Deloitte, working with our auditors PriceWaterhouse, and a number of areas of work that we had to do. We continue to work on it and we began to get a sense of the scale we could get to.

Sorry. I'm one ahead.

Last week, we had the Audit Committee begin to get a size of what we had. We began to be clear in our own minds what we'd begun to see through the two weeks that this is an issue in a single part of the business; it didn't go into other parts of the business. And we could see that it was coming in at around the GBP250 million that we'd announced.

So where we are today, we've had the final verification of the number and we've sized it at GBP263 million. It does impact this year's numbers, and we'll go into that. And we've had the Deloitte report finalized and presented to the Audit Committee and, of course, to the relevant authorities.

That brings the investigation stage to an end, so from now, as Dave says, we move on with the business and the authorities take over. And we will continue to be fully cooperative and support that.

I thought I'd give you a little bit more color behind what it is that we've done there.

So we set up a triage process. One of the realizations we had is that we might get a lot of incoming questions, challenges; we might get more information that came up. So we had a triage process which rapidly assessed that and decided how we dealt with it.

We had 6.3 million documents which have been captured, in the technical word. We've got those data records captured. And we've gone through [18,000][*] invoices as the top level of review for this business. That's the scale of what we've had to deal with in this four weeks and what our assistants in Deloitte's and the auditors have had to deal with.

We've focused in on 500 invoices. We had the paper, which we spoke about. And that highlighted around 500 invoices and areas we had to look at. When we got into that, we then realized that, actually, the complexity of commercial income is that behind any single commercial transaction, there may well be different elements. So those 500 invoices expanded to over 700 invoices, and they go back and forward in time.

All of those have worked through, and we've seen, as I say, no evidence materially outside the UK business. What do I mean when I say materially? Well, actually, in the Irish business, a lot of the purchasing is done in the UK; a very small element into Ireland. But essentially, this is something which is linked to the UK. And we're now complete.

So we've sized it at GBP263 million, and when we look at that, and this is an accounting view of the world, remember, the accounting impact on the first half of this year is GBP118 million.

We've looked at it in respect of the prior year and we estimate that in the last year, around GBP70 million, we've booked GBP70 million for the last year, arose last year, and in earlier years, GBP75 million arose. That means that we had a brought-forward balance sheet of around GBP145 million and a full impact of GBP263 million. Remember that that goes against our expectations for the year and we've had to write that off.

So that's where we are in terms of the numbers, and happy to take further questions in terms of when we get into the Q&A.

We've also looked very -- in great detail from the technical aspects and the important aspects from an investor perspective of restatement of accounts, and the conclusion we've made is that there is no reason to restate last year's accounts. We've accounted for this in the current year but given a size in respect of the earlier years.

So that's it on the investigation. If we now move to the first-half results.

[*] Amended from 8,000 after delivery at the company's request

Again, I'd like to say that this is the format which Tesco has used before. We're going to talk about that and Dave will say a little bit more about it later. But this is a format that you will recognize. What I would say is that don't expect that this format will necessarily continue into the future because it's something which clearly I've inherited. And our job is to invest -- present the investor case as best we can, and we will look at that.

In terms of Group performance, sales of GBP34 billion; down 4.4% year on year. And Group trading profit, because of the operational leverage in the business, is down 41% at GBP937 million.

Our underlying profit before tax at GBP783 million reflects the interest charge and joint venture income from associates. We have a number of one-off items, over GBP500 million, and these fall into the broad categories of UK and European store impairments, GBP136 million.

There's around GBP40 million of a charge in respect of rates on ATMs. This is something which you may well see in other parts of the industry. The rating authorities have chosen to put rates on ATMs, our auto teller machines, at a different rates than historically.

We've had a redress provision in the bank of around GBP27 million. We've got around GBP40 million of restructuring costs. And we've had some stock write-downs of about GBP60 million.

And then finally, we've got GBP145 million of the prior-year element of that GBP70 million and GBP75 million brought forward.

So that's around GBP527 million of one-off items. That brings us to our Group profit before tax of GBP112 million and net finance costs of GBP171 million.

Underlying diluted EPS is down 47% at 7.71p.

It's not a pretty picture, and it's not one that we would like to be reflecting, but it is a reflection of where we are, and it's a base from which we can build.

In terms of segmental performance, we'll come into this in more detail, but as you can see, by far the driver of our overall results is the UK business which is down 56%.

So we'll start in the UK. In terms of what we've tried to do here is to give you some sense of how we look at the business and how we see our performance relative to the market, because the market is always important to us as well.

So overall, we estimate the market performance, where we're down 4.6% excluding petrol, overall down 2.5% if you include petrol, we believe the industry performance is down around that level.

Clearly, within the industry the discounters are taking market share, and we estimate this -- of the 4.6% -- we estimate it, and you can all get your bar charts out and try and work this out; we've deliberately blurred the lines because these are estimates, but we do believe the -- and we see in our business performance the impact of the discounters. Clearly, when you've got a very large market share, you are likely to be more impacted by that.

We've also, as you know, cut back on untargeted promotions, and we estimate this, and this might help you in terms of the scale of this, at around 1.5% of the year-on-year impact of cutting back on untargeted promotions.

And then finally, we haven't performed as well as we should, and a number of our initiatives which we would have expected and hoped to land haven't landed and delivered what we would like. That is the 4.6%.

As I've said, we're a business which is operationally geared. Gearing works both ways. When you're increasing your sales you get a positive benefit. When your sales are falling, you get negative gearing. And the GBP499 million we've declared in terms of the trading profit is significantly down year on year.

Again, to give you some element of the scale, the sales impact is around GBP380 million. The net investment in offer and capability is just under GBP100 million. And we have a cost base which hasn't performed as efficiently as we would have liked, and the productivity loss that we get as that cost base is around GBP160 million, bringing us to GBP499 million for the year.

Getting into the other segments -- so that's the UK element of the business.

Asia. I think it's fair to say that in Asia, all three of our markets there have experienced difficulties. I'd like to call out the difference obviously between what we reported actual exchange rates and the constant currency exchange rate.

In-market constant currency is really important because that's what customers are seeing, but obviously, from a financial reporting segment, when you report in sterling, you potentially face headwinds in terms of your reported currency.

So if we look at the markets within the Korea and Thailand, impact that business, those are big markets there in Korea, the market as a whole continues to face challenges because of changes in the trading hour laws. And that's not specific to us alone; it's something which the market continues to exist.

Within Thailand, we've obviously seen political unrest in the Thai business in the course of this period, and we've also had a convenience sector which is increasingly competitive.

Malaysia is a smaller part of our business. In Malaysia, there have been some elements of against Western businesses in the half, and we've seen some challenges in that.

Overall, our like for like is down at the [4.1%]* on a constant-currency basis in this business, but you can see our trading margin has been impacted as well.

So some challenges in that region. We've got strong market positions and we've got strong businesses in our Asian business.

Turning to Europe, Europe really is two halves. Our Central European businesses have performed pretty well flat in terms of like-for-like sales. Overall though, we're down 1.8%, and that's primarily because of the Ireland business, which is a key part of our and a strong part of our overall European business.

Ireland continues to be a challenging market. Discounters are very active. There's a lot of competitive activity and we've seen high levels of couponing in that market; brings down the overall businesses. We do see in profit terms an increase year on year, and that's largely as a result of the impairment charge we took last year.

The Bank has performed very well. Tesco Bank trading profit over GBP100 million, up just under 16%. And our customer accounts here are up 14%. We've got a very strong deposit base. I've looked hard at the funding, and we've got a very strong deposit base and a core funding which is strong. We've got more than GBP1 billion of mortgage balances in that business, and mortgages are a key part of the success of the Bank.

We launched the personal account in June. That's going well. Again, it's an investment for the future in the Bank. It's a strong push into digital in the Bank. And our overall liquidity and capital ratios are strong.

This is one of the key elements where the Tesco brand resonates very strongly with customers, and what we've seen over the last four weeks is no impact at all from a customer perspective on the Bank, and neither have we seen any in the stores.

So despite the strength of the brand, despite what we see and feel in the financial markets, the customers continue to see us strongly and the customers continue to be with us.

In terms of cash flow, and this is the only change I've made in terms of the historical presentation. It may well evolve when we move forward into next year, but I felt it was important to talk about the cash and the way that I think -- I certainly think about it, and I'm sure that you do as well as investors and market participants within the business.

So we start with GBP1.25 billion of cash flow from operations. We have had a benefit from working capital in the year. We've also had GBP1 billion of CapEx. This is net of a small element of disposal proceeds. And then we've invested in Sociomantic, around GBP70 million. And we've also disposed of our China business, and there was some cash within that acquisitions and disposals.

So this is a slightly masked element by essentially around GBP70 million cash investment, and then some cash moving out of the net debt as we disposed of the China business.

We also have invested in some of our JVs and associates. That's around GBP270 million, and we pay interest and tax.

And finally, the cash element of the dividends we've paid in the period are just under GBP800 million.

* Amended from 9.2% after delivery at the company's request

Part of the China business we disposed of, and we had some debt which moved off. Overall, our cash balances and net debt, therefore, are just under GBP900 million adverse movement on the period.

I will take questions on this, but this is something which I think is important for us to look at; what cash are we generating and then where we're spending that cash, and then linking it back to the overall debt.

CapEx. Again, an area where we will be disciplined going forward. We can see here that the CapEx has been historically very high. In the current year, we're confirming that it will be no more than GBP2.1 billion. And again, we will, as part of the investment and the strategy, we'll look at where we need to invest in order to grow the business, but we'll do that in a disciplined way.

We announced on August 29 that we intended to cut the dividend, and Richard has talked about that. We've confirmed today that the interim dividend will be at the 1.16p per share, and this is in a key part of our conserving capital in order to build on the business.

Our leverage is too high. When we look at the business and we look at what it is, it's clear to us that our leverage is too high. We've got around GBP7.5 billion of net debt on the balance sheet. When we look at it from an operating lease and commitments, we've got about GBP9.5 billion of -- and that's a discounted view of the operating lease commitments. Dave will come on and talk about this as well. And then we've also got our pension deficit.

This is an IAS 19 number, and the one thing I would say about pension deficits is that what's important to me is the cash that we're committed to funding that pension deficit and the agreement we have with the trustees gives to me predictability on cash flow; that's what I would be seeking; and equally to you as investors, predictability on cash flow.

We are going through a tri-annual valuation; I've already met with the trustees. And we will come back on that. It will be many months before we finish that valuation. It's obviously a long and complex actuarial calculation. But the key thing is that we're trying to get predictability on cash flows such that the trustees and we can plan looking ahead in terms of the commitment.

The other thing I'd say about the pension deficit is that the way that IAS 19 accounts for pension deficits is very strongly linked to your investment strategy on the asset side. The liabilities are determined by reference to the bond markets, and that's a very strict calculation. Your asset performance can, depending on your asset investment strategy, make this move very, very strongly, and we've seen that over the years. It doesn't reflect the cash flows, but clearly, it's some measure of the future commitment of what is a very immature scheme.

Investment grade credit rating is where we are. Clearly, we have seen some downgrade on our investment grade rating. Today we're at BBB or equivalent, depending which agency's metric you use, and we will look at that as we go forward.

And then finally, and importantly, what I looked at and what Dave looked at very clearly when we came in, was the funding and liquidity profile. And we have a strong funding and we have a good liquidity when we look forward.

I know that that's an area where even earlier on today I had some questions, but I can assure you that we have looked very deeply at this, and we have strong funding and we have a good liquidity profile going forward.

That's it in terms of the half-year review. As we've said, happy to take questions, and I'll hand back to Dave and hopefully not drop the baton.

Dave Lewis - ***Tesco PLC - CEO***

Okay. So looking to the future. I said at the start that I would share with you three immediate priorities facing myself, the team and the Group. And those three outlined in the statement are recovering the competitiveness of the UK core business, protecting and strengthening the balance sheet, and rebuilding some trust and transparency. Let me talk about those before I get into the detail.

The UK is a little more than two-thirds of the sales and profitability of the Group. As you saw from the results that Alan presented, if we struggle in the UK, it has a dramatic impact on the Group. And therefore, the fact that the UK is where I've spent most of my time in the seven weeks is right. It's also being really clear the number 1 priority for the attentions of the Group going forward.

Alan's talked about the leverage in the balance sheet and I'll talk some more about that also in a second. The critical thing for us is that we will review that as we review the strategy. The important thing is the strategic review that goes alongside the balance sheet review. So we'll make the strategic calls, but we also know that we need to make sure that the balance sheet aligns with, and the choices that we take align with that strategic choice.

And finally, I'll talk about what it means to rebuild trust in a brand and a business.

So let me start. Now the UK, and this actually the presentation I was going to share with you on October 1; this part of the presentation I was going to share then. I'll share it with you now because actually, when I look at the UK core, a lot of people, and some of you in the room would be amongst them, have spent a lot of time sharing with me their perspectives on why the UK core is not as competitive as it might be. And I genuinely do welcome that and please keep them coming.

I suppose I do have to say to you very simply, the good thing is as you see problems, I see opportunities. As you've show to me deficiencies in the business where I sit is it's just an opportunity to improve. And what I'm going to do now is I'm going to talk to you about four of a range of opportunities that I see when I look at the UK core after those seven weeks. And that's going to be -- I'm going to talk to you a little bit about stores. I'm going to talk to you about the team. I'm going to you about the cost base. I'm going to talk to you about the brand.

In store. Now one of the things I'd like to register with you, if we haven't so far, when I look at the UK business, have a guess how much of our turnover relies on a store to facilitate it. There's the obvious part of just shopping the store as normal, but then when you look at the dot-com picking that happens in store and then you factor in what is click and collect, of which 70% is collected in store, actually, more than 90% of our turnover in the UK requires a store to facilitate it happening. So stores, with all of the channel development, stores are a hugely important part of our business model.

So when I talk about the sea of opportunity in terms of improving in store, what do I mean? So I look at -- two things you should know, two facts that I'd like to share with you because they have a big impact in terms of how a store would run.

Over the last 12 to 18 months, the range in our stores has increased by 31%. That's a massive increase in range. At the same time, in terms of how we run the operational model, those who are familiar with it, we have a payroll indices, PI as people will know it, which looks at whether the manning in store is as optimal as it might be, and it's fair to say that over the last 12 months we've been running that PI at more than 115 on average. That means we're putting a lot of pressure into the store, especially against an increased range. So the combination of range and pressure in terms of number of colleagues and people facing are features that we need to recognize.

And those two things have also -- the other thing you need to recognize is that our stockholding over the last three years has increased by about 7.5% when the Group's growth in the same period has been about 2.5%. So when I look at the operational model that's happening in store, I see, yes, some problems, but I see therefore some opportunities to improve.

And I put those opportunities in three buckets, and deliberately so. The first of those is service. A number of people have talked to me, and I said I'd met a lot of people in those seven weeks. In the first week in the job I met more than 3,000 colleagues and I got more than 2,000 emails, all of which I read one Sunday.

One of the bits, the strong bits of feedback is, actually, people notice that we didn't have enough colleagues in-store. So we've made two significant investments in service. So in the numbers that you see, we've made a provision to put more colleague hours in store. Very simply, we'll put 2 million more store colleague hours in store between now and the end of the year. It's not everything I'd like to do; I would like to do more. But it's definitely a step in the right direction. If you talk to my stores now, they're talking about recruiting and filling out colleagues, people in store.

The other thing you should know is, and some of you may have felt it, is something we call feet on the floor. So we have -- in the head offices in the UK, we have a significant number of people. And what I've chosen to do for two reasons, one to help the service, but also dare I say it, to help us reconnect with that customer-facing expertise that Tesco has, is that every two weeks, everybody in our head office will spend a day in store. Between now and the end of the year, so completely and consistently until the end of the year, we'll go and work as a colleague in a team, in a store, every other week.

So 10% of their time, 10% of everybody's time in the head office is going to be faced in store. You can ask my exec team what their experiences have been like, but to give you an idea of that, that means last Friday, 2,500 colleagues from head office were in 610 stores working eight hours, as part of the team.

That helps me. That's 20,000 more customer-facing hours in one day to get the service right, given the operational leverage that I talked about in our model. That's that.

The other big benefit is, and if you come back to it is, the energy and the excitement and the conversation that's going on in the business about how it is we can improve for customers, unbelievable; absolutely unbelievable.

The great thing about Tesco is most of the people that sit in head office have a lot of store experience. And actually, by getting back and re-engaging, people come. And they give you such brilliant ideas about how it is we can improve, and they experience a little bit more what the impact is of centrally-made decisions on the store operation. And I want that feel of the market back into our business.

So service, an opportunity for us to improve the service that we give in-store definitely exists. We're able of giving more service and we will.

The other is about availability. And for those of you who are very close to the operating model, if you take what I just talked to you about in terms of range and I talked to you about stockholding, one of the downsides of that is that you end up not giving enough space to the lines which sell the most volume. It's just as simple as that. And s a result, you can then find yourself in a situation where the availability isn't what you would want it to be at the most peak time of shopping.

Three things; we've done three things in that area. Now again, most of you will be familiar that we change ranges on a systematic basis, and one of the things I'm most careful of at this point in time is I don't want to make an intervention that somehow affects the operating model of Tesco as we walk into the very important Christmas period. So we're not going to make any sharp movements here; we're going to make some surgical interventions.

So a couple of things we've done. We've identified the 1,000 most demanded lines, and we've taken an intervention which between now and week 38 will just force the increase in space available for those key lines. And then as the normal range review cycle happens, we'll make that a systematic change in that particular range. So that's one. So we'll make sure that those most important lines desperately always available.

Second thing we'll do as part of that overall simplification is change or add a new availability measure. So again, some of you are close to this. You've talked to me about this as I've gone through. At the moment, Tesco quite rightly, we take a dot-com read on availability. Right? So I have availability every day based on the literally millions of deliveries that we make as part of the dot-com business. It's a good and very important measure, particularly for dot-com; so no problem whatsoever.

The issue for me though is that that measure is availability just after we've filled overnight, and it measures availability when I've got expert pickers who are doing the looking for the produce in store.

Actually, what I want and what will happen next week, is an automatic, sales-based availability model which tells me at 5 o'clock on a Thursday afternoon what the availability is. So we've put in a new measure that means I track the availability at the sales peak, and then I'll adjust the range and the space according to that.

So that's a completely new measure against availability, because I'm interested in what the availability is at the peak and not at 9 o'clock in the morning when I'm picking dot-com. Important for dot-com, but not for the measure that I want to guide the business by going forward.

And finally in terms of availability, we will look at a number of measures that are around simplifying the range. Right? Very significant simplification of the range which is available to us. And so we will roll that in as we're able to.

Now everybody talks to me -- when I talk about in store, everybody talks to me about price. And I get it and I understand it. I suppose the thing that I would say to you is already at Tesco, we invest a huge amount in price investment.

Now we invest it in a variety of ways. There's a high promotional count, there's a lot of indirect price investment; and let's face it, there's an awful lot of price volatility in the marketplace.

So price is something that I have under review, seriously have under review. I have a number of tests, a number of thoughts. But it's also a place where I need to be very careful. The numbers are significant, so actively under review.

The thing I would say to you is that doing something on price when you haven't got the service and the availability to be perfect might not be the optimal way you would want me to run the business. So my priority is to drive up the service, and I've told you what I'm doing; to increase the availability of key things at key times, and that's what we're doing. And then we'll review pricing and we'll decide whether we need to adjust pricing at any point against that opportunity. It will come back to strategy, but you need to know that there's opportunity in store in the way that I said.

The second area of opportunity is in team. And what do I mean? I told you at the start why it is I joined Tesco and what it is I've experienced at Tesco. Tesco has, and I say this from the outset, now even more when I sit inside the team, is there's deep expertise in Tesco. No question, when I was in my other job, the best retail expertise in the world existed within Tesco, and it's deep, deep, deep.

I didn't pick by accident a picture of the lady picking for dot-com. This is one, just one example of what made Tesco brilliant. This is a small test that happened with a couple of handhelds, a couple of trolleys and work through a picking model. From there, built organically, completely in house to, without doubt -- and I've checked this with everybody -- without doubt, the best in-store picking model you'll find anywhere in the world. And if you don't believe me, I have with Mike a whole series of retailers who want to buy the IP from us elsewhere in the world because they recognize just how good it is. So that deep expertise exists in every bit of the Tesco business.

Having said that though, with deep expertise sometimes, and it serves you well, is that sometimes you miss some of the opportunity that goes horizontally in an organization. And the simplest example that I can give you of this one, but just to illustrate what I mean about opportunity, is signage. So I can't believe I'm going to talk to the investment community about signage.

I walk the store like you walk the store. I walked the store before I came. I walk the store a lot now I'm here. And the one thing that I couldn't quite understand was the number of messages we had. Right? As a marketer, if you like, I walk through and I look at all of the navigation we give and all of the things, and I ask myself how does it work. Right? How does it work? How does a customer digest and react to that? Because there are a number of different messages. So you tell me that. I see it, and we --

Do you know why? It's a really simple reason why. Because actually, because of our individual vertical expertise, if it's in Tesco, if it's touching the building, property decide because that's where the expertise is. If it touches the category, commercial decide on the shelf. If it's on the floor, marketing decide. Right? Because that's where the expert -- individual expertise is.

It's completely understandable given the way the business was before. The really simple opportunity is for me to put that together so that somebody is overseeing the look and the feel and the overall proposition of Tesco in store. That's what I mean when I talk about taking -- keeping the expertise, but applying a team perspective about how 1 and 1 can equal 3.

I think there's an opportunity to simplify. I think I can say, having spent 27 years in Unilever which must be the mother and father of all matrix organizations, that when I look -- that I do know how to run a matrix. And it is fair to say to my predecessors, the top of this business was built thinking about what the west coast of North America to Japan looks like. Actually, when I look at it now, there's an opportunity for me to simplify that hugely.

So I can see a lot of opportunity where I can simplify the top of the organization, the matrix that exists there, in order to put more time back into a customer-facing strategy.

And the final thing I talked about in terms of team is the opportunity for synergy. I did think of giving you a quiz as to what the 32 related to. In the interests of time, I won't.

One of the things that Tesco has done extremely well over time is it's bought businesses and acquired things. It keeps everything very focused. There are dedicated business units. And there's been a time -- and when you're growing quickly that's a very good way to run a business, so absolutely no critique.

I suppose when the market is different and times are different, someone like me comes in and reflects on the fact that we have 32 different head offices in the UK today. Might not be the best model going forward; might be an opportunity where I can get some of that team to work together to use our scale and our expertise a different way. And so I see an opportunity for us to release value and to increase speed by looking for some of the synergy across the team.

Third area is cost, and again, an opportunity in cost. What do I mean by that? If you talk to my team, I suspect they will say to you that one of the things that they would have experienced over the last seven weeks is I talk an awful lot about the customer, letting the customer decide. Part of that comes into letting her decide, or at least letting them decide and have a perspective on the costs that we incur or the investments we make.

So when people ask me about things, we refer to here; if I were to tell you that the all-in National Insurance, everything paid, fully-contributed cost of a colleague in a store is a little more than GBP10 for Tesco.

So what I do for myself, and I'll give you some personal examples in a second, but also for the team is, I look at all the activity and say would we rather spend our money on there, or convert it into colleague hours in store, and ask me whether it's better for the business to put the colleague hours in store or to spend that money in that way.

So when people have asked me in the seven weeks about things that quite frankly I didn't know the history to and am not familiar with the content, my answer to everybody has been the same, which is: Do me a favor; ask yourself if the customer knew that you were going to do that activity, or you were going to run that event, or you were going to do -- would she or he understand that that was the right thing for you to do given what it is you're trying to do for her? And if the answer is, no, don't do it. As simple as that.

Now we need to lead. It's a very different way of looking at it. So what I've been doing with my team is giving some personal examples about how it is I can look at cost in a different way. Corporate planes is one example of that. A decision made in the first week of my being in Tesco to not use the benefit of private planes because I think I can do the job without them. And I can take the money that we spend there and invest it in customer service hours through colleagues in a more efficient way. It's a decision that I take.

It's the very same way -- if you talk to some of the people in Tesco, they remark, I think, about how surprised they are when I bump into them on the train while going from Cheshunt into London of an evening when I have a function. But the decision for me to take the train rather than take the car basically puts one colleague in store for a day.

So if I can plan myself better, so that I don't have to be working and, therefore, I can sit on the train and do something that's not confidential, I look at it that way. And I'm encouraging everybody in our business to be looking at it that way.

So we don't have the colleagues' hours in store that I would want. We've made some investment. It's not enough. But everything that we can do in terms of costs can be reinvested in this way. And so this customer-focused cost thinking is an opportunity that I see within Tesco.

The second opportunity in terms of cost is also significant, and what I've shown you here is what the overhead percentage is. So if you're me, you come in. What Alan and I have been doing is we're looking an end-to-end review of all costs in the business. We've just shared with you profitability. You wouldn't be surprised we've done it absolute end to end, or continued to do it end to end.

Now in fairness, we built an overhead, we built a Group which was about a business which was much more international than we now are. We take some decisions, or Richard and the Board have taken some decisions that mean that that's not the case.

So it's understandable that that Group grew, but now I have to be realistic about where it is, because the increase of Group -- if you take it either at Group from 0.9% to 1.2%, or from 1.3% to 1.9% if you take the UK, that's a significant increase in overhead.

So the opportunity for me to think about how I might streamline and simplify the Group against the strategy that I write going forward is an opportunity for us to reinvest back in the business. So I see some opportunity for cost there.

I also see an opportunity -- the other side of the synergy I mentioned is there's an opportunity for us to leverage our scale more. So the fact that we -- and I can give you a number of examples but the fact that we don't leverage our buying ability in one stop with our Express business is an area of opportunity.

It was perfectly okay to keep them completely dedicated, and we would want them to be dedicated given the customers that they serve. But there is an opportunity for us to leverage our scale in some of the areas at the back of the operation, and I will be looking for those as well.

So big part of where we need to be in terms of cost, and the thing I would emphasize is customer-focused cost culture.

Finally, the opportunity in the brand, and for those who are interested in marketing in the room, I've tried to simplify a whole lot of marketing thoughts onto one chart.

If you look at scale, large brands, and whether they have empathy. You can use empathy, you can use engagement, but it's something around the proximity and the warmth with which.

Not a precise science, but I think it would be fair to say that nobody questions the scale of the Tesco brand, the reach. I've talked about it. It's quite phenomenal. When you look at the reach of the brand, no other brand in the UK has the reach that Tesco has; none, neither the reach nor the frequency that Tesco has. But it would be fair to say that at the moment, there's not an empathetic engagement with the brand by everyone.

By the way, vocal minority, but actually, a huge number of people are really quite happy with the Tesco brand, but in terms of empathy, there is definitely an opportunity for us to improve.

Now those who study brands know this doesn't happen overnight. Those who study brands will also understand that this is not about an advertising campaign and it's not about some PR. You move a brand through action.

So what we have to do is we have to behave in a way -- people have to experience the brand in a way which allows them to reappraise the brand. Brands are like people. Right? You become warm towards people based on your experience of that person and how it is they behave. And that's the secret for re-energizing, reinvigorating, reconnecting with the Tesco brand. So it is a big opportunity. It's not the only opportunity but it is a big opportunity.

So the second of the priorities. I'll come to the protecting and strengthening the balance sheet. And Alan's talked about this. The leverage in our balance sheet is visible to all of us and we face into that very deliberately; GBP21 billion if you take everything.

In terms of property, it's worth just pausing a second on property. There was, strategically and significantly, a very deliberate decision taken a long time ago on sale and leaseback. And it's been a very big funder of the growth of the Group over the period, but we're now at a point where our freehold property is around 53%. And I have a rent bill -- we have a rent bill of around GBP1.4 billion a year.

Now when you look at the total cash flow of the Company, that's a significant part. So as I think about strategic options, thinking about not just the leverage but also the property position, a key and important consideration.

Secondly, as part of that, and Alan touched on it, we also need to recognize with the pension fund the deficit which is there, but also the fact the fund is immature; and we need to make sure that we've got a sustainable model for the pension fund within Tesco.

Having said that, where do I see the opportunities? Where do we see the opportunities? And a conversation that Alan and I have a lot, we will have an awful lot more.

The first of those is around discipline, and those who have followed my career and Alan's career know I've always valued as a businessman good, strong, commercial discipline around capital. So that would be any time. Especially where we are now, it needs to be doubly so.

So there's an awful lot that we can do about making sure that all the returns that we get for the capital we invest are accretive to the business. Right? Very, very strong discipline required.

The second thing is in terms of portfolio, and you read the speculation just like I do. The critical thing I would say to you about the portfolio is it will be a strategic review. We'll look at the opportunities that exist to release value from within the portfolio consistent with the strategy that we write. Okay?

So I hear the speculation, I hear the invitations, I hear the suggestions for advice. It will be a strategic process that Alan and I review. But we will have a full review; a full review exactly as the Chairman had said.

And I put other with a question mark because I thought I'd face into the question on everybody's lips which is around equity. And everybody asks me about equity given the situation with the balance sheet, so let me share with you the following.

Alan and I will keep, yes, all options open to us. You never, ever say never. So we will continue to keep all options open to us. The thing you should know is that we think that there is significant opportunity for us to extract value from the business that we have, either from the self help I talked around in terms of cost, or dare I say it, when we review the portfolio against whatever strategy we finally decide. And we will go there. We will go there first before we look at other opportunities.

So what I would say as my last point is I'm going to take the speculation and just be really clear with you, we are not working on a rights issue today. Right? Never say never. We're not working on a rights issue today. We're going to work on how it is we extract more value from the business we have. We think that's the right thing to be doing for shareholders at this point.

Finally, trust and transparency, and I talk about trust and transparency in the brand, and I talk about it in the business.

Talked about the brand, talked about the sentiment and whether it's a positive or negative sentiment. And there's clearly an opportunity for me to improve. I talked a little bit about it. This is definitely around our actions, not our words. Actions speak so loudly people don't hear what you say. That's exactly how brands need to behave. And there's a big opportunity.

I'll tell you a little story, if I may. I spent three hours in a store on Friday afternoon with a lady who some of you may know. She has a blogger title called the Complaining Cow. She -- no, it's really important because some of your harshest critics are where you learn the most. And she's written a book and her book was inspired by some service or poor service that she got from Tesco.

So I sat down with her for three hours. She had got her many thousands of people who complained to her about Tesco to give her all the answers. So I sat with her in a store in Hertfordshire and went through all the issues she can see as a Tesco customer.

The really interesting thing -- she knows a lot about Tesco, and she's really very, very, very precise -- she had no idea; when I told her about farm to fork, when I talked to her about food waste, when I talked to her about the education program and the free meals and the things that we're doing around our stores, she had no idea; no idea.

So in three hours, she walked away with lots of examples about how the brand was doing exactly what she would want it to do but we hadn't for whatever reason been able to communicate to somebody who is probably one of the most engaged customers that we have.

So actually, there's a lot to do about the brand but there's an awful lot of good things going on in Tesco that we just have not communicated effectively enough. So big opportunity for us.

I think it's also fair, and I put them here deliberately, about the ways of working. Significant, given what's happened recently, and in fairness to my colleagues in Tesco there's already and there was already a review of the code of business conduct ongoing. It's to be launched at the end of this year anyway. It's a wonderful opportunity for us to re-emphasize exactly how it is we would want to behave as a business.

So a chance. It has been a crisis for us, but it's also an opportunity to be catalytic in terms of a change in culture in the ways that we work.

So what Alan and I and the team have done is we've gone back, as an example, given the issue and commercial income, is we have rewritten the rules. We've made it really clear for our people about how it is we want them to use their judgment around commercial income, and we've retrained them so that we don't leave anything to question. We will do that across our business.

And in the same way, and the final way, and I hope this will bring a smile to your faces, Alan and I both recognized in coming to Tesco, that -- and I thought it was just me, but when he reinforced it I felt much better about it which was when I read the report and accounts of Tesco, or some of the information, finding out and getting to the real investment case was a little hard. I found it a little hard, Alan found it a little hard, and a few of you have told me you found it a little hard too.

So actually, what we want to do, as we -- I suppose our commitment to you is as we set the strategy against the investment case that we make, we will change, as Alan intimated, the way that we report around that so that you can track, like we would, exactly how we're doing against the investment case that we make.

So the whole thought about being -- building trust and transparency into the business is everywhere; in the brand, in the ways that we work, and in the investment case that we share with you and everybody who invests in our business.

So it all comes back to the customer, and in wrapping up, let me share with you the following.

It's been a difficult time. There's an awful lot of challenges for Tesco, that's for sure. We're not naive about that but we are prepared to face into them objectively and deal with them as decisively as we can. And I hope the way that we've dealt with the accounting issue gives you some indication of how it is Alan and I would want to lead and how the Executive team would want to lead Tesco going forward.

Despite our problems, we have a significant opportunity. This is a great brand, a great business, with a lot of the structural strategic advantages. We will re-find our DNA, and the DNA of this business is about being champions for customers, letting the customer decide does he or she appreciate what it is we do.

The important thing for us is we need to change some of the behavior around how it is we engage with those customers and everybody who helps us, everybody who helps us give customers that service. And remember, you can't talk your way out of things you've behaved yourself into, so we need to lead that in the things that we do. There's a huge opportunity.

And I'll leave you with a final thought. This is the conversation that I have with my team every day since the first time I can in because the passion, the expertise that exists, the resilience which exists within Tesco is quite incredible.

And the thought is this. There are 320,000 of us in the UK, and if 320,000 of us every day just give to one customer, just one on one, one customer to walk away from Tesco with an experience that was better than they expected such that they become more an advocate for what it is we do, that's 2 million people a week, you can turn a brand if you're giving that sort of experience, because reach and frequency is the key and we have something very significant to offer.

QUESTION AND ANSWER

Dave Lewis - ***Tesco PLC - CEO***

So with that, we'll take your questions. Would you do me a favor? So for everybody, give us your name and where you're from, just so we know.

Stuart Price - ***JPMorgan Asset Management - Analyst***

Stuart Price, JPMorgan Asset Management. At the beginning, your Chairman spoke about the importance of integrity, responsibility and accountability. Maybe this is drawing up old history, but why was the --? Why do you feel the payout to the previous CEO is appropriate? That's question 1.

Dave Lewis - ***Tesco PLC - CEO***

You're going to take that, or do you want me to?

Richard Broadbent - ***Tesco PLC - Chairman***

I think what we should share is that we do not propose to make that payout as of this moment. We have suspended it. We've not decided not to make it. We have simply suspended it while the investigation is ongoing.

Stuart Price - ***JPMorgan Asset Management - Analyst***

Second question is to do with the dividend. I understand what you're trying to do in preserving cash. There's been no comment, as far as I can see, about what you're doing for the full-year dividend and then beyond. What is the policy?

Dave Lewis - ***Tesco PLC - CEO***

There's been no comment because we'll make a decision on the final dividend when we get to the end of the year. Right? So we've made a decision on the interim dividend and we've clearly communicated that. But, Alan, unless you want to add something, we'll make a decision on the final dividend when we get to the appropriate time in terms of full year.

Alan Stewart - ***Tesco PLC - CFO***

All I would say to add to that is I think that that's wholly consistent with the way that companies look at things. Clearly, we're in a period of change. That change is happening today. We will get there. And going forward, once we get to dividends and we communicate, I understand the question of predictability; it's an important one. But right now, we're in a period of change and therefore we will get there.

Edouard Aubin - ***Morgan Stanley - Analyst***

Edouard Aubin, Morgan Stanley. Over the past 20 years, Tesco has made the hypermarket format its main growth vehicle. I think in the UK it's around 40% of your selling space; close to 80% outside the UK. Some believe that the format is facing some structural challenges, so if we could have your views on this.

Dave Lewis - ***Tesco PLC - CEO***

It's a fair and it's a very pertinent question. I suppose my perspective coming in and looking, if I look at the -- that format in Tesco, and forgive me my comments now are mainly UK for the reasons that I've said, two-thirds of that portfolio you would die for. You would absolutely die for. I look at it and I look at its investment, return, growth profile. So actually, in two-thirds of the estate of the hypermarkets we have, really very healthy business.

The interesting thing is there are some of our outlets that are struggling, and that's what impacts the number in the way you say. I suppose what I've seen -- what I've seen so far tells me that, actually, we shouldn't treat them as if they're all equal.

And actually, a true hypermarket needs to think about the catchment that it serves, both in terms of demographic, both in terms of financial capability, and be prepared to adjust. So actually, I start from a place that says it's not about whether the format's dead, it's about whether the format for those people that it serves is attractive enough to warrant them to make the journey and the investment incoming.

So actually, I've seen lots of examples. And I've seen some just recently in Tesco, and I've looked at some from elsewhere, where I can see that you can make them attractive destinations again, and actually, therefore, I don't start from a place that says they're all dead. I understand that they need to be more competitive in some areas than they currently are, and that's one of the reviews that Alan and I and the team will undertake.

Bruce Hubbard *- Odey Asset Management - Analyst*

Bruce Hubbard, Odey Asset Management. If I may, two questions, neither for you. The first is page 21 for Alan. You dropped [GBP600 million] or so sales in the UK; dropped GBP350 million profit in terms of sales impact. I don't quite understand that. At a normal marginal contribution, you'd probably drop about GBP150 million of profit. What's the rest, because your other categories has cost inflation and has net investment in price in it? It seems as if there's a very large gross margin movement in there.

Alan Stewart *- Tesco PLC - CFO*

Bruce, could I come back and ask you --? I'm sorry. It's a very detailed question. I will come back and ask it, and if it's important, we will then make sure that we post the answer to that question.

Bruce Hubbard *- Odey Asset Management - Analyst*

Thank you very much. And a question for the Chairman. Long before the GBP263 million, Tesco had comprehensively lost the trust of the investor community on accounting. This has been written about repeatedly. Can you reinsure [sic] investors that Alan Stewart will review all accounting policies, including for starters depreciation, interest and cost capitalization? And in particular, can you absolutely guarantee to the shareholders in the room that there has been no divergence between the economic form and the economic substance of your sale and leasebacks?

Richard Broadbent *- Tesco PLC - Chairman*

As I said when Alan and Dave came on board, there is nothing that they are fettered or prevented from doing. That was one of the first principles the Board set when they decided to replace the entire management team. I'm not going to give you an undertaking of what they will do, but it is very clear the Boards' point of view that they're not fettered. We want them to do whatever they feel they have to do to take this business forward.

Bruce Hubbard *- Odey Asset Management - Analyst*

And are you confident there has been no divergence between the economic form and the economic substance of your sale and leaseback transactions?

Richard Broadbent *- Tesco PLC - Chairman*

That is a technical question which I'd have to say I'd need to understand before I gave you an answer. I'm not quite sure what you're driving at. I'm certainly not aware of any problem, but if you want to articulate to me privately after the meeting the problem you're trying to elucidate, I'll try and answer you.

Bruce Hubbard *- Odey Asset Management - Analyst*

Okay. Thank you.

Nik Stanojevic – *Brewin Dolphin*

(Inaudible), Brewin Dolphin. I just wondered. Do you think you can --? Do you think you might be able to serve your customers just as well with a lower range of products? And if so, do you think that there is a significant cost opportunity in doing so?

Dave Lewis - *Tesco PLC - CEO*

I think -- so it's a good question. I think what I was alluding to when I talked about the 31% extension in range and the impact on availability that there clearly is a need for us to make sure that we serve our customers better with the products that they want every day.

So the opportunity then to do that and to simplify what it is I do as an operation behind that against the cost opportunity, I definitely believe that there's an opportunity there for us.

Bruno Monteyne - *Sanford C. Bernstein & Co., LLC - Analyst*

Bruno Monteyne, Sanford Bernstein. I have three questions, please. One is you mentioned a Tesco DNA about being champion for customers and the listening you've done in the first few weeks. Would you be able to summarize the one, two, three biggest things you feel customers think you've let them down for, or your predecessors have let them down for?

The second one is the role of the UK CEO. In the past, Tesco didn't have a UK CEO, only a corporate CEO. Given how close you are to fixing Tesco, does it really make sense to have a UK CEO in between you and the operations?

And the third question is around the stock write-down that you have in the exceptionals. GBP63 million, it's a very big number. It's clearly not the usual [shrink], but that would sit in another line. Is it another form of accounting irregularities that the shrink was understated so you need to correct it there, or --? Normally, you would write down stock if you have new strategy, but you don't have a new strategy yet (inaudible).

Dave Lewis - *Tesco PLC - CEO*

I'll let Alan -- why don't I let Alan take the stock and I'll pick the first two, if that's okay.

Bruno Monteyne - *Sanford C. Bernstein & Co., LLC - Analyst*

Thank you.

Dave Lewis - *Tesco PLC – CEO*

So, look, I don't think it's for me to go into the history of what it is may or may not have disappointed customers around Tesco. What I do is I look at our relationship with them today. And I'm very open and very objective about where it is today and there's a reservoir of really goodwill.

The really interesting thing, I know it's not a convenience sometimes for others is that actually, when you engage with a lot of people, there's a lot of people that want Tesco to do well. They remember a Tesco that did actually do things for them that nobody else did.

And the best -- and you know this. The best way of illustrating that is you don't go from being 10% of the market to being 30% of the market by not delighting customers. And the team that did that was a remarkable success story; one of the best British success stories ever.

Now the interesting thing is where do we stand today; and today, what they say is they want to know a little bit more about what we stand for. I think one of the impacts on a proliferation of ranges, sometimes, the message is not clearer.

I talked about signage as a simple example. People don't always get it. And so actually, I think they want us to be a little bit clearer, a little bit more straightforward. I think they want us to react a little bit to the fact that their lives have changed and that, actually, their relationship with us changes. And everybody talks about that in a multichannel way, and I get it. We need to do that. And to be honest, I think we do that really quite well.

So clarity of proposition, consistency of execution, and being prepared to openly engage on the issues that they see. That's what they want from us, and we can do that. You take a luster off a brand if you behave in a way which is inconsistent with what people expect. And actually, the opportunity for us is if I can get the business to be always doing it in the way that a customer expects, I'll be fine. And the business will be even better.

To the second question, I get it about whether you need a UK CEO and a Group CEO. I have to tell you that we've reviewed it and I'll look at the structure. That will be part of the review that I do.

Sitting where I do, I think the operational intensity of the UK business is such that it will keep anybody fully, fully, fully occupied. I think what I would say to you is as a Group, given the strategy review, given the optionality and given some of the other issues we face, having somebody who sits back and looks at the totality objectively about the investment return, is a better model for shareholders, is a better model for customers, is a better model for the business.

So I actually think it's better having somebody dedicated to the UK and somebody who is stewarding the Group.

Do you want to mention stock?

Alan Stewart - ***Tesco PLC - CFO***

In terms of stock, I'm going to give you two perspectives to the answer. The first one is the specific question you asked, Bruno, which is the stock write-off is a judgment and it's made based at the half year on what's there. It's an accounting entry and it's the right entry on the judgment of what the right level of provision is.

I wasn't around. I can't go back. But it's the right judgment and it's been appropriately accounted for.

I think the more important question behind stock is, actually, what's the purpose of a stock provision that we're making. The purpose is in order to reflect what we're going to achieve from selling that product. And if you have product which isn't selling as well as you would have liked, then you provide for it.

But having provided for it, from a customer perspective, you actually have to get that stock away from the floor and you have to get the shelves filled such that you can give them products which they want. And that's, I think, an important part of the business operation and the linkage of the accounting provisions into what the customer sees and what we sell.

And I think if you go around some of our stores, and if you go around -- and I've been around them -- if you look at what's there, it's not always clear that provisions are matching what actually the customer is experiencing. So having made the provision, we now have the flexibility actually to get that stock cleared such that we can replenish with what the customer wants.

So we've made the right judgment. We've done it correctly. And going forward, we have to ensure when we make provisions that we actually give the customer the flexibility and the business the flexibility to stock what that provision is intended to achieve.

John Kershaw - ***Exane BNP Paribas - Analyst***

John Kershaw, Exane. Three for me. First of all, to the extent you can, Tesco, as you say, scale business; 30% market share or so, but apparently only making a couple of percent margin and you need to invest more.

I suppose coming back to the first question, really, can this business go into losses, because you say you need to do more? And the corollary of that is, actually, have you invested more? In the first half, you talked of providing for staff in the second half 2 million extra hours. Has that gone into the first half to suppress the number to give us a sense of where the business is; more of a sense of an underlying profitability?

Second, how do you gain trust? Does 40% promotional intensity gain trust? Or is there something structural that needs to address that?

And perhaps give us your initial thinking on synergies within the Group. You've talked about operational cost savings, but the broader, global Group synergy.

Dave Lewis *- Tesco PLC - CEO*

I think the -- okay. I'll try -- actually, I think the answer to the first two is actually the same, which is I see an awful lot of opportunity for us to reduce and release costs that I can reinvest back in the business. I do. Okay? I also see that we make investments in other parts, be it promotions and the intensity you talk about, or some of the activity that we run that I might be able to redirect in a different way.

So actually, what I'm going to be doing, and what I was trying to say is I'm very deliberately going to be looking at the business model as it exists today and think about how it is I can redirect the money that's already there in a way which is much more effective. And that's the part of reviewing strategy that I mentioned, and clearly, price would be part of that.

To your point, the assumptions that we've made about investing in colleagues is in the second half of the year. There was nothing in the first half of the year. That's a decision we make which is we need to.

So what you need to appreciate is that in this business going forward, we're going to make sure the store is perfect. We're going to make sure that the store is perfect with colleagues, with range, with service, with availability. And then we're going to adjust and look at all the cost and the way of servicing that store through the lens of whether it helps the store or not. And that's the lens I'll look at. Right? And that will have an impact in terms of where it is I choose to take costs or I choose to take costs out.

The final point, in terms of the Group, do me a favor. Give me a call in December. I'll have gone and visited the Asian business. Alan and I are off for 10 days next week. And then we'll go through Central and Eastern Europe. One of the questions I have is how the Group works and where the synergy is. So it's a great question, but I think I'll wait until I've seen the other two-thirds of the operation before I try and answer, if you don't mind.

John Kershaw *- Exane BNP Paribas - Analyst*

If I may just come back. That sounds like investment before cost reduction. Is that the clear message?

Dave Lewis *- Tesco PLC - CEO*

It's not about -- it's not a clear message in that sense. I think what I'm saying in the last bit is I'm not going to make a comment about what the synergies might be, which was where your question was between the Group, when actually, I've spent all of my time in one part and not gone and visited Korea and the other businesses. So I wouldn't put the cart before the horse.

Mike Dennis *- Cantor Fitzgerald - Analyst*

Mike Dennis, Cantor Fitzgerald. I've got several questions; first of all, the FCA investigation. Is that the end of it now you've written the GBP70 million in the historical figures off, or are we expecting them to come back and say those figures could differ via their investigation? And when are you expecting that investigation to complete?

And the other thing is you put on that nice chart the 1.9% head office costs. Am I right in thinking that you're saying that your head office is over-costed by GBP250 million, just looking at the UK sales figure, a rough estimate?

And could you give us some indication on working capital? You saw a benefit in the first half which looked rather good. Is that expected in the full year in terms of working capital?

And lastly, just as an indication of how successful Christmas may or may not be, 1,000 lines is what percentage of your business?

Dave Lewis *- Tesco PLC - CEO*

Why don't you take the investigation? I'll take the --

Alan Stewart - ***Tesco PLC - CFO***

I'll take investigation and working capital.

Dave Lewis - ***Tesco PLC - CEO***

Please.

Alan Stewart - ***Tesco PLC - CFO***

In terms of the investigation, the numbers, we've had the independent review, we've had our own view, and of course we've had the auditors with their usual review of the half-year numbers. That is what we believe is the right number.

As of now, I don't know what the FCA will do. I don't know where they're going to go. But I wouldn't -- on the numbers, I don't think that's going to be the primary focus of their investigation. I think the focus of their investigation is more focused on the how and the why. And we do have the numbers, and to the best of our knowledge and belief as we have them today.

In terms of working capital, I think it's too early to talk about full-year working capital. Clearly, there has been a benefit. Working capital, I think as Dave has spoken about in terms of the stock and the stock turn, that's something we will look at, but I don't want to be drawn today on what it means for the full year.

Dave Lewis - ***Tesco PLC - CEO***

And to your other questions, I won't talk about the number, but do I see some opportunity for us to improve the costs of the head office? Yes, I do. Yes, I do, but it will be consistent. I want to put it in the round in terms of deciding the strategy for the Group, but I suppose what I'm indicating is a willingness to think about how I might reinvest costs in the business in a way which I can make sure that customers feel.

Katie Ruci - ***JPMorgan - Analyst***

Katie Ruci, JPMorgan. I'm probably in the minority here, but as a bondholder, what we've seen for the last few years is that as you pointed out, Alan, your leverage has gone up and your credit ratings have continued to come down from -- let's just say your initial A rating.

So give us some of the comments brief that you made on presentation. Would it be fair to assume that you are, or Tesco is absolutely committed to investment grade rating, and probably a current rating, given your funding needs, your commercial paper program, and obviously the need to come to the market quite often?

Alan Stewart - ***Tesco PLC - CFO***

Well, where we are today is we're a BBB. We're on a negative watch; and we are engaging and will continue to engage with the rating agencies in terms of that -- their rating.

They will form their own view. I think from my perspective, the funding and financing we have is very important to us. As I've said, I believe it's stable and we have a strong funding profile. And the redemptions that we have are actually in the next couple of years relatively low in terms of our overall leverage. And that's a good position and it's a measure of the prudence with which the capital has been structured.

In terms of commitment, we still have to go through the strategic review. We still have to work out what the shape is of the balance sheet. And we still have to see how the rating agencies will take that. So I've operated in my prior life at a BBB minus for a number of years and have been perfectly comfortable in that.

I don't believe -- and please don't take this the wrong way, I don't believe that the rating of itself is -- it's clearly important to us, but more important to us is to get the business into the right shape for the future. And it's a very important part of what we look at and we will take it into account as we form that shape and form, but in terms of commitment, you're asking me slightly early in the process for me to give that commitment.

Katie Ruci - ***JPMorgan - Analyst***

Okay. But I don't think it's early for me to ask whether you are committed to being a low BBB versus being high yield. It's quite a bit of a difference.

Alan Stewart - ***Tesco PLC - CFO***

I understand the difference; I absolutely understand the difference. And please don't read any positive or negative or any direction in that. It's just very early in the process.

Katie Ruci - ***JPMorgan - Analyst***

Okay.

Alan Stewart - ***Tesco PLC - CFO***

And, sorry, the one thing I would add is I do understand the importance of a BBB or an investment grade rating. I understand that absolutely.

Rob Joyce - ***Goldman Sachs & Co. - Analyst***

Rob Joyce, Goldman Sachs. I've got three. The first one is just could you quantify the impact on the UK profits of investments in price above what you're seeing in your input costs?

The second one is just on the UK property. Can you confirm the freehold percentage of UK property and the book value that's held that in the accounts?

And third one is just on Asia. Can you talk a little bit more about the quarterly slowdown in sales there and how margins have held up so well when the deleverage looks similar to what you've seen in the UK business?

Thanks.

Dave Lewis - ***Tesco PLC - CEO***

Alan, do you want to take the first two and I'll take Asia?

Alan Stewart - ***Tesco PLC - CFO***

Would you like to Asia? And I'll -- I'm afraid I missed the first one.

Dave Lewis - ***Tesco PLC - CEO***

I think the issue in terms of sales in Asia can be summarized in two places. One is in Korea, and I don't know how familiar you are with the situation in Korea with Homeplus. There's being quite a lot of publicity about -- across the industry, not just for Homeplus, across the industry, around the sale of customer data. There's an industry within Korea not dissimilar to other markets where actually there's provision of customer data for other activity. That's come in to some review in Korea. Ourselves and indeed I think the whole market has suffered from that. So we felt that in Korea; we definitely felt that in Korea.

And again, if you go to Malaysia, we've seen some reaction to what's called the Gaza defense, which is in terms of foreign companies who are seen to have any connection with the Middle East, and so our business in Malaysia as an international business has been part of that.

So performance in the quarter affected by that. We've put some activity in place in the last three or four weeks and we've seen the business start to come back. So that's what you've seen in terms of the Asian sales.

Alan Stewart *- Tesco PLC - CFO*

In terms of the percentage of freehold, is what Dave spoke about, that was a [Group]* number. In terms of the book value, the book value is as per the accounts last year. And the impairment charge of GBP136 million which we took is primarily -- well, it's about two-thirds UK and about one-third Europe.

Rob Joyce *- Goldman Sachs & Co. - Analyst*

Sorry. And just in terms of the profits in the first half, in terms of how much of that decline came from investing in prices above your input costs?

Dave Lewis *- Tesco PLC - CEO*

The investment in price in the UK wasn't material in the first half year. In fact, if you take the two things, it's always difficult to talk about a period that you weren't in the chair when you come to the operational detail of it, but what I see is there was quite some stepping back from untargeted promotional activity. So if you look at it net-net, and I'm looking at Chris whether I get this right or not, the movement in investment was something like [0.6%]. It was relatively small.

Rob Joyce *- Goldman Sachs & Co. - Analyst*

Thanks.

Clive Black *- Shore Capital - Analyst*

Clive Black, Shore Capital. How courageous are you when it comes to price? Because you talked about once you've sorted out your availability and staff that price would fall into place, which I get. But just tell me where you feel price actually stands for Tesco in the UK and how much courage have you got to see what you believe is necessary.

And secondly, just on capital expenditure, you talked a lot about your employees and your customers and the maximum GBP2.1 billion of CapEx this year. Is there a reasonable undercurrent for us to take away from this that you could actually materially cut what you have to spend in capital as opposed to investing in your employees and your customers?

And then just finally, given you're fresh to the job, could you give us a reasonably honest assessment, given you've got a vested interest now, of what the supply chain thinks about Tesco; this business that was delivering lots of growth for many years and now isn't?

Dave Lewis *- Tesco PLC - CEO*

Okay. So if I remember all the parts of it, so first and foremost, I think my appetite for price is customer-driven, not risk aversion. I think if you look at all of the money that's invested in promotion and price, and you look at some of the other things I talked about, I think the opportunity for us to be able to reinvest.

I suppose the relation -- the thing I want to understand is from a customer point of view what is the right price positioning for Tesco and how do they want that price positioning delivered. And when I've worked that out, I'll modify the rest of the business to deliver it.

But it's that way around. It's not about my appetite. It's about what it is in terms of the overall proposition I can give that a customer wants from the brand and the business Tesco.

* Amended from UK after delivery at the company's request

I think it would be premature for you to take away from here what the right level of capital expenditure would be going forward. I think it will come back to the decision on strategy and how it is we think we can best realize value within the Tesco Group. The GBP2.1 billion was the decision of the Board that was taken earlier this year, and we'll definitely respect that and be within that by the end of the full year. But what the capital expenditure will be is part of the strategy going forward.

And so your third question. Look, I think -- everybody asks me from a supplier's point of view. I think, look, everybody who worked with Tesco through the growth years appreciated just what a fantastic business it was and where the growth was. I think not unique to Tesco, when any business that you're supplying loses some of that growth momentum, you have to think again about how it is you engage with them in order to be commercially sensible.

So I suspect that the supplier base in the countries, in the UK and around, are reassessing what the future is. So actually, what suppliers most want to know is exactly what you guys want to know from me, which is what are you going to do next.

So I think that there is an awful lot of goodwill out there. I think it's fair to say that, and I'm not naive to the fact that we might have a reputation somewhere of being a little too aggressive and maybe not recognizing that we're not growing the way that we did. I hear it; I do hear it.

My own personal experience of dealing with Tesco, admittedly six years ago, was it always a firm relationship but it was always a fair relationship, and I would want that going forward.

So that's what they will get from me. We will negotiate hard, but we'll negotiate hard because we are doing the best that we can for customers. And that's what Tesco always did very well, and that's where I'd want us to get back to.

Xavier Le Mene - ***BofA Merrill Lynch - Analyst***

Xavier Le Mene, Bank of America Merrill Lynch. Two questions, if I may, the first one on timing. We talked about the strategic review, the financial review, you're doing action already. But what can we expect, or when can we expect actually to get the overall strategic review, the financial review? And when can we expect an inflection point where the action will start to deliver progress? So what is timeframe there?

The second one is we talked a lot about Tesco, but what about the current environment? What about the structural changes in the market? What about the high discounters, online? How do you see actually the market evolving?

Dave Lewis - ***Tesco PLC - CEO***

So, look, I understand the first question, and as I tried to indicate in the best way possible, I'm not going to set a date where I'm going to stand up and I'm going to announce the strategy. You're going to feel it as it evolves, you're going to feel it as it hits the marketplace, and we'll talk about it in terms of how the customer reacts to it.

So I just need to get your expectations right. This is definitely dynamic, definitely evolving, and we will be in a place where we're constantly reviewing. Right? So I'll just -- and I'll be looking for the inflection point, exactly like you will be, but it's not a question of a big announcement on certain dates. Don't get yourself into that level of expectation.

Look, to the environment, what would I tell you about the environment? You know -- I don't want to stand here and tell you about the fact that the market has just gone into a deflation. You know what's happening in terms of the softening of the market. You know what's happening in terms of the channel dynamics and the impacts of --

I suppose what I would say to you is it's not for a -- my principle on this is as a leadership team, it's not for us to worry too much about what happens to the market. If we think that we're influencing the market in that sense then we've got it wrong. The question for us is can we adapt our business to the market that we face, and that's what we're going to do. That's exactly what we're going to do.

And, look, we've -- you take the first half and you look at the second half. You've seen what the performance was in the first half, and what have we said? Against that, the market looks like it's going to be softer than we thought. Our relative performance in the first half year is not what we would want it to be. Right?

So if the market is softening and our performance is not there, we need to compete harder. We need to be prepared to move our business in order to compete for the choice that customers have.

So that's the thing that we need to think about. Everything that happens in the market environment. The job for me, Alan and the management team is to move our business if we need to, whatever the prevailing market conditions are.

Norbert Ling - ***BNP - Analyst***

Just a follow-up question for Alan. Norbert Ling, BNP. So on the debt side, you talk about why IG rating is important, and particularly given your comment as to the [relevance] of refinancing needs because how prudent and conservative the funding policy of Tesco has been. So I'm trying to understand as a bondholder what gives me comfort that Tesco as a company thinks that IG rating is important and relevant.

Second question is more following up in terms of how it fits the bits of the business. You talk about taking down costs and overhead costs at the headquarters, reinvesting into customers. Is in a way of thinking about it is lowering your interest costs will allow you to invest more into the business and therefore there will be a desire to keep an investment grade rating instead of sliding down to [high yield].

Thank you.

Alan Stewart - ***Tesco PLC - CFO***

The investment grade rating is obviously important as we're issuing funds, and it's important to you as a holder of funds. I will do what I can to ensure that the Company is understood as well as it can be by the ratings agencies, and we will work with them to ensure that they give the appropriate rating for us. I understand that that rating can influence the view that -- of what that -- the price of the asset in the market.

The other element, and I'm afraid this is a long-term answer, the other element of any bond is is it going to be redeemed, and that's the other side of it. So prices move day to day. We see the impact of that. But ultimately, the other question is are we good for the money, and we are good for the money.

So that's not going to help you when you're marking to market daily. Neither is it going to help your relative performance against others, but I understand that.

In terms of the interest costs, yes, interest costs obviously, and this comes back into capital structure, and I think the capital structure flows from the strategy and flows from what we will look to. Once you've issued debt, you've got the debt at the price it was issued. You then have a question to make whether you -- a bit like remortgaging your house. Do you take advantage of a lower debt market and issue capital at a lower price? Maybe you can, or you change your structure.

So these are things and questions we will ask. The financing charge relative to our profitability today is a lot higher than it was, but the leverage in the business is much more on the operational side of the business than on the balance sheet side of the business in terms of the financial results. And the delta on interest costs is relatively low compared with the leverage within the operational part of the business. Okay?

Shannon McDayah - ***Aviva Investors - Analyst***

[Shannon McDayah], Aviva Investors. Just to go back on your point being good for the money, is that influenced by the fact that we are in a very low interest rate environment and it really doesn't matter whether investment grade are high yield any more?

Alan Stewart - ***Tesco PLC - CFO***

We're spending a lot of time talking about something which I really understand the importance of, and I don't want us to -- you to feel at all that this is an area that I take very lightly.

The -- my philosophy on how I think about businesses is that I think we have to get the leverage in the business appropriate for that business. And I've never believed -- and this comes back to sale and leasebacks -- I've always believed that one of the strengths of a retailer is the fact that its operating costs are known and fixed. Once you put a lot of rentals into your structure, you end up with something which potentially creates a mismatch between the market and your fixed costs, and that's something we will have to look at.

So I'm not answering your question directly, but it's the way I think about the capital structure. And equally, when we then look to the capital structure, we have to try to ensure that we can protect the providers of capital as much as possible from significant influences in that. And we can predict -- give a business which will deliver increasing returns in those elements.

It's not a direct answer because these are long-term questions and they're structural questions, and we will come to them. I'm sorry. I haven't answered it directly.

Jaime Vazquez *- JPMorgan - Analyst*

Jaime Vazquez, JPMorgan. Dave, would you ever consider selling Dunnhumby if a good offer was put on the table? Or do you think that as a matter of principle it would be wrong to sell your customer intelligence? That's the first question.

Dave Lewis *- Tesco PLC - CEO*

Do you have more, or --?

Jaime Vazquez *- JPMorgan - Analyst*

I've got two more, one on property. Your predecessors used to talk about a GBP20 billion UK property value. That was based on a 70% freehold. Obviously, we now find out that it's 53% freehold, which makes a lot more sense to us because -- I want to make sure that I understand the difference and why that is.

Is it because you have now excluded the properties sold to JVs from your definition of freehold, which would make a lot of sense to everyone in this room, I guess? And your views on the GBP20 billion market value as a result of that redefinition of ownership.

And the third question is: Have you done a thorough review, Alan, of the asset valuations, so the book values? So the write-downs in the first half which are small, are they the result of a thorough investigation and review of asset valuations, or is it just a specific -- a store here and there? Have you gone through the tangible and intangible and property valuations and the depreciation? Do you think that depreciation fairly reflects the true depreciation of assets?

Dave Lewis *- Tesco PLC - CEO*

Why don't I take the first one while, after four weeks in the job, Alan prepares for the second two? Because I think there is an expectation of what can be done in a relatively short amount of time, especially given the circumstances.

To your question about Dunnhumby, the question I will ask is, as I said before, as I review the strategy -- so everything is in review. So as I look at the -- so if you look at the whole portfolio, I will review the portfolio against the strategy that we decide, both in terms of its ability to give me competitive advantage, but also in terms of what is the maximum value from that part of it.

So all I would say is what I said at the start, which is everything's in review. I'll look at the portfolio in the context of, and I'm not going to speculate on one part of it be it Dunnhumby or indeed other things that people are speculating on, but it will come into the total business review that I'll do. And we'll make those decisions as we firm up what the strategic direction is that we take.

Jaime Vazquez *- JPMorgan - Analyst*

I was talking about as a matter of principle.

Dave Lewis *- Tesco PLC - CEO*

Yes, I understand. But the principle would be for me, which is if by owning it I can extract and I can realize a value which is unique and differential from somebody else owning it, then it becomes a unique value to me in terms of competitive advantage, then for sure it's part of the strategy [and it stays].

If there's a model that means I can get all of the things which I need for my business and it can release funds, then there's an optionality to it. But I'm not yet at the place where I'm going to say, actually, which is the best model to extract the value from the unique capabilities of Dunnhumby, or indeed other parts of the business at this stage. So I wouldn't jump too much to conclusions at this point.

Alan Stewart - ***Tesco PLC - CFO***

In terms of -- I think your second and third questions are actually very, very closely linked. In terms of those, as Dave says, four weeks in. I think the -- I'm very aware that there have been a number of questions raised by people in this room, maybe people outside this room, over the years against Tesco. I'm not going to go back to those, but I'm very aware. And from the outside, I've been aware of those.

I think what's important as we draw up the accounts for the year that we're currently going through, and as at February next year, that we have -- and this comes back to what Dave was talking about in terms of the investment case -- that we have a clear understanding of what we have within the business, that we present that appropriately in terms of the environment and the business we're in, and that we try to present that as clearly as we can to the investment community.

We do have a bank within our accounts. That's always going to make our published accounts more complex than somebody who doesn't have a bank. We're going to have to think about that. How do we present the business with and without the bank?

Again, I don't want to be drawn into whether the bank is part of the business or not because that's -- those are strategic questions. But on the assumption where we have a bank, then our accounts are going to be more complex than any of us might like from a simple looking at it as a retailer.

But those are the things which we'll look at, and we'll make sure that we draw them up appropriate to the business, appropriate to the strategy and appropriate to the market.

Jaime Vazquez - ***JPMorgan - Analyst***

Sorry. Can I just repeat two specific aspects of my question? One is: Is the 53% freehold excluding any property within JVs? Is it a true [owned] freehold?

And the second question is: Should we expect a deeper investigation into asset valuations in the second half of the year?

Alan Stewart - ***Tesco PLC - CFO***

Well, part of our job as -- in drawing up the accounts is to ensure -- and this is where impairment comes in -- that it's ensuring that we actually reflect the asset at the right value relative to its cash earning potential and its market value. Those are the two tests which we have in respect of market value. In respect of the 53%, that I believe is what we own and what we don't pay rent on.

Sri Chandran - ***Metropolis Capital - Analyst***

I probably should have asked this question earlier. Sri Chandran, Metropolis Capital. I've just got a couple of questions. First just regarding your net debt figure, Alan, does it include the present value of the GBP4 billion of property bonds beyond minimum term?

And my second question is to Richard, actually. You mentioned the investigation. I respect there's confidentiality, but did your previous auditors mention in the annual report that that was an area of concern? So I guess why did it take so long for it to hit the fan? And what does PwC have to say about it?

Richard Broadbent - ***Tesco PLC - Chairman***

Well, as I said at the outset, and I haven't had to repeat it as many times as I'd thought, it's very hard to comment on the whys and wherefores because of the investigation. I think what I can say is that the audit committee of Tesco has worked hard to cover the risks it's seen in the business. Like any other audit committee in the retail sector, it's well aware of the potential risks around commercial income. They were identified. And as you would expect, they've clearly spent substantial time working with the auditors to make sure those risks are understood, were well managed.

And so on a net basis rather than a gross basis, you could say we've been through these risks. They've been audited. They've been checked. And on the basis of the information we have, the gross risk which we understand is there, has been reduced to an acceptable and non-material net risk. And I'm not -- I cannot go into the whys and wherefores of what then emerged.

Sri Chandran *- Metropolis Capital - Analyst*

But did PwC have an opinion on it, because --?

Richard Broadbent *- Tesco PLC - Chairman*

PwC gave the accounts last year a clean audit opinion.

Alan Stewart *- Tesco PLC - CFO*

In respect of the question on debt, the way that -- and again, I appreciate that there is complexity. As David said, we've -- over the years Tesco has embarked on a number of sale and leasebacks. The specific impacts of those structures are ones which I haven't had a chance to understand fully. I will.

The way that I would look at the commitment in looking at indebtedness is what are we committed to in terms of those payments. If there are structures, and this again is the way that I think about commitments, if there are structures which are there whereby the -- that structure is a standalone structure and is genuinely a standalone structure, then I -- and it is financed separately, then I wouldn't include those in my calculation of net debt.

Sri Chandran *- Metropolis Capital - Analyst*

It is included, but beyond the minimum term, there's an additional GBP4 billion of payments.

Alan Stewart *- Tesco PLC - CFO*

We're getting into details which I'm afraid I just haven't had a chance to get into, but the way that I would look at it is if there's an exit on an agreement, then -- and that exit is at my option, then I wouldn't calculate that future liability as something which is a liability, because if I'm able to exit, then it's not a high liability.

Dave Lewis *- Tesco PLC - CEO*

Why don't we take --? It does sound like a very detailed question. Why don't we try and follow that up so that you have a chance to look at it and answer the question in more detail?

Bilquis Ahmed – *JP Morgan Asset Management*

Bilquis Ahmed JPMorgan Asset Management. I had a couple of questions. The first is the investments that you are going to be putting in in the second half, or have started putting in in terms of service and availability, can you just give us a sense of whether that brings you within the market average or whether that actually allows you to leapfrog what the expectations of the standards that already exist in the market?

And can you also give a sense of -- from the quality of your food perspective, whether you're happy --? We've talked a lot about shelf-edge prices, but whether -- that comes into a question of whether the quality is right to start off with and what your assessment of the quality of your offer is.

And then the third question, I guess, which might be more of an Alan question, is over the years, Tesco's always been renowned for their cost cutting, for cost productivity programs. There used to be a very formal number that was presented every year. So it's a little bit surprising to hear you talk about a cost opportunity that still exist within the organization. So could you please clarify it perhaps a little more?

Dave Lewis - ***Tesco PLC - CEO***

Sure. So to the points on service and availability, your first question, I think the measure that I've got in my mind is the improvement for Tesco second half/first half. Not in a position to judge that relative to the competitive set. All I do know is that we're going to put 2 million more colleague hours in store in the second half that weren't there in the first.

Is that enough? I don't think it is probably enough, and I think there's more that I could do in terms of getting colleagues in store.

The second thing is, the service and availability is again a measure against where Tesco is. And as soon as I have the peak signal of availability, I'll tell you what it was and what it's going to be.

Those 1,000 lines that somebody asked me about before are quite a significant part of the portfolio, so I'm hoping that I will see the benefit. But the bigger solution, the more structural solution is that we get the range right; that we do the simplification and we make sure that everything is available all of the time. Easy to say and always to do 365 days a year over 3,300 stores, but that's the objective.

I think to the question on -- linking to your question on cost and then I'll let Alan add to it, I think in fairness, I think you build a business and you invest for a future. And the future was a very strong growth future and it had an international strategy that was part of it.

So I think why do you see -- why do I see a cost opportunity? I see a cost opportunity because against that forward build, the momentum hasn't been there, the market has changed in all the ways that you know, and we've made some decisions about the portfolio that mean we don't have the business footprint that it was designed to service. Therefore, what do we do? We come back and we have the opportunity to reshape the Group, and that's where the cost opportunity comes from.

I don't know if you want to add anything more to that?

Alan Stewart - ***Tesco PLC - CFO***

I think that's it. Clearly, things have changed. We are a new management team and we will assess the appropriate costs. So I wouldn't necessarily take it as a surprise that there hasn't been a cost-cutting measure. We're looking at things differently.

Dave Lewis - ***Tesco PLC - CEO***

Quality. It's a great question. So coming -- and it's good that you mention it, because when I talk about the value proposition, the price and quality, a big part of it. I spent a lot of time in the period before, seven weeks and since, going through quality.

I have to say, I think from what I've [shown] in the team is that there are parts of Tesco quality that really surprise -- really very, very good, as evidenced by the Lewis family who is competitively tasting an awful lot of product from an awful lot of offerings; and so too are the leadership team, but we'll tell you about that at a separate occasion.

But there's one thing that I do think we have an opportunity to [do]. So actually, our ability to do really good quality definitely exists. The hidden gem for me, I have to say if I give you an example, is Tesco Finest Wine. It's absolutely stunning, and all across the portfolio. So we know how to do really good quality.

I'm not sure. I think the opportunity for us might be in terms of clarifying how the portfolio plays in terms of price and quality from finest to value. I think there's an opportunity there. But the thing you should take out of this is Tesco has the ability, capability, expertise, wherewithal, choose your adjective, to deliver outstanding quality. And we have an opportunity to value that against the prices that we charge. So no issue there.

David, you've got the last question because then we've got to round it up, so -- as if you needed a microphone (laughter).

Dave McCarthy – ***HSBC – Analyst***

It's nice to have the last word. Just a few things, first of all on the discounters. You put a chart up with showed losing [them]. Do you think it's inevitable that you will keep losing to discounters at the rate you are, or can you minimize that, bring that down a lot lower? Or is it just something that you shrug your shoulders and say: Oh, well, that's just the world we live in?

You mentioned you had people interested in buying your store picking Internet IP. Would you be prepared to sell that to anybody around the world?

And then I wanted to just come back to the PI. You've put an extra 2 million hours in, but it's not going to move the dial, is it, on the PI? So if we think what's a realistic number for that, 102/103? Because running above 105, the stores will fall over is my understanding.

Dave Lewis - ***Tesco PLC - CEO***

Okay. So three questions. To the discounters, no, I don't think it's inevitable; absolutely don't. I think it's about making sure that that our offering is competitive and just listening to customers.

I suppose I grew up in a world where discounters, as they were known then, were 13%/15% of the market and they -- then people like Kwik Save disappeared because people like Tesco competed in a different way. That's not to say -- I recognize why it is people are buying discounters, and we have to adapt our business to it, but I don't --. David, you know me well enough. I don't take anything as inevitable in the marketplace. It's for us to compete.

To the IP, I think, look, one of the things that we have to do as Tesco is we have to be prepared to look at all the different ways of extracting value from the assets that we have. So it's not -- I certainly -- I will look carefully at propositions which are not competing with my business in a way of realizing value, and so not just in that area but in some other areas as well. And I think Tesco, dare I say it, we have an opportunity to be more collaborative than perhaps we've been in the past.

The 2 million hours, as I think I've said, I don't think it is enough. I think there is more that we can do. I suppose what I would say to you is I didn't just spread it out thinly. I tried to make some surgical interventions as to where we would put those 2 million hours and we've tried to use the feet on the floor to give a pulse to that as well.

I think the other thing, and I suspect you know this but it's worth saying for others' ears, one of the questions about PI, and Tesco historically have run the estate very efficiently -- somebody mentioned the operating efficiency of the Tesco model before, and it is true that it was there -- is if you talk to the Tesco old hands, and I've talked to a number of them, is they will tell you that a store works really well when it's about 104 to 106; that that's the right amount of stretch into an organization. So anything more than that, you're stretching it a little bit.

But actually, in the way that this model's gone, and if you look at the range and you look at some of the others things that are happening in store, you've also got the issue of complexity. So one of the things that we need to do is we need to make it much simpler for people in store so that actually we release the time to be really customer facing. And I think there's an opportunity there as well.

So we've got two stores -- we've got a couple of stores running with completely streamlined different ways of operating that release the PI to be front customer facing. So it will be a combination of operational efficiency, simplification range, less price fluctuation and investment to get the service level where I'd want it to be.

Okay?

Ladies and gents, I know there -- I think we just about exhausted the questions. We've certainly kept a lot of your time. So thank you for your time, your attention and your investment in our business.

Thank you very much indeed.