A blueprint for profitable retailing in China

Ken Towle, CEO Tesco China

Tesco in Asia 2010, 21st–23rd November
Contents

• Introduction

• Market opportunity

• Our vision: best retailer in China

• A plan for profitable growth

• Summary: a winning strategy for China
A clear blueprint has been developed for profitable retailing in China

- China offers an unrivalled opportunity in a large, rapidly growing market

- The prize is enormous but the challenge is complex – China is a vast continent, with cities the size of small countries

- As a leading international retailer in Asia, Tesco has the experience, skills and scale to be a market leader in China

- Tesco has spent six years learning about the local market and developing a strategy for profitable growth

- We’re making good progress with the foundations – investing in infrastructure and capability – that will create long-term value

- The path to long-term profitability is now clear – leveraging our substantial up-front investment as we grow our scale
China Economy: an outlook of strong and stable growth

- c.10% growth rate projected for foreseeable future
- Low inflation outlook – stability projected
- Set to be world’s largest economy by 2030
Growth of the urban middle class

- Steady growth in urbanisation
- 221 cities of >1m population by 2025
  - 35 in Europe currently
- Growing urban middle class
- Booming car ownership
  - 85m cars in 2010
  - 390m cars by 2030

Growth in Urban Population, 2005-2025

Source: McKinsey Global Institute China

% of Households Grouped by Income

Source: Euromonitor
Annual disposable income at constant FX rates
Low: <=US$5,000; Middle: >US$5,000-US$15,000; High: >US$15,000
**Economic and demographic trends are driving a rapidly growing, modern retail sector**

- **£600bn grocery retail sales in 2010**
- **Forecast for continued growth**
- **Rapid development of hyper and superstore channels**
  - 2005: ~1,000 outlets
  - 2010: ~2,600 outlets
  - 2014: ~3,800 outlets

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**China: Grocery Retail Sales 2005-2014**

- Total Grocery Retail Sales CNY k bn
- Forecast

**China: Hypermarkets & Superstores**

- Sales & Number of Outlets 2005–2014
- Number of Outlets
- Banner Sales CNY bn

*Source: Planet Retail*
Our vision: best retailer in China

<table>
<thead>
<tr>
<th>Regional strength and responsiveness</th>
<th>Leveraging the Group Operating Model</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image1.png" alt="Map of China" /></td>
<td><img src="image2.png" alt="Group Operating Model" /></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>High quality new space enabling organic growth</th>
<th>Integrated supply chain and distribution network</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image3.png" alt="Tesco outlet" /></td>
<td><img src="image4.png" alt="Supply chain network" /></td>
</tr>
</tbody>
</table>
Focusing on our Strategic Provinces

Our approach focuses us on the best of China

- Land Area: 87% Tesco Regions, 13% Rest of China
- Population: 56% Tesco Regions, 44% Rest of China
- GDP: 39% Tesco Regions, 61% Rest of China

Source: 2009 China National Statistical Yearbook

Regional teams required to address China’s scale...

Shenyang to Shenzhen
2,800 km by road
30+ Hours

...because customers are different in each region...

Regional Differences

- Average Age: North 41, East 38, South 32
- % Employed by SOE: North 27%, East 15%, South 10%
- % Migrant: North 17%, East 17%, South 34%

Source: Tesco Exit Surveys

... and because suppliers are regionally structured

Coca-Cola's Regional Approach: Agents across China

Source: 2009 China National Statistical Yearbook
How the Central and Regional Structure works

**In the Centre**

- Policies, Systems, Processes, Service Centres, Leveraging Scale, First Among Equals
- As much as can be the same
  - Financial control and reporting
  - Commercial: Hardlines, Electronics, Clothing and national FMCGs
  - Marketing: Insight, Membercard, Trade Planning and Customer Comms
  - Development/deployment of Operating Model
  - Ordering, IT, Distribution and Supply Chain
  - Property Services and Management
  - Leasehold Mall Management
  - Human Resources

**In the Regions**

- As different as it needs to be
  - Tailoring our offer for local customers
  - Commercial: local suppliers and regional divisions of FMCGs
  - Marketing: local Trade Plan
  - Operating our stores to deliver a consistent Shopping Trip
  - Finding and developing the people to enable our growth
North Region (Richard Baker, Vice President)

North China

- 236m people – 75% of US population
- 522k sq km – bigger than Thailand
- GDP similar to India
- 34 of the Top 100 cities in Tesco’s regions

In 09/10 opened most space of key international retailers – 36% of total

Total Tesco hypermarkets per city

<table>
<thead>
<tr>
<th>City</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beijing</td>
<td>3</td>
</tr>
<tr>
<td>Tianjin</td>
<td>6</td>
</tr>
<tr>
<td>Shenyang</td>
<td>6</td>
</tr>
<tr>
<td>Dalian</td>
<td>4</td>
</tr>
<tr>
<td>Qingdao</td>
<td>1</td>
</tr>
<tr>
<td>Jinan</td>
<td>2</td>
</tr>
<tr>
<td>Other cities</td>
<td>10</td>
</tr>
</tbody>
</table>

Source: Tesco Site Research

Shandong and Hebei - new Provinces 2009
North Region: building on growing scale and maturity

<table>
<thead>
<tr>
<th>Progress since 2008</th>
<th>Priorities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Increased store numbers by 70%</td>
<td>• Being the best for Fresh Food</td>
</tr>
<tr>
<td>• Opened four Lifespace Malls</td>
<td>• Further improving the local part of our offer, particularly on the Deli</td>
</tr>
<tr>
<td>• Established team in Shandong province</td>
<td>• Being No. 1 in every city</td>
</tr>
<tr>
<td>• Opened first Fresh Food Distribution Centre; second to open in December</td>
<td>• Developing the structure and capability of the team</td>
</tr>
<tr>
<td>• A deeper understanding of the differing needs of customers within the region’s five Provinces</td>
<td>• Opening Blueprint Distribution Centre</td>
</tr>
<tr>
<td>• Improving Trade Plans and growing like-for-like sales</td>
<td></td>
</tr>
</tbody>
</table>
East Region (Gordon Reid, Vice President)

15% of key international retailer space

Source: Tesco Site Research

East China

- 208m people – bigger than Brazil
- 361k sq km – same as Germany
- GDP similar to Russia
- 14 of Tesco regions’ 20 most affluent cities

East Region

Total Tesco hypermarkets per city

<table>
<thead>
<tr>
<th>City</th>
<th>Hypermarkets</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shanghai</td>
<td>19</td>
</tr>
<tr>
<td>Hangzhou</td>
<td>4</td>
</tr>
<tr>
<td>Wuxi</td>
<td>4</td>
</tr>
<tr>
<td>Ningbo</td>
<td>3</td>
</tr>
<tr>
<td>Suzhou</td>
<td>2</td>
</tr>
<tr>
<td>Changzhou</td>
<td>2</td>
</tr>
<tr>
<td>Hefei</td>
<td>2</td>
</tr>
<tr>
<td>Other cities</td>
<td>12</td>
</tr>
</tbody>
</table>

\(^1\) Source: Tesco Site Research

Anhui - new province 2009

Shanghai

Jiangsu

Zhejiang
## East Region: customer loyalty, maturity and leveraging scale

<table>
<thead>
<tr>
<th>Progress since 2008</th>
<th>Priorities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Increased store numbers by 50%</td>
<td>• Market leading growth, building on existing strong positions</td>
</tr>
<tr>
<td>• Opened first stores in Anhui Province</td>
<td>• Leveraging the supply chain and Operating Model</td>
</tr>
<tr>
<td>• Investing in refits to improve our older stores in Shanghai</td>
<td>• Leading a high performing team</td>
</tr>
<tr>
<td>• Improving the customer shopping trip</td>
<td>• The best shopping trip for our customers</td>
</tr>
<tr>
<td>• Improvements on Fresh, particularly Meat, Produce and Bakery</td>
<td></td>
</tr>
</tbody>
</table>
South Region (Winnie Liu, Vice President)

South China
- 131m people – as big as Japan
- 304k sq km – as big as Poland
- GDP similar to Turkey
- 22 of the Top 100 cities in China’s regions

9 stores by 2010, with footholds in all major cities

<table>
<thead>
<tr>
<th>City</th>
<th>Total Tesco hypermarkets per city</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guangzhou</td>
<td>2</td>
</tr>
<tr>
<td>Shenzhen</td>
<td>1</td>
</tr>
<tr>
<td>Dongguan</td>
<td>3</td>
</tr>
<tr>
<td>Xiamen</td>
<td>1</td>
</tr>
<tr>
<td>Foshan</td>
<td>2</td>
</tr>
</tbody>
</table>

Guangdong - Fujian

Fujian - new province 2010
### South Region: strong growth as first stores start to mature

**Progress since 2008**
- Increased store numbers by 80%
- Achieved market leading growth
- Successfully entered Fujian Province
- Opened Fresh Food distribution centre and step-changed Fresh quality
- Made key additions to senior team

**Priorities**
- Increasing new store programme including LifeSpace Malls
- Building on strong growth
- Earning trust in the Tesco brand
- Best for Fresh Food in every store
- Developing the supply chain
- Building the capability of the team
We know our customers

We understand our customers and their changing needs

We are earning their loyalty

Active Membercard Holders*

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3.6m</td>
<td>4.7m</td>
<td>5.5m</td>
<td>6.4m</td>
</tr>
</tbody>
</table>

* New members shopping within 120 days and existing members shopping within 370 days

Improving the Shopping Trip

Providing Broad Appeal
We are building our skills

Commercial Capability

Direct and International Sourcing

Own Brand

Category Management
Our experience in other markets has taught us the importance of investing in high quality assets.

Despite being in Tier 2 and 3 cities, our hypermarkets in Lifespace malls have similar sales levels to stores in Tier 1 cities.
Our supply chain is strengthening…

Centralised, Tesco-managed supply chain

Demand driven replenishment

Space, range & display helps efficiency of supply chain

Efficient Consumer Response utilising data and insight
... and our physical network is improving

**To-be network 2014/15**

**Our first freehold blueprint green logistics centre**

**Distribution centralisation**

**Proven global model**

**Centralisation**

- Total Fresh
- Total Ambient

**China and Korea Centralisation**

- China total
- Korea total

- 2007 2008 2009 2010
## Community and Corporate Social Responsibility

### An important part of what we stand for

- [Image of people and activities]

### Carbon Emissions Reduction

- Energy Management Centre (EMC)
- EMC System
- Energy Efficient Chiller
- Ground Source Heat Pump in DC
- Informed customers
- LED Lighting in Fridges

### Get Active and Nutrition

[Image of TESCO 2010 Summer Soccer Camp]

### Customer and stakeholder recognition

[Image of awards and certificates]

**Top 50 CSR Company Award**
**Government as a Stakeholder**

<table>
<thead>
<tr>
<th>Our priorities are aligned</th>
<th>Relationship Building</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Grow Domestic Demand</td>
<td>✓</td>
</tr>
<tr>
<td>• Carbon Emissions Reduction</td>
<td>✓</td>
</tr>
<tr>
<td>• Food and Product Safety</td>
<td>✓</td>
</tr>
<tr>
<td>• Foreign Direct Investment</td>
<td>✓</td>
</tr>
<tr>
<td>• Develop Local Talent</td>
<td>✓</td>
</tr>
<tr>
<td>• Modern Supply Chain</td>
<td>✓</td>
</tr>
</tbody>
</table>

**Advisory Board**

![Advisory Board Members]

**Making important progress**

- MoU with Ministry of Commerce
- Tesco Climate Change Seminar
- MoUs with Anhui and Shandong governments

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**Our Team**

### A growing team

<table>
<thead>
<tr>
<th>Year</th>
<th>Headcount</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>9,000</td>
</tr>
<tr>
<td>2008</td>
<td>19,000</td>
</tr>
<tr>
<td>2010</td>
<td>26,000</td>
</tr>
</tbody>
</table>

### Developing Talent

- Understand customers
- Be first to meet their needs
- Act responsibly for our communities
- Treat people how we like to be treated
  - Work as a team
  - Trust and respect each other
  - Listen, support and say thank you
  - Share knowledge and experience
  - … so we can enjoy our work

### Earning Loyalty

### One of the best retail employers in China

<table>
<thead>
<tr>
<th>Year</th>
<th>Overall Employee Satisfaction %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>45</td>
</tr>
<tr>
<td>2008</td>
<td>62</td>
</tr>
<tr>
<td>2010</td>
<td>75</td>
</tr>
</tbody>
</table>

**Viewpoint:**

- 2006: 45
- 2008: 62
- 2010: 75
We’ve made strong progress so far

**Customers per week**

- 2004: 2m
- 2008: 3.7m
- H1 2010: 4.3m

**Sales per week – GBP**

- 2004: 8m
- 2008: 15m
- H1 2010: 22m

**Hypermarkets**

- 2004: 25
- 2008: 58
- H1 2010: 82

**Distribution Centres**

- 2004: 1
- 2008: 3
- H1 2010: 6

*Sales at actual exchange rates*
Foundations for long-term profitable growth (Richard Holder, CFO)

Over the next five years (by 2014/15) we plan to...

- More than **double** the number of hypermarkets to over 200:
  - Similar to the number of Extra stores in the UK today

- **Almost triple** the number of customers per week to c. 12m:
  - Still less than 4% of the urban population of our three Regions

- **Quadruple** sales to c. £4 billion p.a.:
  - Similar to Korea today

- Deliver significant levels of profitability and returns:
  - As stores mature and economies of scale are realised
The road to improved profitability is clear

‘Mature’ stores already at good levels of profitability...

- Similar 4-year maturity curve to other countries
- Rapid growth in new stores will mean high proportion of immature space for the foreseeable future

... which we expect to improve further as the business matures

- Improved profitability from:
  - Investment in centralised distribution
  - Own-label
  - Direct sourcing
  - Data & insight: dunnhumby
  - Superior formats and locations

Growing scale will bring cost efficiencies

- Central costs as % of sales planned to fall 2.6% points over five years due to:
  - Rapid growth in space & sales
  - Tesco Operating Model
  - People capability
  - Organisation structures

With our low-capital leasehold model, we expect returns to increase rapidly as profitability improves with scale

<table>
<thead>
<tr>
<th>Year</th>
<th>Store profitability (%)</th>
<th>Central costs as % of sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010/11</td>
<td>All stores: 0%</td>
<td>Central costs as % of sales in China are 2.3x higher than in Korea</td>
</tr>
<tr>
<td>2011/12</td>
<td>'Mature' stores: +2.7%</td>
<td>-2.6% points</td>
</tr>
<tr>
<td>2012/13</td>
<td>+2.5% points</td>
<td></td>
</tr>
<tr>
<td>2013/14</td>
<td>+2.5% points</td>
<td></td>
</tr>
<tr>
<td>2014/15</td>
<td>+2.5% points</td>
<td></td>
</tr>
</tbody>
</table>
The building blocks towards greater success

• Customer insight
  - using dunnhumby to respond first to changing customer needs and lifestyles as incomes rise

• Regional structure
  - succeeding in a country the size of a continent requires local customer and operational focus

• Integrated supply chain
  - provides a unique competitive advantage, bringing scale and infrastructure to deliver great products and prices for customers

• Operating Model
  - proven, efficient and effective Processes, Systems and Organisational Capability to enable rapid growth at lower cost ratios

• Local leaders
  - the winning combination of in-depth local market knowledge coupled with Tesco Values, leadership and operating skills

• Focus on delivering over the long term
  - investment and decisions that will provide a strong base for generations of customers

• High quality property
  - a unique strategy for future-proof retail developments