Tesco PLC

Q3 & Christmas Analyst Call

9 January 2025

Transcript

Ken Murphy : Good morning everyone, and thank you for joining us and a very, very happy New Year to you all. I'm here in Welwyn with Imran, and I'll give you a brief update on our performance before we start Q&A. As you'll have seen in our release this morning, customers responded well to our Christmas offer, and we're very pleased with our performance as a result. We delivered our biggest Christmas ever, and 23rd of December was a record day of sales in the UK. We continue to invest in service, including in colleague hours, recruiting over 28,000 festive in-store colleagues. I'd like to personally thank all of our colleagues for delivering a really great Christmas experience for all customers. Our commitment to offering the best possible value, quality and service continues to resonate with customers, and resulted in strong market share gains, with switching from all corners of the market, and further improvements in customer satisfaction. At 28.5%, our market share in the UK is now the highest it has been since 2016.

For more than two years, we've been the cheapest full-line grocer, and we're proud to have invested once again to offer great value, including a traditional Christmas dinner for £1.84 per person, which is down 12% versus last year, which is helping customers celebrate regardless of budget. Great quality is always important to customers, especially at Christmas, and we've continued to innovate with over half our festive products this year new or improved. Customers have recognised this, and as a result, our quality perception has grown ahead of the market. Tesco Finest continues to be a valued brand for customers, with sales growth of 15.5% year-on-year. Over 20 million customers shopped Finest in the period, which is up 6%. Our Finest champagne, Premier Cru, won best champagne in Which’s taste test, and we sold over 1.4 million bottles of our Finest Prosecco, which was the top-selling Finest tipple over Christmas.

Online saw strong growth with sales up 11% over 19 weeks, including our biggest-ever week in the run-up to Christmas. And we were also pleased that our Whoosh rapid delivery service played an important role for customers, helping them shop whenever and however they wanted, as they got ready for those important festive celebrations. We have now also rolled out Whoosh to 32 large stores, in addition to over 1,400 Express stores, offering even more choice to customers. Marketplace continues to scale, with over 300,000 products now available on the platform. It's still very early days and we're learning a lot as we expand the business. Our customers continue to benefit from increasing personalisation and great value with Clubcard. Customers collected over half a billion extra Clubcard points over the period through Clubcard challenges, and across the year saved up to £393 on their grocery bill through Clubcard Prices. This week, the majority of our 23 million Clubcard households received Clubcard Unpacked, showing them how they shopped and how much they saved last year.

We also revealed the UK's most popular meal deal combination featuring our chicken club sandwich as the favourite main. In the Republic of Ireland, our strong performance continued, driven by ongoing investment in quality and innovation, reflected in some great accolades at the Taste of Ireland Awards. In a challenging year, and despite ongoing headwinds from the decline in tobacco sales, Booker continues to deliver outstanding value and service for customers, reflected in great customer satisfaction scores. I'm pleased with the strength of our core retail and catering businesses, both of which continue to grow across the 19-week period. Our Central European business has also made good progress as we invest in the customer offer, with strong customer satisfaction improvements in all three countries, driven by value perception.

You'll have seen in the release this morning that we've reiterated our guidance for adjusted operating profit and cash for the current year. We're happy with our progress and continue to focus relentlessly on customers and building our proposition to drive long-term growth and value for all stakeholders. We carry strong momentum into the new year, with the right strategy and the right people in place to deliver it. We'd be really happy now to take your questions. Thank you very much for listening.

Operator: Thank you. Ladies and gentlemen, if you would like to ask a question on today's call, please submit by pressing star one on your telephone keypad. Again, that is star one for your questions today. And up first, we have Izabel Dobreva from Morgan Stanley. Please go ahead.

Izabel Dobreva: Hello, good morning. I noticed that there was no change to your profit guidance. Could you help us understand whether you have seen any change in the competitive environment? Which means that you're stepping up price investments or promotional activity. Has anything changed since the last update you gave last quarter in terms of how you're thinking about the margin development into year-end, so that we can contextualise the lack of profit upgrade given the very strong sales and market share momentum?

That's my first question. And then my second question is, could you share your thoughts around the volume outlook for the industry for the year ahead, given the evolving UK consumer backdrop?

Imran Nawaz: Let me take the first one. Good morning, and happy new year, Izabel. As you might remember, at the half year, you will see, we had upgraded from at least 2.8 billion to around 2.9 billion, and at that time we had said, "Look, as part of this upgrade, if we see opportunities in the second half to make investments where that can help us win further, differentiate ourselves from our competitors, and gain market share, we would make those investments." And the truth is, the investments we made, whether there was an availability in really backing our range, store payroll hours, value, they've really had a great payback. I mean, you've seen our market share performance, 80 bps essentially, and the biggest market share since 2016 for us, that's sound, and I feel good and really happy, and I'd take that any day between an upgrade versus the market share performance.

The way I think about it is, the environment that we're in is essentially as competitive in October as it is today, so it hasn't really dramatically moved. This was much more Tesco on the front foot, making sure it takes advantage of its position, advantage of its ability, and advantage of its capability to continue to win. And I think that's no bad thing when you think about the long term as opposed to just the short term.

In terms of next year, I mean, look, it's early days, obviously. We are, as you might imagine, working through all the different building blocks of how we think about next year, and we'll obviously give you a lot of colour when we speak in April. So it's really hard for us to comment on the volume outlook. What I would say to you is over the Christmas period, as well as over the 19-week period, we saw really solid volume performance. And in fact, over both Christmas and Q3, the volume was the majority driver of the sales growth that we've seen. And you also saw the fact that quite a few of our customers ended up trading up into Finest, and you saw the 15% growth. So at least on the evidence of the last 19 weeks that we're reporting on today, volume growths continue to do well and we're very pleased to see that performance.

Izabel Dobreva: Okay, thank you.

Operator: Thank you. And we're moving on to a question from Rob Joyce from BNP Paribas. Please go ahead.

Rob Joyce: Hi, good morning. Happy New Year. Thanks for taking the questions. So first one, just following on from Izabel's there on the guidance, it seems like you're saying that the investments have been made at your discretion. I guess taking a step back, it suggests profit growth for the year of around 5% to 6%. It seems like you'd be happy with that. Is that something we should think about as a longer term EBIT growth aspiration for the business, reinvesting to hit that mid-single-digit EBIT growth? And then the second one is just on the overall food inflation. Couple of questions, I mean, are you seeing food inflation... Do you think it's tracking ahead of input costs at the moment? Is there any evidence of op-ed from wages last year being recovered? And just to follow on from that in terms of what the suppliers are looking at for next year, do you have any early indication as what your suppliers... What the inflation implied from what they're asked to are into next year? Thank you.

Ken Murphy : Thanks, Rob. I mean, I would start off by saying look, that we really use our kind of performance framework to guide how we think about those things. So the first thing we said is we'd be the cheapest full-line grocer in the market. And so pricing has been very important and as Imran said, we spotted an opportunity in the run into Christmas to really lean in in pricing and to build volume momentum, win new customers, win new missions, and that's what we've achieved. And pretty much every bet we made in terms of investment has paid back in terms of market share growth. And that gives us real momentum because that builds scale. And as Imran said, most of the sales increase came through volume. So that's been really pleasing for our supplier base, allows us build economies of scale, put more volume through our operating model and our fixed cost base.

And so that's kind of the kind of momentum we're looking to build as we go into next year. That said, clearly there's lots of variables out there. There are a lot of challenges out there from a macroeconomic point of view. I would say that from a headline inflation point of view, Tesco's inflation number is materially lower than the number that was quoted on Kantar. And that's a little bit also the policy. If you think back to the last three or four years, we've always tried to be a little bit less and a little bit behind the market in terms of inflation. And that speaks to the work we've done on efficiency, cost savings and optimisation of our model. It's allowed us actually to invest more in pricing, more in colleagues, and actually more in automation and capital expenditure, which we've been able to increase progressively over time. And that framework will continue to evolve as we look forward using volume at scale to further enhance our position, further reduce our costs, and ultimately give a good return for shareholders.

Rob Joyce: Okay. Just to follow, I guess the question is, it's sort of... It's implied zero profit growth in the second half versus 10% in the first half. I'm just wondering how those investments you're thinking about, is it longer term, this is much more profit longer term?

Imran Nawaz: Ultimately, the way I think about it, Rob, is I go back to the framework that Ken laid out at the last statement and the one that we just referred to. Our goal is to continue to drive market share gains. Now when we set that out, we truthfully, were thinking more like tens of bips rather than 80 bps in one go. And that's obviously nice to see that it worked as well as it did. And as long as that translates into annual profit growth and into cash, we're in a good place. The trade-off now between do you want to drop a bit more, a few tens of millions onto the bottom line versus actually making an impact that will create value for the long term, I think is an easy one for us to make. And you'd expect to us to make that any day and that's the one we make. So next year I think we continue to do the same way. Wherever there are opportunities, we will make those investments.

Rob Joyce: Thank you.

Operator: Thank you. And up next now we have Sreedhar Mahamkali from UBS. Please go ahead.

Sreedhar Mahamkali :Hi, good morning, Ken and Imran, thank you for taking my questions. Maybe just to build on a couple of the themes already, I fully understand it's a Christmas trading statement and that you won't be drawn into a debate on next year's outlook, let alone this year. Maybe you can talk through the puts and takes as you see them. That's the first one. Secondly, I guess on the consumer, we are seeing fairly mixed pictures and contradictory sort of indications from different channels. How do you see the consumer's willingness, intent and ability to spend in the year ahead from your Tesco lens and detail insights that you have on the consumer? And a third one, you've referred to marketplace in thousand plus items. Now on it we see some really interesting customer perception metrics on it from our side, but are there any numbers you can share with us on customer engagement or how it is tracking versus your expectations? So that'll be very helpful for us. Thank you.

Ken Murphy : Thanks, Sreedhar. So let me start with the overall consumer sentiment. I think that the sense we've gotten from our data and what we've seen is a gradually improving customer sentiment over the last 12 months. And I think that is really on the back of a moderating inflation number. So if you think about we were over 7% inflation this time last year, we are much, much lower than that, largely within the kind of normal inflationary tram rails that you would expect. So that has helped the customer a lot, a kind of a stabilisation in terms of pricing. I think the second thing then is that their willingness to spend and treat themselves in food and food related missions has been very robust. We saw not only very strong performance in volume through Tesco UK but also through Booker's catering business, which means that they also ate out and enjoy themselves out socially as well.

That said, there definitely is a moderation of their behaviour. So over the twelve-month period, they have been eating out less and they have been buying less in terms of discretionary purchases. And you see that in some of the big ticket item retailers and some of the clothing retailers. It's been a lot more challenging. We've been very lucky because we're only 7% non-food and actually our non-food business has had a strong growth over the Christmas period because it's great value for money. So we feel that regardless of the fact that consumer sentiment is probably subdued coming into the new year with all the volatility politically and geopolitically, et cetera, the actual core behaviours of looking for great value for money, great quality product, really convenient isn't going to change. And that's something we're focusing all our energy on in terms of then the marketplace.

Clearly we're on a sharp learning curve, Sreedhar, on that. We have increased the number of SKUs. We're learning tons from it. But for us, we don't really have any concrete insights right now that we think we could share with you as an indicator that you'd want to build into your models. You'd have to bear with us on that one. And then clearly on the longer term outlook around the puts and calls, we'll be happy to get into more detail with you and April on that.

Sreedhar Mahamkali: Okay, thank you.

Operator: Thank you. And we're moving on to a question from Clive Black from Shore Capital Markets. Please go ahead.

Clive Black: Hello. Good morning. Happy New Year and well done, gentlemen. A couple of questions if I may from me. You've touched on the investment in the period and you've mentioned the 28,000 people. I just wonder if you could give us a little bit more colour as to where you prioritised your investment across the business now and an expectation or otherwise as to will that continue. And then just some of the dynamics of your business. Just be interested to gain a feel for how private label did versus proprietary brands, given the dynamics around that over the last two or three years. You touched on Finest doing well, but were you seeing trading up across the board or was it just very Finest focused? Thank you very much.

Ken Murphy : Thanks very much, Clive. Yeah, so what I would say to you is we had a balanced approach to investment, so we invested quite heavily in value. We also invested more in colleague availability and we invested in product availability, so supply chain, and it was the balance of those three that really gave us the breakout performance. We also did a bit more marketing and that was also very helpful. So it was those four areas with the principal sources of investment and in combined way, in a targeted way, they really gave us the kind of standout performance that we achieved over Christmas.

Imran Nawaz: Then in terms of own label versus brands, I mean it was a very similar picture over Christmas as it was over the first half that we had reported to you. So we saw strong performance across own label and actually even very, very strong performance as well with the brand. And then clearly the standout performance was from Finest, so a very balanced picture.

Ken Murphy : Our fresh food was a particularly strong performer, Clive, which of course is predominantly own-brand, and also particularly important for us because it's centre place meal occasions, which means that we get the halo from that. So that was really quite important to us.

Clive Black: And then just a very quick follow, you talked Ken about Clubcard in your opening comments there. It is very fleetingly mentioned in the statement. I just wondered in general how you would characterise

Clubcard given the power of the Clubcard Prices in recent times, please?

Ken Murphy : Well, look, it continues to be a real bedrock of our performance. It's a very important driver of choice for consumers. They see the benefits of it and they really like it. I think what we've done and what we alluded to over the Christmas period is clearly we introduced a little bit of personalisation and a little bit of gamification through Clubcard challenges to over 10 million customers, and that had a great effect. There was a really, really strong response to that, and that was just another example or iteration of our continuous move towards greater personalisation through the Clubcard.

Clive Black: That's great. Thanks very much for the insights gents. Well done. All the best.

Ken Murphy : Thank you Clive.

Operator: And from Jefferies, we now have Freddie Wild with our next question. Please go ahead.

Freddie Wild: Good morning, Ken, Imran and team, thank you for taking my question and happy New Year and all that sort of thing. First of all, you at half one characterised the consumer sentiment as stable to positive. Now I think since then, you've seen an acceleration in finest sales into Christmas. Would you still characterise consumer sentiment in that way or has there been any change there? And secondly, again, at half one, you referred to in relation to retail-free cash flow as it being your ambition to deliver at the top end or even above guidance there. Is that still the case? Can we still think about retail-free cash relief for this year coming in right at the top end of that 1.4 to 1.8 billion range? Thank you.

Imran Nawaz: On the cash flow one, I'll go first and then Ken, on the consumer sentiment. Look, on cash flow, we always basically give the range as 1.4 to 1.8. What we've always said is, yeah, over the last few years, we've delivered at the top end, but the range is a range and we will let you know where we land once we report back to you in April, but we feel good about cash and the delivery.

Ken Murphy : Great, thanks Imran. In terms of consumer sentiment, Freddie, yeah, I would reiterate that from a Tesco perspective, that the consumer sentiment remains neutral to kind of marginally positive. And so the battle of winning the customer basket is as ferocious as ever as you'd expect in January, post-Christmas, lots of credit card bills coming in, belts tightening, looking to be healthy, but that's the same every year. So we're geared up for that, we plan for it and our offer is reflected. So I would say for now, consumer sentiment is stable.

Freddie Wild: Fantastic, thank you.

Ken Murphy : Thanks Freddie.

Operator: Thank you. And up next we move to Monique Pollard from Citi. Please go ahead.

Monique Pollard: Hi. Morning everyone. Thank you for taking my questions. The first question I had was just whether you're able to give any colour around general merchandise performance over Christmas, either in store or what you're seeing via the marketplace. The second question was just around the Booker trading, obviously very strong from core retail and core catering over Christmas. Core catering, as you mentioned, was also strong in the 3Q, as customers eating out more and just wondering how we should think about the potential for that to normalise as we go past the Christmas trading peak. And then the final question I had was just around brands. Obviously you mentioned branded products selling very well alongside private labels. I'm wondering how you're seeing brands willing to invest in promotions in order to rebuild share there.

Ken Murphy : Thanks, Mon. Okay. So starting with general merchandise, we had a great performance on both clothing and our home performance at 5% growth. If you strip out the fact that we have effectively outsourced our toy business to The Entertainer, so they don't feature in our sales anymore. So that's just an important point to remember when you're looking at the top line. But the underlying performance on both home and clothing has been really, really good. And we feel particularly pleased because we relaunched our home business under the F&F brand in September, and that's been really successful. I think we've upgraded the product range, the environment, and that customers are rewarding us for that. So that would be our take on general merchandise.

In terms of Booker trading, you're right, the Booker performance and catering was very pleasing. It was really strong. It was a testament to the quality of particularly the fresh food that the Booker network provides and the value and the fact that they were in stock and available when others struggled. And so that really helped Booker's performance over Christmas. I think it's too early to draw conclusions on what that means for this year coming. I think that consumer belt tightening is a feature of the market and therefore we're pleased with the fact that we believe Booker has gained market share and is the winner in the market, but it's a market that continues to be tight, and so we have to wait and see. But what I can guarantee you is that Booker we believe will be in the best possible position to continue to win share in that market and continue to innovate in the market.

Imran Nawaz: Then in terms of percent on deal and brands, I mean clearly as every Christmas you see a step up and we've been seeing that step up from quarter to quarter. In any case, as we already told you at the half, and again over Christmas, if I look at it year-on-year, percentage volume sold is maybe up three percentage points higher this Christmas than last Christmas, but it paid off, helps Clubcard pricing and actually has been good for market share performance.

Monique Pollard: Very helpful, thank you.

Operator: Thank you. From RBC, we have Manjari Dhar with our next question. Please go ahead. Your line is open, Manjari Dhar, you can pose your question.

Manjari Dhar: Great, thank you. Morning guys. Thanks for taking my questions. I just had a couple by May. My first question was Finest and obviously another strong period of growth. I wondered if you could give some colour on the cadence of the growth in the 13-week Q3 period versus over Christmas, just trying to get a sense of whether that was relatively consistent or there was an angle of consumers looking to treat themselves. And then my second question was on Central Europe, that's obviously seeing a bit of recovery. I guess how do you see the outlook for that to continue this year and where could that get back to in terms of returning to prior levels? What's the trajectory there? Thank you.

Ken Murphy : Thanks very much, Manjari. So first of all, I think the finest growth was pretty consistently strong over quarter three and Christmas. So it was above strong double digits across the board, slightly stronger over Christmas, but nonetheless the momentum is there and so it's a continuation of the performance you saw in the first half. And what's particularly pleasing is that building on double-digit growth last year. So it's a brand that's really on fire and we're really, really pleased with it. Sorry, can you remind me your second question?

Manjari Dhar: Just on Central Europe and where you guys see that going across the next year or so?

Ken Murphy : So it's been recovering nicely as we've gone into the third quarter, growth rates around the 4%, strong in all three markets. So we're pleased with that, improving customer sentiment. They had a particularly strong sales performance on their non-food business, particularly in their toys and gifts. So we're pleased with that and we think they're in great shape from a value and proposition point of view as we come into the new year.

Manjari Dhar: Great. Thank you.

Ken Murphy : Thanks, Manjari.

Operator: Just a brief reminder, that is star one for your questions today. I'm now moving to Francois Digard from Kepler. Please go ahead.

Francois Digard: Good morning. Thank you for taking my question. First, coming back to the consumer sentiment, linking that to the UK budget on political tensions based on your presidents if not on the precedent episodes, what impact on consumer sentiment are you expecting for the year that starts? More precisely in your P&L, what kind of impacts of the higher UK rate do we have to expect? And finally, if I may, if you could update us on the retail media on where you stand now in terms of number of partners contributions to your profits, anything you can share with us would be welcome. Thank you.

Ken Murphy : Okay, so starting off on retail consumer sentiment as informed by the budget and the rise in kind of gilt rates, I think largely the consumer doesn't really take a whole lot of notice of things like employer NIC and gilt rates because it doesn't impact them directly. That's the reality of it. Not a lot of them are aware of it. Clearly for us it's more concerning. So it's something that we keep a close eye on, but it actually doesn't affect consumer behaviour on a day-to-day basis. Time will tell what impact it will have more broadly on jobs, inflation, et cetera. So that's something that we will keep a very close eye on, work very hard to mitigate for consumers as we have done over the last couple of years.

In terms of your second question, what we have always done consistently is talk about our ambitions for retail media. That it's there in the service of building stronger relationships with both consumers and with suppliers to first of all make us the most desirable place to build brands with as a supplier by giving very cost-effective, but very high returning results on media expenditure, but also other elements of brand building both in-store and digitally. And that's been very successful for us and it continues to be in strong growth. We don't break out the number individually and won't, we've always said it is a contributor to profits and it continues to grow as a contributor to profits and we believe it will continue to do so in the future. That's kind of as much as I'd say on it at this stage.

Imran Nawaz: Right. And then your last question on the P&L impact, and clearly we'll give you more colour when we discuss in April the year ahead, but look, I mean the way we think about it is it's another year essentially the way the last three years have gone, which is you get headwinds from the cost side. You can imagine the national contribution is going to be an impact, wage negotiation is going to be an impact. But at the same time as we had energy over the last few years or our own payroll record investments that we've been making, we've done well in that environment by making sure we take care of our own house.

And making sure we have a strong safe to invest program and mitigate the cost as much as we can. So as we put that math together, we'll give you perspective when we speak. But look, ultimately the principles of how we run the company won't change. We mitigate as much as we can, make the right investments for customers, make the right investments for colleagues, and continue to work on customer satisfaction. That has to be the right way and it's been working.

Francois Digard: Thank you very much.

Operator: Thank you. And as there currently no further questions in the queue, I would now like to hand the call back over to you Mr. Murphy for any additional or closing remarks.

Ken Murphy : Thank you. Saskia, thank you to everybody who's joined us this morning and for the questions, they were really excellent. I'd just like to repeat, we've had a really strong Christmas. As a team, we feel really proud of what we've been able to achieve, both from a customer point of view, but also in terms of the quality of the product that we're bringing to market and the relationships we've continued to build with our supplier base. We think it puts us in great shape for the year to come. Despite undoubtedly uncertain times, we have every intention of continuing to win. So we look forward to seeing you again in April, and I hope 2025 brings better things than perhaps it has alluded to over the last couple of weeks. Thank you. Cheers.