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EDITED TRANSCRIPT

TSCO.L - Full Year 2014 Tesco PLC Earnings Presentation

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PRESENTATION

Dave Lewis - *Tesco PLC - CEO*

Okay. Good morning. It's always reassuring to get some reaction from the audience first thing in the morning. Oh behalf of Alan and myself, but also on behalf of our new Chairman, John Allan, and other members of our executive committee, I'd like to welcome you to our results presentation.

As usual, Alan and I will make the presentation and take your questions at the end. But obviously, if there are some things where I can get extra flavor or answer any very specific information, I may call on some of my exec colleagues who are here, if that will be helpful.

January 8 we stood in a room similar to this and I remember saying to you that it was a very particular day. In fact, I think at the time, I described it as a bittersweet day because we had two messages to share at that particular point.

We had the positive message which was around a Christmas trading period that was stronger than many were expecting and was a demonstration that the retailing capability of Tesco was still alive and well, and when expressed in the right way, a very compelling and competitive force.

But it was also the day that we faced into and made the announcements around the need to restructure and to face into some of the financial challenges that we as a group had to do; and it was a phasing that we had thought very carefully about, but it was a day where we had two messages for you.

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And I suppose today's is similar. We have two big, big messages for you. We will talk around a GBP6.4 billion statutory loss. It's a big, significant number. And we'll share with you what it is that we did that got us to that number.

We'll share with you objectively how it is we looked at our business; how it is we faced into the fact that the market conditions that we find ourselves in are indeed challenging. But we've also faced into the consequences that our business has not been as competitive in recent years as we would like it to be. And we've looked at that objectively, and we'll share with you what it is we've done as we've faced into the consequences of that.

And whilst I can understand why there will be a lot of focus on that, there will -- and I'll seek through the course of the day to talk a lot also about the second story that I have to share with you which is we've been relatively busy over the last seven months with the help of a lot of colleagues around the Tesco business; in fact, all colleagues around the Tesco business. We've been hard at work in addressing the challenges that I've shared with you before.

And the story I have to tell you there is, actually, we're starting to see some very early -- key words very early -- but encouraging first steps that actually we're getting a return from that investment.

So those are the two messages that we need to share with you today. We'll do it in a similar way to what we've done before. I will start by updating where we are on the three key priorities, and will start with that message of what it is we've been doing to enhance the competitiveness of the Tesco business. Alan will then lead us through the Q4 results and the full-year results; and I'll come back and tell you a little bit about what happens next.

As always, obviously on January 8, we talked about the third quarter and we talked about Christmas trading. And today, we're going to talk about the transformation plan and the fact that we would say that transformation plan is progressing well. And you'll have a chance, if you didn't at the coffee break, to meet some of the new members of the team that are responsible for the activities of the last six months or so.

You've seen this chart a lot. It's consistent for a reason. We set out three priorities: Competitiveness in the UK; protecting and strengthening the balance sheet; and rebuilding trust and transparency in both our brand and, indeed, our investment case for the business. So what I thought I'd do now is tell you a little bit about what it is we've been doing against those priorities, since we last met.

Since the very first day, since the very first day back in September, looking at the business, talking about the business, setting out what it is we wanted to do for the business, you know that what we've been talking about is a need for us to really focus on investing and improve service, availability, and then selectively price.

That sequencing, as you know, I've emphasized. It was important for us to get the base availability better. It was important for us to get the service right. And when that's right, you get more bang for your buck when you do invest in price.

So we weren't saying we didn't need to invest in price. We just said we needed to do it in a sequential way because investing in price on a poor operating model is indeed wasteful price investment.

So some of the things we've been doing, we shared these with you. I'm sorry. This screen is a little small for the size of the room. You've got the books in front of you. I suppose, what I'm seeking to do here is show to you the long-term commitment that we have to be tracking that service improvement, that availability improvement, and that perception of price improvement.

I think what you see here is that we took a step up, and we took a step up and we've maintained it; and we continue to [hitch] it up. And for those who are very familiar, and the reason I take this to Tesco week 52 is, I think if you look back historically, actually, as the year got -- and Bruno's famous for having called this out in a particular call -- is, actually, these indicators normally went down at the end of the year; and, actually, we've held them consistent through the end of the year and, indeed, into the first part of this year.

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One I'd pick out, because a couple of you have asked me about it, when we talk about availability. Remember, for those [who work] the detail, we now measure it in two ways. We measure it through dot-com availability first thing in the morning; but we've also put a sales-based availability model which is done in the evenings. And we've seen a step up in both of them.

There's one benefit in that which I think few have -- the ones I've had a chance to walk stores with I've shared with, but I'll share it more broadly now because, actually, when we were running our stores very lean in terms of people, the impact of it was -- the unseen impact was as dot-com was growing, as our home delivery service was growing, actually, that was taking up a disproportionate amount of the colleagues in store.

You'd see, therefore, that there were more people in the store for longer, and you'd get poor -- not the service you would want in dot-com necessarily, and you'd also have a knock-on into the store.

The interesting thing, whilst this is about store based availability, as we've made this improvement, over the last four weeks, for example, our dot-com availability, grocery and home shopping availability, is the best we've ever had it since we launched that service. So we're getting benefits across our whole business by raising the fundamentals and the foundations in the way that we have been doing.

On price, you've seen some of the things that we've done at Christmas, at Easter. You'll have seen just lately that we've invested also in some more essential products. And if you were observant around in stores, you'll have seen the work that Jason and the team have done around chicken, around meat, around some of the dairy products, and again, some of the essentials. We said before that we would invest selectively in price, and that's exactly what we've done as we've done range reviews and the like.

I also said to you that one of the things, and we talked last time, is I was keen for us to improve our operational performance. So as we've driven up availability and as we've driven up service, actually, we've managed also to improve quite significantly across the Group the stock position.

So what this is is we're now three days lower than we were. It's a trend that I would like to see continue. It's an opportunity for us as a business going forward. And I'm pleased to say that, actually, as we've reshaped and refocused the business, we've actually been able to improve the offer for customers and make the model more efficient in terms of the way that we utilize our working capital.

But actually, the next two charts, the next two charts to that story that I want you to think about for a second are probably, probably the most important and leading indicators of those encouraging signs that I said. You saw from Kantar in their last 12 weeks, they commented on the fact that a 0.25 million people had come to Tesco's more than had done in the previous period. So more people are. I said to you at the first we were holding our footfall. Actually, we've seen our footfall improve over the last wee while.

The way we measure it is transactions, the number of times that the till rings. And what you see here, and I've gone back to the first quarter of 2013/2014, is for the first time in quite a long time we've got transaction growth in the UK Tesco operation. Right? So more people are coming, transacting more with Tesco in the fourth quarter than they had been doing for a long time.

And very, very, very importantly for me, I've used the phrase before that this would be a volume-led recovery, that actually what we needed to do was to get that engine running again because of the leverage that it builds all the way through our model, and I'm pleased to say that after four years of quite aggressive volume decline, for the very first time in that period, we now have registered a small volume growth of 1.2% in the fourth quarter.

In that quarter, there was deflation of around 2.2% in our business. Significantly, some of that was market. And you're very familiar with what's going on in the market, but some of that was obviously the investment that we were taking as well. But the important thing for us is that the volume is growing.

So the simple message over the last six months, as measured by that fourth quarter, more people are buying more things in Tesco as a result of the things that we've been doing and the service and the offer that we've been giving.

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So that's what's been happening in terms of regaining competitiveness in terms of the sales line. We also in January told you that we had some plans to unfortunately close 43 unprofitable stores. I suppose the news I have for you today is, as of April 4, that's done. Those stores are closed. It is being completed in, I think, a very professional, very considerate way. But it's also being done in quite rapid order and without too much disruption.

I've put on the right-hand side what that means, because we had the question: What does it mean in terms of the impact in terms of our square footage? And you see it; 0.6 million square feet as a result. And the breakdown you see there in terms of superstores, all the way down to Expresses. So that is being done.

In terms of the office, last time, we got a lot of pressure to say what's the number, so I'm going to give you some numbers today. I didn't give you the numbers then because I wanted to go through the consultation and the consideration for our colleagues. That's all now done so I'll share with you what the outcome of all of that is.

We were looking for a 30% cost reduction. That's indeed what we've done. And what I've given, for those who are very familiar with our detail is to give the reduction in headcount by work level.

So at the executive level, at my executive table, we're talking about 35% less roles. The level below, work level 5, it's actually 43% fewer roles. Walks all the way through. It's 25% in terms of jobs; it's 30% in terms of cost.

And I've given you the numbers here. On September 1, what I'm doing with all of these numbers is, if you like, from the day of starting in the business for Alan and ourselves, or just about -- Alan and ourselves, a couple of weeks later -- there were 9,766 people in the head offices of Cheshunt and Welwyn Garden City across Group and UK. Post the restructuring, it's 7,348.

So no problem in sharing the numbers. These are exactly what they are. Have to tell you that the senior management team that were at level 5 and 4 left the business at the end of February, so that's done already. The consultation is all finished for the rest. And over the next 10 to 14 days, actually, that will be completed as a restructuring of the office. We're on track to close Cheshunt in the way that we'd indicated and move everything into Welwyn Garden City in the first quarter of 2016.

We also announced that we wanted to make some changes in stores. And in stores, that was about simplifying the management structure in stores; delayering, if you like; but reducing also hugely the administrative burden that we were placing on stores to free up more time to be customer facing. It's a massive consultation. We're talking about a 0.25 million people that need to walk through that consultation.

And it was also about addressing some legacy issues we had around flexible working hours, and that's been part of that consultation too. The consultation started in March and will be, as we said it would be, complete by the end of this month.

In terms of numbers, on September 1 in store, we had 254,658 colleagues. At the end, as of -- when we finish this consultation at the end of April, there will be 259,310 colleagues, a net increase in numbers by 4,652 colleagues. I'm giving you the numbers because there's been lots and lots of numbers written about. None of them have been accurate, partly because we've chosen not to fuel speculation until the consultation is finished, but very openly giving you what they are.

The other bit I would give you is that that net 4,650 colleagues is net of closing the stores and delayering in. Right? So if you want those numbers, if these are particularly important to you, is the 43 stores that we closed had 2,500 roles in them, so they have come out. A little sidebar: 30% of those colleagues were able to find employment elsewhere in the Group. In terms of delayering, it was a similar number. Right? So we're positive 4,652 colleagues, having also taken around 5,000 roles out as we've gone through those changes.

So a little more than 2,400 colleagues have come out of the office. Net-net, post closures, delayering, 4,652 colleagues in the UK have gone in. So, actually, in the UK operation, we're talking about more than 2,000 net improvement in employment from September 1 to the end of April as a result of the changes that we've made.

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The question you'll ask me is -- because the thing that I'm interested in is if you take all of that and look at what the percentage of people are in our whole organization who are now customer facing, significant increase in customer facing, consistent with what I said to you before which is, actually, head office is about supporting the store operation, about helping stores serve customers. It's not stores serving the head offices, as has been suggested before.

We've also done some work in Central Europe. And we didn't talk about this in January, but it is a significant move that Trevor and the team there have led. Those of you know that in Central Europe we've been challenged, particularly in terms of profitability over the years and the return that we would want from that business. We have chosen to look at the four businesses and [run them as one]. We won't have four head offices in Central Europe. There will be one CEO for the totality of those four countries.

That's about leveraging the expertise. The offer that we're trying to reinvest in would be familiar to you. It's not dissimilar to the offer that we talk about in the UK around fresh, doing the ranging differently, giving great service and getting trusted on price.

So a significant move within Central Europe. And I tell you that, A, for information; but, B, because it also helps as I come to this.

On January 8, we said we would look for GBP250 million of cost savings as part of this restructuring, and we told you that it would cost us GBP300 million one-off to get that. These are all annual numbers. We've identified since then and taken action to generate another GBP150 million of cost-saving benefits.

So the program that we're running now, the program we announced in January, is very well advanced. But the program I'm telling you about today is, we're looking for GBP400 million of cost savings from our business, with a one-off cost of GBP350 million. Central Europe is part of that.

What I've tried to do, and we've not talked about this detail before, is if I put together the changes that we're making in international, which is principally Central Europe -- no big changes in Asia, Central Europe -- in the Bank with [Benny], and also in our shared-service center in India, again, same thing. From September 1, we would have had 18,672 colleagues there. Post these changes, 14,575 colleagues. So we've taken 4,000 colleagues out of International Bank and shared-service India as part of this reshaping of our business model. Net-net-net, GBP400 million; annual cost savings for GBP350 million one-off cost. That's the program as it stands today.

Second priority, the balance sheet, and questions I'm sure we'll get later today. Reduce the CapEx to GBP1 billion. In plan, in budget; everybody working too. You know, because we told you at the third quarter there won't be a final dividend, but what I would update you on is that as of Monday this week, we started the consultation on pensions.

We've started that consultation. It's a 90-day consultation with everybody that works with us. And that's about recognizing and keeping up to this point what people have accrued in terms of defined benefit, and then going forward, offering a competitive defined contribution scheme for Tesco colleagues within the UK. And I'm sure we'll talk about that when we get to the results and the questions that you've got for Alan.

The other thing that we talked about in terms of strengthening the balance sheet is we said in January 49 sites exited, not going to be built out. We are exploring with Steve and others what the alternative uses of those 49 sites are, and there are indeed some, including residential, but more to come on that later in the year. But we've also since we were last together concluded a deal with British Land. And that basically, if I put it in essence, is a swap of assets plus about GBP80 million/GBP90 million of cash to Tesco, but importantly, regaining the freehold of 21 of our superstores.

In terms of reshaping the portfolio, you know what we've done in terms of Blinkbox, Broadband. All of those things are now done, closed and completed. Dunnhumby is progressing exactly as we would want it to; very happy with the progress that we're making there. And we'll run that process exactly as we said we would.

You're going to ask me -- you are going to ask me, I know you're going to ask me, about where else we are in terms of the portfolio review and all of the things that go with that. I am afraid that the answer I'm going to give you is very similar to the answer I gave you in January. We're working very hard. We've got a clear idea about what it is we would want to do.

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In any way revealing that would make it executionally harder for us to do, so you need to respect the fact that we won't be in a position where we're going to tell you what it is. We think we should do it in the rest of the portfolio, but I will just give you some reassurance we've got a very clear idea about what it is we do want to do, and we're working very hard on it.

The third was about building trust and transparency, and that was around the brand, and it was around the business case. And we'll talk to you about the business case. Indeed, Alan will talk to you about enhanced disclosure of results in his section.

We've done a lot since we met. Alison, particularly Jason Tarry, who's running the commercial team, in terms of redefining what it is, how it is, we expect people and colleagues within Tesco to behave. So everybody, new code of conduct, March of this year.

In the commercial area, very specific new guidance and training around commercial income and how it is we want to recognize and how it is we want to deal with our supplier base. So a lot of work going on in that particular space.

A lot of work going on in -- we touched on it a little bit last time in terms of our activities in the community. Honestly, I cease to be absolutely in awe of how much colleagues do for communities as I go round and I find out more and more about what it is we do.

And part of that is that we talk about it in terms of the partnerships between Diabetes UK, between the British Heart Foundation and the Cancer Trust. I suppose we're by far and away the largest supporter of public health charities in the UK by a country mile. And we're proud to be so, and we continue to invest. And the results have been nothing short of spectacular.

You would have seen, I should say for Rebecca's benefit, that some of the activity that we've been doing which is about eating happy, the whole Farm to Fork initiative that we have in educating children about the supply chain, and food in general, received a very strong CSR award for the first time just a little while ago. And that's a nice bit of feedback to a team of people that have been working hard on that for a long time preceding me.

But there are some other things that we've been doing, Jason in particular, the tall fellow at the back. We had 24 different ways of generating accounting for commercial income. That's a lot. We think it's too many; we think it's too complicated. We think it potentially leads to some of the wrong behavior.

I've said it publicly before. I think if commercial income is focused on closing a profit gap you lose some of the purpose of what it was designed for in the first place.

Under Jason's leadership we're simplifying that. We're going from 24 of last year to five this year. And then -- and that's on a step to next year, it will be down to three. In fact, in our own-label supply chain, we've gone straight to three. We need one year to do that in our branded supplier base.

It's about simplifying, it's about being clear. Commercial income is an important part of our business, and we won't be changing that. We're just going to choose the way we choose to negotiate and how it is we want to see the value that is within a relationship with our supplier base is reflected in the cost for customers rather than in the way that we might buy or ship product.

Again, with Jason and his team, since we last met, I think I've [team] counted it up. I've spoken to 110 or so CEOs of our suppliers. Jason and I have had different sessions and spent -- either collectively or individually with suppliers walked their supply chain, got to know their business; but more importantly, listened to them. We've really gone with very open ears as to what it is they experience about our business; what works, what doesn't; what they'd like to see in the future; and had some very big, grown-up conversations about our business together.

I have to tell you, I've been really, really impressed and enthused by the fact the response that we get from them is, actually, they want us to do well. They've got some concerns about how we've operated. Some of them, just in terms of that complexity that I talked about in commercial income, they've found us an incredibly complicated business to work with.

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So what Jason and the team are doing, helped by Alan in the [finance], is just trying to make it simple again, get it customer-focused. They are the lord and master of everything that we do as a retailer, or indeed as a supplier. So we have a mutual interest in doing something for customers that nobody else can do together. And that's the conversation we've been having.

Jason's done a lot; commercial income training, all of those things. But he's also put together -- for people who may not know, we've put together a supply network. So actually, our suppliers can talk to each other about their experience of dealing with Tesco. They can share experiences; they can learn from each other. That was launched in the beginning of this year.

We do have a supplier Protector Line, so if you had a problem with Tesco in any way, shape or form, in the same way we have for our employees, there's a completely independent place where you could lodge that and be able to register with us if you think that we've done something that we shouldn't do. I'm pleased to say that nobody's called that so far, but it's been there since January.

We also a couple of weeks ago, and partly as a reaction to the feedback that we were getting as we went around as to there's just an awful lot of admin and bureaucracy that's taking up time and effort in the relationship where we wouldn't really want it to be. We've put a team, a very small team of people, so there's a helpline.

So if you're having a difficulty solving an invoice query, or a credit note or a piece of admin, or just the nuts and bolts, dare I say it, of the admin, there's now a place that you can call, and we resolve to solve those issues within 48 hours. And I have to say, suppliers have been particularly responsive to that.

The one I read last night which made me laugh as I looked through, because that is the one in fairness where we have had some calls -- Jason's nodding at the back -- there was one which was, there was a dispute with a particular supplier that had gone on for over a year. There were 102, I think it was 102, email exchanges that had gone backwards and forwards between and hadn't managed to resolve this relatively small issue that had been going on between different parts of the business. Happy to report, in 24 hours, the guys who were doing this sorted it out, resolved it, moved on.

But it's about just putting some focus into that area, and it's just a small example of that commitment to get us to back to a supplier relationship based on the customer.

The other thing about the new commercial approach, is, and here I do make a clarification, is we've talked a lot about range Reviews. We talked a lot about the end-to-end range reviews. And I -- previously, on January 8, I took you through one of them in quite painstaking detail to illustrate the point. You'll be pleased to know I'm not going to take another one and go through it in that detail today.

There's been about seven. There's a combination of two things going on here. If you want to do a real end-to-end, it takes time. Remember, we've just changed the people in Jason's team, and so, actually, I'm very keen that the new people are the ones that are doing [it], so it's important that we phase it right.

And there are some very significant end-to-end ones which take a lot of time. Some of them involve supply chains with the lead time of a year. So on those big, those really big range reviews we're talking about a program that will take us 18 months to walk through. Right? And to change that program will give us operational difficulties and I don't think it's the right thing for us to do. So we set out a program and we're really clear what we're going to do.

Having said that, there is some low-hanging fruit, and what we're doing is, where we can, making changes too. So in the last -- since we were last together, frozen food, oils, ready meals and three other categories, have gone through that. On average, there's about between 15% and 18% of SKUs net have come out of those range reviews. There's a lot more for us to do, but that range work that I told you about is going on. But I just want to be clear. When we finish end-to-end ones, it will be 18 months from now.

The whole objective clearer, lower, simpler prices, more stable prices. And that's where we talked about -- we did it on brands. We talked to you in January about brands. And the one fact I would give you there was if you looked at the detail of what we did on January 8, we lowered those brand

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offerings in Tesco by on average 25% in price. We stopped promoting. We put it into the price. We said these brands, your favorite brands, are now cheaper in Tesco.

Interestingly, in the four weeks following that move, the volume on those lines was up 28%. So some feedback as we've tried different things over this time about actually what it is we can do as we invest, remember, selectively in price, and get a different response, it is working for us. And as I said at the start, we're doing that in other places as well.

The one thing I would keep emphasizing is, because when I say range, I'm very surprised if I'm honest about the number of people that say: So you're going to become a discounter then. No. We're not. We're not going to become a limited-range discounter. Our intention is still to be market leading on choice. One of our great advantages is that breadth of range.

So having 2.5 times the range intensity of our nearest competitor is something we still see core and important to Tesco. The fact that we got to more than 3.5 times is too much for the model. It has unintended consequences and we want to get that away. But we do need to get back to, and will keep a range and a choice offer that's unparalleled in the UK.

So last from me, where are we so far? Volume-based sales recovery is beginning. I've shared with you the numbers for the fourth quarter. There's been a lot of active engagement with our suppliers, this point about redefining that relationship. There is quite an aggressive cost reduction exercise going on. And there's some active balance sheet management, some you can see, and some you can't see, so I will be recognizing that.

I suppose the two things -- three things I've got to say now is to the first part, and I'll come back to this at the end, I can say this to you,. I've been absolutely blown away by the way colleagues in Tesco have reacted to the challenges and the changes that we've brought. I've run through it in 15 minutes and it looks very easy when you write it on the chart. But the way people have engaged around restructuring, store closures, and all the things that we've talked about here, has been nothing short of amazing.

As we've walked through it, as difficult as it has been, nobody said to me, Dave, this is the wrong thing to do. I don't like what it means for me personally but I don't disagree. And the way that colleagues have engaged has been just very humbling, really very humbling, and it shows you something about the pride and the passion that they have in the business and it's really, really impressive.

Having said that, [God], have we just started? We really have just started. And we've got a lot to do. You can talk to me as much as I can talk to you about the market, the volatility, deflation, and all of those things. I'm quite happy to have that conversation. But in addition to that, we've got some things that we need to do. We need to keep investing in our offer; we keep needing to introduce some deflation of our own.

And as we repurpose our business model and make some changes, it won't all go smoothly. I'm really clear that it won't go smoothly. Touch wood at the minute that things have worked for us. So we expect some volatility. It won't be a straight line. I'd love it to be a smooth line. It won't be that. I think you probably know that, but it's worth saying. I think it will be volatile in the next 12 months.

The thing that I would want you to have no doubt about at all is we're clear about what the fundamentals are for our business. And even whilst it's volatile, we'll deal with the volatility, but we won't deal with volatility in any way that has a negative impact on our customers. Indeed, even though our level of profitability is lower than it's been historically, if we need to invest more in order to continue the momentum, we will do that.

So you'll see us all talk about reinvesting, reinvesting, reinvesting, because actually, over the next 12 months that's what we feel we have to do for the long-term good of the business.

So that's what we've done since we last met. What I'm going to do now is give Alan the -- is the results.

Alan Stewart - *Tesco PLC - CFO*

Thanks, Dave. Good morning, everybody.

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As Dave has said, what we've done is we've looked at our business, we've looked at our results, we've looked at our position, and we've taken that objectively into the results which I'm about to run through.

So on a headline basis, and these are the actual results -- I'll move into constant currency when we get deeper into the presentation -- but these are the actual results.

Our sales on a 53-week basis, we complicated things again. As it happened this year, we have a 53-week year. Generally, we have a 52-week year. So wherever relevant, we'll talk about 52 weeks because that gives a better comparison, but the sales and the overall statutory results are on a 53-week basis.

So 53-week basis, sales down 1.7%; translated into a 52-week like-for-like basis, down 3% at reported currencies.

Group trading profit. You'll recall that in December, we said we expected our trading profits to be not more than GBP1.4 billion, and in the full-year period, we've reported GBP1.39 billion.

The one-off items I'll come back to, a very large number. By far the majority of them are non cash. And that led to an operating loss of GBP5.8 billion and a statutory loss of GBP6.4 billion.

The underlying measure of profit, which again I'll come back and talk about later in the presentation, was GBP961 million, significantly down year on year, leading to an underlying diluted earnings per share of 9.42p and a statutory loss per share of 70.24p.

If we then look into the segmental performance, and these are on constant currency, 52-week basis, so really giving a better feel across the four business segments we have. We have the three regions geographically and we have the Bank.

So in the UK, our sales down 1.7% and trading profit significantly down at GBP467 million. A lot of you asked earlier when we spoke would the UK make a loss in the second half of the year. In the results today, we're clear that we did make a small loss in the second half of the year. And that's the base from which we're building the business.

Asia also impacted, and we'll come on to some detail; 0.9% down, and profits down 15.3% at GBP565 million.

The European business, 0.6%, GBP164 million; significant drop in profitability in our European business. And in the Bank, despite the investment we've made in the personal current account which launched successfully in the period, profits flat at GBP1 billion, leading to the overall results, GBP1.39 billion trading profit and sales of GBP69.7 billion.

Turning into more detail on the UK, the like for like in the UK is an important measure of the way that we look at it. And we look at it on a quarterly basis. As Dave has said, you should expect volatility and we wouldn't necessarily expect that this would be on a straight-line basis, particularly because it is by reference to prior-year periods.

However, the trends that we've seen since the low point in the second quarter of the financial year we've continued to see improvement. So Q3 results we reported down 4.2%. Q4 results are down 1%.

Now within that, the Christmas trading period, which we reported back in January, was slightly better than that. But overall, we can see in the quarter sales down 1%. Christmas, just for reference, was down 0.3%. So over the whole quarter though, a significant improvement in terms of the quarterly performance.

And if we look at that by segment, which again gives some greater insight into where the different parts of the business are trading, and this is something which a lot of you have asked questions about.

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We've continued to see the trend across all four categories, the Extras, the superstores, the Metros and the Express businesses. And I think the thing that's worth calling out is that the greatest improvement in the quarter, admittedly we're talking about decimals here, but the greatest improvement in the quarter was in our Extra stores which are our largest stores.

It says something in terms of when you get the range right, you get the availability right, and you get the pricing right, these are very attractive destinations is our belief. And we'll continue to look at those and look at the business across those four categories.

The other element which is worth calling out is how our online business is doing. So you can see across the whole year our grocery business grew by 11.5%, our general merchandise by 14.3%, and our clothing business grew very strongly at 28.5%.

So we continue to see shift into that channels, and we continue to balance the way we trade those channels. But they all remain very significantly low in terms of overall parts of the business than these four store -- four channels, which are by far the bulk of our UK business.

When we look at trading profit, and I'll say it again because every time we put this slide out you will get out your bar charts and your rulers and try to work out exactly what's happening. But what we're trying to give you here is a bridge from where we were last year in terms of the UK trading profit to where we've turned out in the year.

And you can see that some of the -- last year, we had the commercial income adjustment which we've set out in the presentation and the press release today, and that effectively lowers the base for last year, GBP208 million lowering of the base. The -- sorry, in the UK it's GBP145 million lowering of the base.

The like-for-like sales clearly have an impact, and we've tried to estimate what that like-for-like sales decline is. And then, of course, we move to what have we done in the second half of the year having been here since September and really taken some initiatives. And we've invested around GBP300 million in terms of the extra service into stores, the extra availability and some of the selective price.

Of course, there were a number of initiatives that had been entered into in the first part of the year, and those had consequences, and we see those now.

The other thing which is important is that, and this is something we have spoken about, is that our yearend was invisible to our customers. We've had no elements of yearend in our results here because we have taken those out, and we've got -- from a customer perspective the businesses continues to trade as if there was no yearend.

So that takes us down to the -- this level in the chart. And then, of course, we also have cost base inflation, and we have quite significant inflation. We have upwards rates, we have cost inflation in terms of our salary bills, and we've had some benefits. But net-net, that takes us from the GBP2.19 billion last year to the GBP467 billion -- GBP467 million that we made in the second -- in the 2014/2015 financial year.

I come back to the base for the second half of the year in the UK, was a loss.

If we then move to Asia, Asia as a market -- in all three of our markets in Asia, we face challenging conditions. Korea is our largest business. Malaysia and Thailand we also face some challenges.

Overall profits were down 15.3% in constant currency, and this really reflects the operational gearing in the business. And it's something which we look at and we'll continue to focus on. We need in all of those markets to get volume coming through our businesses. And our trading margin relatively flat year on year with a decline overall; between constant currencies and actual exchange rates, but overall, about 100 basis points decline in our margin in our Asian business.

Europe, again, challenging market conditions in our European businesses. Equally, currency strongly impacting these businesses, but on a constant currency basis, our like for like down 0.8%, trading profit at GBP166 million, and a change overall of 31% down.

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Our Irish business has faced strong discount pressure. We've spoken about that during the year. And our Central and Eastern European businesses continue to face pressure.

Included in these results is also a one-off charge of GBP30 million in respect of our Turkish business where we wrote off a petrol wholesaling debt. However, in all markets, challenging conditions. And again, margin change of around 64 basis points in terms of our trading result. Challenging market conditions in -- across all of our territories.

The Bank, as I've said, performed well. It invested strongly in the customer offer. Personal customer accounts were raised. And overall revenue up 2.1%, with the deposit strongly up and our profits held stable.

It's got a very strong capital ratio. Tier 1 capital ratio is up 1.2% to [15.2%] in the Bank. And it's a business which we see continuing to grow very strongly. From a customer perspective very, very high trust in it and a very strong residence with what we offer our customers. So continue to invest in that business and to see the growth that we've seen coming through.

The next line on our P&L is our JVs and interest and tax. And in here, the major change I will talk about is that the fact that our JV result in the current year includes from May the inclusion of our previously owned business, the China business, it's now treated as an associate. And that business made losses in the year, which is the primary reason for the shift in JV profitability year on year.

Our net interest cost went up for a number of reasons. We've refinanced our facilities. We are capitalizing less. We're carrying less CapEx. We're -- therefore, we're carrying less capitalized interest into it. And we also had some redemptions. So overall, GBP409 million compared with GBP315 million.

And then finally, our tax, GBP199 million of tax. Our effective tax rate is 20.5%, and this is higher than last year, principally because last year, because of the change in the overall UK tax rate, we had two years of deferred tax balances catch up, and we would have spoken about that last year. Overall effective tax rate 20.5%.

So that takes us down to the one-off items, very significant one-off items. And I'll just talk you through these in a little more detail. There is a lot more in the deck, and then there's a lot more in the detail of the financial statements at the backend of the press release as well. Please feel free to ask any questions about them in the Q&A.

The largest in the property. This splits into two elements: The trading stores, and this is principally UK, but it's also we've look at all of our trading stores around the world.

GBP3.8 billion of impairment in respect of the trading stores. We've also written-off GBP925 million in respect of the development sites we're not going to develop, and we've ensured that we're not carrying anything on our balance sheet that isn't going to give us value in the future. So that's GBP925 million. Those two together give the GBP4.7 billion property write-down.

Within the goodwill and other impairments, GBP630 million of that goodwill impairment charge is in respect of our joint venture with China resource in Hong Kong. You may well have seen that those shares have been suspended for two weeks. Yesterday morning, China Resource Enterprises and CRH, China Resource Holdings, its holding company, announced a proposed restructuring of that business whereby our joint venture will be transferred out of CRE into CRH.

For us, it means very little change. The joint venture continues, but clearly, there's been some value put on that business. And we've looked at it compared with the expectations of that business and the value which has been put on that as a third-party transaction. And overall, there's a GBP630 million charge in respect of that.

The balance of the goodwill write-off principally relates to Dobbies. And then, we've also look at other UK elements such as Harris+Hoole and Euphorium where we've slowed the rollout of those. As Dave said earlier in the call to the journalists, the way we look at some of these ventures

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is we want to ensure that they are making money. We're very strongly in favor of innovation, but equally, we don't want to roll them out strongly until we're very clear as to what the offer is and what we're going to get from it. So in respect, those are the goodwill and other impairments.

The stock write-off comprises principally two elements: GBP570 million; again, this is across the whole of the Group. And we've moved from a basis of provisioning stock based on the basis of when we bought it, so an age basis, to a basis now based on expected sales. And the way we look at those expected sales is by reference to the last three months sales actually. So this reflects the realities of the business as we are. Again it's a non-cash item and it's the large majority of that.

We've also looked at given the changes we've made in store activities as to how do we capitalize costs into that stock, and we've taken GBP168 million of a one-off charge, reflecting the fact that previously we'd be capitalizing more costs into stock. Now, with the new ways of working, we're not doing quite as much of that, so GBP168 million.

The restructuring charge, GBP450 million, is -- by far the majority of it is either what we've previously disclosed at the half year, or the GBP300 million that we announced at the start of the year. There is some further in relation to what Dave has just spoken about, and we'll deal with that as we go into the current financial year. So the GBP300 million that we previously announced, plus the already announced half-year numbers, forms the majority of that GBP416 million.

Commercial income. We previously announced in October GBP145 million of prior year adjustments for commercial income. As we said in October, we would continue to look at this and we'd continue to look at it as we went through the yearend. We have done that, and having now carried out further audit work, having carried out further work into all of these areas, we've now increased that charge to GBP208 million in respect of prior years. And we've given some detail in terms of the press release as to how that fall in -- fell in last year and the year before that. Again happy to answer any questions.

And then the other items are a number, including the disposal of Blinkbox, about GBP80 million. We previously spoke about the change in the ATM ruling in terms of rates on ATMs, and that's GBP41 million of it; and also, in the Bank, the PPI charge of GBP27 million, which is somewhat up from the -- slightly up on the half-year number.

So overall, that leads to one-off charges of GBP7 billion. GBP600 million of that is the cash element in terms of what we expect to spend in cash. The remainder is a balance sheet item.

Again, come back to a format which we set out back in October in terms of retail cash flow. And what we're trying to do here, and will continue to do as we go forward, is to give you a clarity on where we're earning the cash and a clarity of where we're spending the cash. This is obviously looking at the retail business because the Bank has a very different way of operating, so we'll always look at retail cash flow.

So cash flow from operations before the one-offs, GBP2.5 billion. We've set out detail in here how the one-offs work through, working capital as statutorily recorded. It is complex. It's very technical. I'm sure that we will face questions on it. But I'm sure we can take it through.

And we've tried to give you a very, very clear linkage from what we're showing here back into the detail of the financial statements that we're publishing today and the reporting and the notes. But it is technically quite complex, so please, please bear with me. This is the cash flow from operations that we generated in our retail businesses.

We then have working capital, and in the year, we've had a GBP660 million outflow of working capital. You'll recall that in January, I spoke about the fact that one of the ways we engage with our suppliers was in relation to payment terms and that we expected to see some outflow of cash as we went through our yearend; and, indeed, we did.

So this GBP660 million is about a GBP400 million improvement in underlying working capital, and we've seen some of what Dave said in terms of stock days, offset by that change in the payment terms. This is an adjustment which we have taken. We think it's the right way to run the business, but it has adversely affected working capital in the current year.

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There is a very small amount which we still will take as we go through the current year we're in. That's about a GBP200 million aspect of working capital further outflow which we would see as we go through this reporting year. But beyond that, we will be operating again on a basis that cash payment terms and timing of payments is not something that we talk to our suppliers about other than on our standard terms.

We spent GBP2 billion on CapEx net of disposals, and that's in line with the guidance and what we'd set out.

We then get into three areas which are linked: The acquisitions, the disposals, the investments in loans and the debt disposed of. And these, very little change from what we spoke about in October. This represents investments such as Sociomantic, investments in our online -- the platform Lazada in South East Asia; and also, the investments we've made as part of the China Resources transaction we carried out. With the disposal of our China business some debt went with it, and those three are shown here.

Interest and tax are calls on the business, as are the dividends, and this represents the cost of the dividends in year from a cash perspective. In the current year, of course, we've got no final dividend, and we'll talk about dividends in respect of the year we're in when we get through the year. But that represents last year's final dividend and the interim in terms of the cash impact.

That led to an overall outflow of movement in net debt of GBP1.9 billion. And the other side of it is, of course, the net debt on the balance sheet which is GBP8.5 billion.

We set out very clearly our CapEx. This is no change from what we said in January. And just to reconfirm that the CapEx for the current year is at GBP1 billion. That CapEx is focused very strongly on productivity. We're focused on return from it, and we're focused on ensuring that we do not damage the business.

And that's something which a lot of you have asked about and I can ensure and assure you that we will make investments where we need to; we will invest in stores. We will ensure that we keep the stores satisfactory. And equally, in markets where we can see growth and opportunity and a return from that CapEx, we will invest in new store openings.

So we're trading very, very selectively. We're being very disciplined in terms of it. And for the year that we're in, we've confirmed that it's GBP1 billion of CapEx spend.

Liquidity and funding, again, a very important part of our overall balance sheet and the way we look at the Company. Just to confirm, the bilateral facilities we've got are GBP2.2 billion. They expire in 2017 and they're across a very wide range of banks. So essentially, they were entered into as three-year facilities.

We then have the revolving credit facilities of GBP2.6 billion which expire in November 2019. Those are extendable for one year plus another year, so they're a 5 plus 1 plus 1, which is very standard market practice. And then again, they're with a very wide and strong group of banks.

There is, some of you doing the math might well ask, well, that adds up to GBP4.8 billion. We'd set out previously GBP5 billion of facilities, or GBP4.8 billion. We set out GBP5 billion. There is GBP200 million of the initial facilities we put in place which we would expect to see moving into bilaterals over the course of the year. So within our overall business, we have GBP5 billion of facilities currently undrawn, and that's a very strong position.

Leverage is something which again we've highlighted, and we spoke about it in October. The way we look at our total indebtedness is the on balance sheet debt, GBP8.5 billion. We then look at our lease commitments, and we have estimated those as GBP9.4 billion within our overall -- again, there's detail on this in the press release today -- GBP9.4 billion, which is slightly down year on year.

And then the pension deficit, and this is an IAS 19 pension deficit -- I'll come back and talk about pensions -- IAS 19 pension deficit of GBP3.9 billion, which is up from the prior-year figure. Overall indebtedness, GBP22 billion at the balance sheet date and the way that we look at it.

What I would stress is that we have the facilities. We have no short-term maturities. In fact, we've got no significant maturities for more than two years. And we have an undrawn perspective with that. So we've got a strong funding and a strong liquidity position.

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We announced in January that we would start consultation with our colleagues in terms of closing the pension fund. More importantly from my perspective is the triennial valuation which was in train as Dave and I joined in September last year, and the triennial valuation is done off the March 2014 actuarial valuation.

Very important to us is that we meet the obligation we have given all of our colleagues and that our trustees administer on behalf of that. And we're committed to meeting that obligation.

What's very important as well is recognizing that that obligation will pay out over a number of years. And, therefore, this is something which is going to be with us for many, many years.

Important for us as a business is understanding with the trustees the risk we've carrying in that pension commitment, and the cash payments, if there is a deficit, as to how we're going to fund that.

And I'm really pleased to be able to confirm that we've agreed and had the trustees enter into a deficit funding plan with us which gives us clarity of cash flows of GBP270 million per year through this triennial valuation. Now that will be subject to every three years it will be tested, and that's something which the regulator in truth is able to look at at any one time, at any single time. But for us, it's important that we understand, and for the trustees, what it is that we're funding on a regular basis towards our pension deficit. And it's GBP270 million that we've agreed.

The actuarial deficit as at March last year is GBP2.8 billion. Again, we've looked at this and shown you the IAS 19 number. The IAS 19 number has moved year on year, but for me, much more important is the cash that we're paying out, because the IAS 19 number will move. It's a function of bond rates, it's a function of asset performance, and it's a function of different factors. It's the cash that we're focused on.

One comment in respect of the pension fund performance, and a lot of people -- a lot of the speculation in recent days has been what size is the pension fund deficit.

The bond yields have certainly come down; that's driven the liability as measured by that bond yield up. But the assets in the second half of the year performed far better than had been expected by those making those calculations.

So what we have today is a recognition that at GBP3.9 billion, the pension deficit IAS 19 is big, but we do have assets and liabilities which move. And we will continue to focus on de-risking the asset investment side such that we can give predictability on how we're closing that pension deficit, whether it's measured actuarially or IAS 19.

And then finally, and this is very important to colleagues, and as Dave has touched on as well, we are in consultation on closing the defined benefits scheme. We will replace it with a DC scheme. That DC scheme will be market competitive and it will give colleagues the security in terms of their pension arrangements, but it will be different from what we've had up until now. And we've just launched it. We will continue to engage and take feedback as we go through this year.

We've also spoken about trust and transparency in the investment case and how do we present ourselves in a way that helps our investors and our other stakeholders. And thank you for all of you who've engaged with me, with Chris and with us to try and take your feedback.

Some of you have asked for commercial information, which I know why you want it, but for us, we need to protect ourselves and our investors. So there's some information which has been asked for which we won't give. But we will continue to look at this and we seek to improve it.

We've given more and different disclosure in all of our press and reporting today, and when we publish the annual report and accounts in a few weeks time, there will be additional notes. But we've tried today to capture that important information which you would want and we would want to be giving you on the day of the results. And we've tried to do it in a way which is clear and in a way which reflects the further information you've asked for.

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So we've spoken about commercial income, we've spoken about property, and I'll give in to you more detail on that. And we've also split out the retail and bank net debt. So it meant for reporting, we've given more information, and as I say, we will continue to listen and hear. We've also moved to a simpler profit measure.

So commercial income, and this is something which forms, as David said, really forms the backbone of our relationship with suppliers. What people call commercial income is different in different businesses. That's very, very clear to us. Equally, commercial income by itself doesn't represent the full economic relationship we have with our suppliers. But the FRC has asked us, and we've responded and we will respond, to look at the areas where there's subjectivity and to look where there's judgment.

So we've had 24 categories. As we've said, that's not an easy way to do business. It doesn't give clarity as to what it is that we'll be looking at. And we'll move progressively to the three that Dave has highlighted. Most of the way we engage are just impacts on the price that we're buying the goods. No judgment involved in that. That's just the price we're buying the goods.

When we get into the yearend, there are some adjustments where we have volume-related transactions, for example, where we have a price that will be dependent on volume, and we have to make judgments in respect of that. We equally have areas where we don't have -- we have not yet received the income or we have not yet invoiced the income. And I'll just talk you through the three categories.

I've put up on the slide here the Group and the UK figures for the current year. Within the presentation and the press release, there is also the prior-year number, so you can see how they've moved year on year.

So inventories, where we have effectively got a reduction in the price that we will expect in future based on volume deals that we've done, GBP93 million in the Group, GBP67 million reduction in the inventory carrying costs of the -- on the balance sheet of the stock that we've bought.

The other side of that entry for those of you who are doing the math, the double entry, is effectively it reduces the overall trade payable that we have in our balance sheet. So it's a balance sheet adjustment, but it's a judgment.

The next three categories, the trade and other receivables and the trade payables, really are different sides of income that we've earned but not yet received. So we've either recognizing that it's invoiced but not received or it's not invoiced and not received, or it's an offset against a trade payable where under the technical accounting rules we then have to reduce the creditor that we've set up. So those are very -- all three similar aspects relating to judgments in terms of income not received and balance sheet items.

We then also finally get where we, for whatever reason, have received income in advance but we haven't yet earned it, and that obviously is something which goes the other way from the other three.

So that's the transparency we've put on it. That's the judgment. As you can see, there isn't significant judgment in terms of our yearend accounting balances, but that's the clarity which we've given on it. And we will continue to give this information as we go forward.

In respect of property, this is an area that a lot of you have asked about. There is a lot of detail, and please feel free to ask questions. Overall, our property valuation is down year on year, and we've given the details for that and we've also changed the way we look at it.

So prior years, we've included JVs in that headline number. This year we're not, but we've called it out separately. So GBP22.9 billion is the owned property valuation. On top of that, there's GBP900 million of JV valuation which is -- could be added to the property, but we've split them out. We've given the segmental view of it in terms of this presentation, and as I say, there's more detail in the deck.

We've also introduced a new way of looking at the space that we have. And I think this is an important metric because we've always defined space by reference to value, and values, as we can see, can shift because we have -- there's a market view on that. So we've given both the by value, 40%, 71% and 74%, overall a Group position of 53%, which is consistent with what we said before; but we've also then looked at it by the actual physical space which is a metric which nobody can really argue with because there's no value implication. And when you look at that, it's a 59% that's owned by the Group, and a somewhat higher percentage of space in two of the markets; somewhat lower in the Asian market.

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Those metrics are ones which we will continue to look at, but I would increasingly focus on the space measure because it isn't influenced by external metrics on value.

And then finally, just for the record, as Dave said, we completed the British Land asset swap, and that is not in these numbers because it was completed after the yearend. Within the numbers, it's just under 2% in terms of the UK numbers, that it will shift the numbers.

We've also looked and listened in terms of the way that we measure ourselves in respect of business results. And going forward, we're removing the concept of trading profit. We're removing underlying profit as metrics, which we will talk about. And we're moving to an operating profit measure. So we will judge ourselves in terms of operating profit as the key performance measure for ourselves internally and externally.

Against that, if there are large distorting items, we will call them out. But the principle we're adopting is operating profit, which then, I think, gives a clear line of sight from the statutory reported numbers through into the way that we run the business, through into the different divisions. And we'll be adopting this with effect from our half year at the end of August when we come back later in the year.

So in summary, what we've done is, as I said at the start, we've faced into the conditions we're trading in; we've recognized that our performance is not satisfactory, and we've taken an objective translation of that into these results.

Our pension deficit is agreed. We've got a clear line of sight in terms of the cash commitment to that. And we expect that to run through irrespective of accounting variations and then to be measured and tested every three years under the pensions regime.

We've had a disciplined approach to all of our CapEx and we've got a strong funding and liquidity position.

Over to Dave.

Dave Lewis - *Tesco PLC - CEO*

Thanks, Alan. So with those as the results, let's talk about where we go next. You wouldn't be at all surprised to see this chart again. Our priorities for the next 12 months stay unchanged. The focus on the UK, the balance sheet and the rebuilding that we've talked about, is clearly where we feel we should be focused and addressed. There's still a lot of activity going on elsewhere in international, in the Bank and others. That will continue. But in terms of the priorities, we see these as staying consistent.

I suppose the thing, and I get asked this question in different ways, but it gives me a chance to talk to you a little bit about the market and the outlook.

Everybody talks, quite rightly and you don't really need it from me, about the market volatility that's out there. At a macro level there's deflation, or the prospect of deflation. Commodity prices are softening. And that's great news for customers; not so much great news for retailers in that context. But that's macro; it's exactly what's happening.

The interesting thing is whilst it is good news for customers that they have more money in their pocket, it doesn't seem that they're spending that money in our categories. They're spending it more on bigger capital items and travel and paying down debt than they are here.

There's also all the challenges that come from what's happening to the channel mix. Again, you know all of that. So the market is unprecedented in terms of the volatility, the change and the things that are happening.

In addition, we've got our own. We're changing our business model quite considerably. Some of you are more familiar than others, but what we're doing, we try to share with you what it is at an operating level we've done. But what I would also try and give you a sense for is the conversations that Robin has been running the UK have, [Jill] also in her role and myself with Jason is we sit down and we say: Look. It's not that we haven't been investing a lot of money in the customer offer. We have; a very significant amount.

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We talked about it back in October and January. The question for us is we actually look at whether that's the right way of investing it, and we say: Actually, do you know what? Given all the conditions, we'd actually prefer that to be reshaped and offered in a certain way.

So we're clear about how it is we'd like to do it; that clear, stable, lower prices, run in the way that we said. But the activity of actually stopping that activity -- and the guys are smiling at the back of the room -- because you know, you can tell what the impact was of that spend, taking that, repurposing it, putting it into the offer in a different way whilst we improve the quality of everything, is not a precise science. Predicting exactly what the reaction is of taking from there, putting from there, reshaping everything whilst you're trying to raise the floor, that's what we're doing.

And that's why when we say we've got our own volatility, we've got our own investment to make, we've got our own deflation to put into that mix. So the combination of the market volatility you know well, and the management challenge of walking through that changing business model, that's why when I'm saying, I think, do I consider it to be a volatile situation going forward, yes. Will this recovery be a bumpy recovery? Yes, I think it will. And that's okay, but we'll do it on a fundamentals basis. But that's what it is we're trying to deal with.

People always say, so I'm preempting some of the questions I might get probably in the other room after this rather than here, is that people say: So, Dave, what's the biggest thing; what's the hardest thing at the minute? And honestly, I have to tell you, the hardest single thing at the minute is gauging the pace of change.

We've told you what we've been doing in stores, in head office, in our operating function; also in terms of what it is we're doing with our offer. If you sit in Alison's shoes as the HR Director at Tesco at the minute, you're sitting on one of the largest ever restructuring consultation programs you will ever see. Right? Now Jill, in her transformation role thinking through how it is we manage all of that change program, and changing things, whilst at the same time trying to keep that momentum in improving the operational offer, that's difficult. Right? That's the difficult bit.

Because I suppose what I'm saying to you there is: We do know that there are other things that we could still do, that we could do on top of what we've got already as a plan. And some of you have been kind enough to write to me and make those suggestions. And do you know what? I didn't find many that I disagreed with.

I suppose the question for us is we've done a lot in six or seven months. Getting that pace right as we walk through, consulting with, changing all the operations and not dropping the ball, that's what it is we as a team are trying to manage at the minute.

So that's where we are in terms of our biggest challenges.

I would re-emphasize that our priority is, and will always be, investing in the customer offer. So I make no apology for the fact I will keep talking to you about what we're doing to raise our service levels; what it is we've done in terms of investing in colleague hours, simplifying the offer and getting the service right.

You will hear me keep saying, I say it to every colleague I see, I just want customers if every day one customer walks away from Tesco with an experience they didn't expect, that's 300,000 people a day who start to think differently about our business. That's what we're focused on.

The availability. I talked to you about the range, and that's an offer that people really do appreciate. Everybody talks to me -- I thought I'd say this when Alan was talking. Everybody talks to me about the convenience trend or the move to convenience stores. Actually, the trend is to convenience. But actually, what's more convenient to going into one place where you have everything you want at a price that is competitive and the service is excellent? That's the most convenient shopping experience you can have. And I think Tesco is uniquely placed to do that. We just have to reengineer ourselves to offer it again more consistently.

And then there is more work to be done on price. We've done it carefully, we've done it selectively, and we've seen a reaction to it. We're clear that there's more that we want to do. But we're also clear that we have to keep the discipline of generating the benefits in order for us to be able to invest in price. The results speak for themselves. We don't start from a place where that's something that we can do for free, and we need to generate it to do it.

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And on there, I suppose it allows me here to make a comment about the profitability. We've announced an operating profitability of around GBP1.4 billion, just under GBP1.4 billion, in line with what Alan and I were saying. But within that is a second half-year, UK basically, break-even position.

We've also got a significant cost inflation issue around leases of around GBP200 million or so. And we've got some other challenges: The investment in price I'd like to make, the fact that Hungary legislation has taken away the profitability of that business. So getting back to the profit that we made this year is -- tell me it's not without its challenges. We've reset and we're going to rebuild.

I suppose the one thing that I would say to you is: That is our aspiration. We don't -- really, ideally, do not want to go below the level of profit that we have today. But I will be honest with you and tell you that, actually, if we see the progress continue in the way that we are, and depending on what happens competitively or whatever in the marketplace, we feel that we need to invest, and invest GBP0.25 billion more, we will.

The long-term fundamentals of this business are absolutely fantastic. The market's difficult. I get it. But it's a cyclical market as well. We will do the right thing for the long term of the business. That's what shareholders would want us to do, and that's what it is we're committed to doing.

Two final things from me. KPIs. Part of the trust and transparency, part of the openness, but also helping you going forward, these are the KPIs. So for me, myself and everybody, all the way down to the shop floor, our annual KPIs as a business will become quantum of sales. It's 50% of people's individual target, quantum of sales.

Quantum of Group profit is 30%. And everyone, myself included, will carry three individual objectives, specific initiatives that we're responsible for delivering, which together will make up 20% of any annual reward.

There are also -- in terms of long term, we've made some changes to the long-term incentive plan for this next 12 months. Some review going on there. 70% of that will be TSR, and we'll share with you what the peer group is, and 30% on cash generation.

So those are the KPIs and performance that you'll see us manage the Group to going forward. And also, for those who are familiar, the simplification of the steering wheel that goes all the way down has a balance of six measures in it. The three which are around sales, profit and cash are all there, but they're also balanced with three measures: One for customers, one for colleagues and one for our engagement with communities and suppliers. And those will be the six things that we drive all the way through our business.

Finally, and if you haven't got your pink T-shirt yet, I encourage you to get one. We kicked off last week -- in fact, if you'd come into the exec meeting last Thursday you would have been met by a sea of pink, which is quite a sight to behold. We've been 14 years, I think, as a partner with Cancer Research. And over the weeks ahead, my colleagues, but also a lot of other people, will be Racing for Life.

And I thought it was an appropriate picture to put up to reprise what I said a little earlier, which is we've changed a lot, we've done a lot. Some of it has been really quite painful. Some of it certainly has affected the business that colleagues have worked for a very long time.

These guys have been amazing, absolutely amazing. As a group of people, to face into the challenge that we have, couldn't wish for better. So whilst people will talk about many stories today, the size of the loss and the things that we're doing, these guys have done a tremendous job since the time I started, and I just wanted to say thank you to them.

We're facing to the reality, as Alan says. We're having to deal with, yes, a difficult market, but we're also facing the fact and being clear that our recent performance hasn't been what we would want it to be, and that's had a big impact.

We've not shied away from those consequences openly, but objectively, we're taking that into account. We've got a transformation plan in place. It's progressing well. We're ahead of where we said we would be on cost savings. And there's more to come and we'll reinvest that back into the business.

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The customer -- there are some signs that our customer offer is improving and he or she is responding well to what it is we're doing. And that comes, first and foremost, as we said it would, in the volume. So as I say, for the UK part, the improvement in transactions and improvement in volume is an important piece of feedback to us that we're doing something that people appreciate.

We've done some work on the balance sheet. There's more to come. You will ask us questions about it. We get it. But we are working.

The rebuilding the transparency and the trust in the business, we'll do it piece by piece. I've said it before, I'll say it again. You can't talk your way out of things you behaved your way into. We're going to behave our way out of this. Right? People will experience us differently every day, in store, in the supply chain, in the community, and we will invite them to reappraise us as a business.

I think, speaking for [Tesco], there's a unprecedented pace of change. It really has only been seven months. And actually, if you think about where we started in January, what it is we've managed to deliver in only three months is really quite important.

And the final thing I would say to you in terms of summary is this theme of a great business, great fundamentals, great long-term potential, even though the market is challenged at the minute. So we see -- where we see the opportunity to invest for long-term shareholder return, we will do it.

Okay. That's it. Do you have any questions for myself or Alan? And if we need some help from our team, we'll go (multiple speakers).

QUESTIONS AND ANSWERS

James Collins - *Stifel Nicolaus & Company, Inc. - Analyst*

James Collins, Stifel. I've got a few questions, if I may. So firstly, thinking about the waterfall chart that you showed on the UK profitability, what had impacted it year on year, the one bit that you didn't break out was what happened from the reduced focus on commercial income. So you talked in the statement about the fact that, clearly, there's been investment in availability, service, etc., but the reduced focus on commercial income has hit profits. Where does that fall? And an associated question, how much of that comes back as that normalizes?

Second, on your comments about volatility one thing that I note in Kantar data, it looks like your promotional participation has actually been rising over the last six to nine months. So is that something that you will be pulling back on, and is that going to be one of the sources of volatility that you're talking about?

And then lastly, can you just talk about vouchering; where you are on vouchering, where you've been and how that's impacting the business?

Dave Lewis - *Tesco PLC - CEO*

Do you want to talk about the waterfall chart, and I'll do the --?

Alan Stewart - *Tesco PLC - CFO*

Yes. In terms of -- it's a good question in terms of the commercial income. And, look. There are judgments involved in trying to break things out because you can always put them into different areas.

I think for us, the important thing is that the base was too high and we've adjusted that. Equally, and this is very important, we haven't had the yearend activity which perhaps accelerated and then led to a deceleration. Now we all know that when one gets into those sorts of activities, wherever they are in a business, the next year it has to be bigger. So we've stopped that and we've taken it away.

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The final point I'd make is that we are prepared as we reengage with our commercial suppliers, we are prepared to do what's right for the long term of the business, but maybe to short term detriment. So we will need to change the way we work, and if necessary, we will leave what might be some short-term money on the table in order to get the long-term right way of working with them.

Quantifying that is very, very difficult, but I really wouldn't expect that you should -- if what you're asking is should we see a bounce back in commercial income in the next year, I really wouldn't take you down that path, because if we look at where we were, we've changed the way we're running the business. Some of what we did earlier hasn't worked. What we're doing is focusing on what we can see working from a customer and a volume perspective.

Dave Lewis - *Tesco PLC - CEO*

So building on that, and then I'll come to the promotional question is that I think to support Alan and Jason is that movement from back to front is something that we see as important. So the quantum of commercial income we would look to recover. It's not a bounce back; it's not an immediate thing.

We talked about recognition in the half year of commercial income [when we took]. There was an assumption in our business that what had got us to that first-half position would happen in the second-half position, and we clearly didn't do that. We just clearly didn't do that. So let's just be candid; we didn't do that. We didn't do some of the things at the end of the year that perhaps we may have done in the past as well, and that had an impact.

And the other thing, and it's fair to say as Alan said, is actually having had that behavior for two or three years, then saying to suppliers, actually, we're not going to negotiate was also difficult. So there were some things where we chose to walk away from suppliers who wanted to negotiate within the old way. And that's not a critique, it's just that they'd learnt that as the way of doing it. And we said: Do you know what? We're not. So as a result, we did have to walk away from some things that historically we wouldn't have done. And that's about resetting the base.

But we want to get back to the level of commercial income that we had, but we want it to be simpler; more in the case price, less in the other deals. And it will take us some time to do that. It won't happen immediately, so not the bounce back.

Second thing is in terms of volatility, we should share with you separately what the promotional breakdown is, because actually, and it links to your vouchers point, so if I were to tell you in the fourth quarter we issued 30% less vouchers than we'd done in the year before, or the period before, we have -- it's back to that repurposing money. We've not issued anywhere near as many vouchers and coupons as we had been doing. And I checked it very specifically before I came here again.

What we have done, and it comes back to giving that benefit directly in store is we've taken that money, we've repurposed some of it, and we've increased those amount of promotions which give away product in certain categories at the point of [shelf]; so extra free, or things such as that.

So in certain categories, at certain points, we've done that. I don't recognize the overall increase that you mentioned in Kantar. Actually, when I look at our overall promotional participation, it stays about the same, but the mix underneath of it has changed a lot; significantly down in vouchering and more in terms of product that the customer walks away with and gets an immediate benefit from. And we think that's a better way for us to be running our business.

Clive Black - *Shore Capital - Analyst*

Just one question, if I may. The question on the balance sheet, if I may. I know you want to be relatively -- keep your options open, so to speak, but can I just set out maybe some ground rules that may help us? Because would you concede that you can't trade your way out of the leverage you've got at the moment?

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And in that respect, understanding that you've got various negotiations on, that you either have to raise capital or have to engage in disposals to get to where you want to be. Because you said you know where you want to be and you know what you need to do, but just to help us understand the sort of options you're looking at, is that the basic situation?

Dave Lewis - *Tesco PLC - CEO*

Well, I don't think it is exactly. Let me give you the overall general view and I'll ask Alan to comment more specifically. I think that there's an awful lot more cash that we can get out of the trading arrangement. And one of the reasons why cash generation sits in everybody's' thing is, I actually think there's a big working capital job for us to do. That's why I keep talking about stock in the way. And I'm not talking about manipulation of creditors and debtors. I'm talking about fundamentally getting the stock levels right. And if we can release that, and we can get the volume growth and we can get the cash delivery, I actually think there is a trading contribution that can come from that cash generation to the leverage that's there.

But we've been very -- to your second point we do look at all of the assets that we have. That's why we've put Dunnhumby where we've put it and why we've dealt with some of the others. So I think we recognize that to do it only with trading might take longer than people would like it to be. And that's why -- but we do continue to keep all of our options open because we don't want to box ourselves into a corner, Clive, in terms of saying it's got to be this, because that would -- I think would be commercially stupid on our part.

But do you want to say something to Clive?

Alan Stewart - *Tesco PLC - CFO*

I think the only thing I'd add is Dave's final point is what we balance is the cash generation. And there are clear opportunities if we can turn the stock more quickly, and particularly in some categories, then we will get more cash out of it if we can. So those are clear opportunities. But also, we factor the risk that we run from running a higher level of indebtedness than we would be comfortable with.

And that's the basis we do. We look at things through a strategic lens. We've always said we'll look at things through a strategic lens in terms of what's the opportunity and how do we view that from a business perspective and we weigh those up. So I don't think it's quite as stark as you said, Clive.

Clive Black - *Shore Capital - Analyst*

Can I ask the question in a slightly different way then? Is there a Group-wide debt to EBITDA level that you would aspire to?

Alan Stewart - *Tesco PLC - CFO*

Sorry. say again.

Clive Black - *Shore Capital - Analyst*

Is there a Group-wide net debt to EBITDA level that you would aspire to?

Alan Stewart - *Tesco PLC - CFO*

What we've said very clearly is that we believe that we're a business that should be trading at an investment grade rating when looked at through the rating agencies' eyes. We recognize we're not there now, but to put a time and bound on that, and to put a when we're going to get there, I

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don't think would be good for us as a business. And I think it will be very, very difficult now given the volatility and the reinvestment that we'll be making. But over time, that's where we would expect to be. When we get there that's going to be a much more difficult question.

Clive Black - *Shore Capital - Analyst*

Thank you.

John Kershaw - *Exane BNP Paribas - Analyst*

John Kershaw, Exane. Just following on from that, perhaps comment on why you might want to keep the international assets then, because the performance, certainly in Europe, you're disappointed with. And the DIDA, or the store closures in Korea, for example, seem to have been going on for about three years. So can we see a view where you get into a positive like-for-like in Asia? Because presumably, if you're going to keep these businesses, that's what we need to see.

Secondly, just coming to the UK, perhaps on the write-downs, can you give us a sense of what your medium-term margin assumption is there because you say long term you've got a great business? So perhaps give us a sense of what your thinking has been in those write-downs and perhaps actually quantify the UK write-down.

And finally, what does retaining momentum mean in terms of the UK business? Because the business has been in cardiac arrest. You've stabilized it; it's in the recovery suite. But is that winning market share? What does that mean?

Dave Lewis - *Tesco PLC - CEO*

Okay. Well, I'll have a go and then you can -- of all three questions, I'll try and --

So, look. We see -- so let me talk about Asia -- I think highly attractive assets in a growing and vibrant part of the world. So the fundamentals of those businesses are still ones that we see as attractive, and we invest in them. And let's be honest. They've delivered significant profitability to the Group at a time when we've needed it most.

So in fairness to Trevor and the others, whilst we've been dealing with some of the things in the UK, he's perhaps not had the freedom and the flexibility to be able to do as much as he might want to in parts of Asia because of the level of profit that we've been asking them for.

Like yourself, I've tried to understand DIDA. I'm not sure I've completely got it. I think every year, and this -- I'm reassured that it's now worked its way through with the difference of Sundays and Wednesdays. And when we [check] -- good Lord; there's a lot, there is a lot. So I get why you asked the question.

But you shouldn't in any way take away what we think about fundamentally an important business in Asia. And if you were there now, you'd see important plans that are in Korea, Thailand and Malaysia, that kick off quite strong trading activity in those businesses.

And when it comes to Europe, Europe's been more challenging. We talked about it before as an economic situation, particularly for us in terms a return on the capital that we've invested there.

Look. I think the interesting thing for us is in Central Europe. We talked about it in Q4. Actually, some the positive momentum in the top line, and that's continuing. And actually, what Trevor and the team are now doing is saying: Actually, we think that there's a way of running this business which actually allows it to become more attractive than it had been in the past.

So that's all moving in the right direction. We're taking account of doing our business differently. We've got the new challenge of the Hungarian law and the profits, so we'll have to deal with that. But I've dealt in so-called developing emerging markets all my working life and they have that

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sort of volatility. And if you're any good at it, you have to be able to roll with the punches now and again. And I think we know how to do that, but it doesn't make it convenient when I'm standing in front of you trying to explain some of the numbers.

Look. I think the -- to your UK point, what I would say is I know why you asked the question. I'm going to continue to say to you the following, which is: I have no doubt my mind that the opportunity for Tesco to have above average industry margins in the UK, definitely. We might debate how quickly we get there given the position we start from, but I'm absolutely no doubt that that's the case.

And we will lead this business back into that position. I don't have any doubt about that. Right? I would be foolish to tell you what date of which year that will be, but we'll do the fundamentals; we'll do it right.

And to your question about what KPI, the volume, the transactions, the people coming, the relationship measures of what it is people think about our offering, those will be it. Those will be the things that matter. In terms of the way that the market share performs, there will be lots of things that happen in that volatile situation.

So we'll keep tracking how many people come, what it is they buy with us when they're there. We will value volume over value at this point because we know that from a price point of view there's still investment that we need to make, irrespective of what happens out there. So that will have that impact. But we'll track it at that level, John.

Unidentified Audience Member

I just had a really quick question. On online, given the strong sales growth that you've had, has profitability improved in the online channel?

Dave Lewis - *Tesco PLC - CEO*

So in grocery home shopping, 20% increase in orders, 11% increase in sales.

We have invested something in that business. We invested something particularly around the delivery charge and some of the service elements during the course of the year, so that did have a depression in profitability. But we've also seen the growth that's there.

So net-net there's been some reduction in profitability, but it's against a 49% market share and a growing business, so actually, we think it's a good investment for us to have made.

Mr. McCarthy.

Unidentified Audience Member

Three questions. The first is your UK property. Is 40% too low, and do you expect to increase the ownership of that? And how are you going to pay for that? Because you're effectively putting money into a format that a lot of investors -- not a view I share, but a lot of the investors think the superstore, hypermarkets are dead.

Second one, you talk about transparency on pricing, so any comments on the super complaint that's been lodged with the Competition and Market Authorities? Could it cost you any money, or is that just going to be a reallocation of resources?

And thirdly, the relationship between CapEx and depreciation. Could you run your business over the medium term with CapEx running below the depreciation level, on a like-for-like basis? Whether you're talking Group or UK, you [decide].

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Dave Lewis - *Tesco PLC - CEO*

Very clear. Do you want to talk about the property and CapEx?

Alan Stewart - *Tesco PLC - CFO*

Yes, property and CapEx. I'll take depreciation first.

We're very -- depreciation Group wide GBP1.5 billion, and investment GBP1 billion. There's a point at which those two have to meet. We're very clear that what we're investing in isn't damaging the business and we will assess it as we go through.

But there is a likelihood, I think, that the depreciation charge will run ahead of the CapEx for a number of years. How long that is, it will certainly be two or three years. Beyond that, it's much more difficult to get visibility.

In respect of the property, the 40%, which is the owned percentage, you're right. It's a calculation we have to make. Our aspiration is to own more of our property because through that ownership, we remove the pressure on the business through external rents. And we also create flexibility in terms of what we're doing.

The decision for us to make is is that a good use of our cash and our capital as we buy back properties that we've previously sold either into joint ventures or other structures.

So those are the things we do. What we won't do is do something which is economically the wrong decision for us to do, and that's something which we will always factor into account.

So if we take the British Land deal, very clearly there was, as it happened, a buyer and a seller who were in two different transactions and we could look at each other as both buyer and seller and we could do something which made sense for both of us.

That's more challenging when we look at some of our sale and leaseback transactions and structures that we've got, but that's the way we'll look at it. So we'll look at it from a value perspective, combining flexibility, removal of pressure, but are we getting a return for this.

Dave Lewis - *Tesco PLC - CEO*

I think I'd add to that. I suspect we'll see more volatility in the UK property market going forward than we've seen for a while, and I think we should, with all the principles and framework Alan's talked about, I think we'll be very mindful of what those opportunities might be.

To the super promotion, as you refer to it, I think firstly, it's very early. I'm not sure we've fully assessed everything that's in there. The bit that I've had a quick look at is some of the things that are in there, certainly as they relate to anything we might have is they're very, very specific in terms of some of the mechanics that they pick.

So I'd answer in a broader way, David, which is that we talked in October and again in January about what it is customers said to us about our pricing integrity. They'd said to us in Tesco: We don't understand what you're doing sometimes. We don't understand how it is you change your prices.

And they also said to us, we don't understand some of the integrity of your promotional discount curves. And I seem to remember receiving one or two comments from yourself about that also in terms of the thing. The gentlemen two/three seats further on knows about that conversation.

So I suppose what I'd say to you is: We want to get it really clear for Tesco customers. That's the journey that we're on. Getting off where we've been not straightforward, but we would want it to be so simple, so straightforward. And the question we ask ourselves is: Can you explain it to your mother very quickly, and are you proud about the offer that you gave her? And if the answer to either of those questions is no, don't do it.

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Andrew Whitney - *UBS - Analyst*

Three questions, if I can. Andrew Whitney, UBS. The first, and you opened yourself up to it, but what is an average industry margin?

The second is just help us understand why trading profit for next year won't be substantially below this year. We obviously have the H2 number which is clearly a lot lower than H1. You've talked about leaving -- picked your words, but short-term money on the table from suppliers. And as well, obviously, we've got this change in definition, so moving towards this IFRS number which I think is about GBP100 million lower. So why won't trading profit move substantially below the GBP1.4 billion reported for this year?

And then the final question is just on the pension. Clearly, as you move towards this defined contribution scheme, should we gear ourselves up for an exceptional payment into the scheme to bring down the deficit?

Alan Stewart - *Tesco PLC - CFO*

In respect of the pension, we are in consultation. Clearly, that's early stages in terms of what it is, and we really want to receive feedback from colleagues in terms of part of that.

One of the ways, if one looks at how pension funds have moved from defined benefit to defined contribution, you're right. It's that there has generally and quite often been some element of payment for that change.

We're conscious of that. I wouldn't like to say, if anything, what that will be, but it's certainly one of the things which I would expect would be part of the discussion with colleagues and with the representatives as we go through that. Very difficult to factor in, but it's certainly something worth thinking through.

What we're intent on doing is giving something which is competitive in the market, which is a appropriate for our colleagues, but exactly the shape of that, very difficult to call as we go through it.

Dave Lewis - *Tesco PLC - CEO*

In terms of average margin, we look at a competitive set of food retailers within the UK environment. That will continue to be the basis on which we look at the industry average.

Andrew Whitney - *UBS - Analyst*

Average current market?

Dave Lewis - *Tesco PLC - CEO*

Well, industry margin in any year amongst that competitive set, I think Tesco should be at the top end of that range. We're not at the minute. We have to regain that position. And that's the benchmark is what I mean.

Trying to think if I missed anything.

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Alan Stewart - *Tesco PLC - CFO*

In respect of the profits, we've set ourselves an aspiration which, as you say, is coming off a base which didn't make money in the UK in the second half of the year.

We've also said that we clearly are not wanting to forego commercial income as we move through time, or the price at which we're buying what we're buying. And those are things which are challenges which we face ourselves, but it's not an easy task.

Andrew Whitney - *UBS - Analyst*

But just coming back to your earlier comment, you said that any gains, for instance, from cost savings and productivity would be reinvested back into the offer. So any positives are going back into price.

Dave Lewis - *Tesco PLC - CEO*

What we're trying to say is that the level of profitability that we've achieved this year, to achieve that next year would be something that we'd aspire to. Right? It has a challenge that you say in the second half of the year, but we think that's a challenge that we should take on. That's the transformation program and that's a cost.

As we go forward, as we make that, and if we were to get to a place where, let's say, we were exceeding that, anything above that would be reinvested back in the offer.

Andrew Whitney - *UBS - Analyst*

Okay. Thank you.

Charlie Storey - *Macquarie Research - Analyst*

Charlie Storey, Macquarie. Two quick ones for me, please. Just doing the rough and ready math on the profit bridge, 3Q and 4Q investment offer looks to be about GBP200 million. I'm guessing that's Q4 weighted. And if so, is there a target you have for this coming year, this current year?

And then also, related to that question, rough split between price and service. Probably can't give it, but I'm going to ask it anyway.

Dave Lewis - *Tesco PLC - CEO*

Sorry. I thought those were your two. Sorry. Go on.

Charlie Storey - *Macquarie Research - Analyst*

So leading on to my second one, you've got very easy comps coming up in the UK like for like. Obviously, you don't know and it's a guess, but does it feel like it's a positive like-for-like year?

Dave Lewis - *Tesco PLC - CEO*

So in the spirit of time and questions, the answers to the first two, no and no; not going to share. You know we're not going to share. I get the question but I won't break those things down.

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And I'm glad it feels where you're sitting that this year feels like I've got some easy comps coming up (laughter). There are about 10 of us in the room going, hmm. Look. We're not going to speculate. We're going to do the right thing every day, every week, every month, and we're going to rebuild the business. That's what we're going to do. You're going to see us manage the business on the right things every day.

And if there are some easy comps out there, I'd love to see them. I haven't seen any just yet. But I do see -- what we talk about in the fourth quarter, we see the fundamentals improving, and that's the most important thing.

Alan Stewart - *Tesco PLC - CFO*

I'd only add -- Dave, sorry. The one thing that we haven't used yet is deflation, and there is deflation in the overall line and there's deflation in what we're doing, and don't forget that.

Dave Lewis - *Tesco PLC - CEO*

I think that's very important. Thanks, Alan.

James Tracey - *Redburn Partners - Analyst*

James Tracey, Redburn. Three questions from me. The first one is: Where do you see your price gap with the discounters on KPIs currently, and where would you like it to be in future?

The second question is: Could you quantify the reduction in depreciation from the GBP4 billion PPE impairment? And is that included in the cost-savings targets?

And the final question is in terms of the second-half UK trading profit being slightly negative. Surely there will be some unwinds of one-off effects. Could you quantify the benefit from the stock write-down and the absolute P&L impact of the commercial income? Because you've disclosed the balance sheet but you haven't disclosed the P&L impact. So if you could tell us where it was and where it is now in terms of percentage of sales.

Alan Stewart - *Tesco PLC - CFO*

There's a lot of detail there, as I'd expect from you, James. In terms of depreciation, the -- look. It depends on the timing of our investment spend in the current year, because that would give rise to this year's charge for depreciation. It also depends on last year's spend and we spent GBP2 billion last year. So there's an upwards pressure on depreciation. Equally, when we spend this year, we'll determine it.

I think there may well be a slight drop in depreciation when we get through into next year. It's non-cash, but it may be a slight drop. But I wouldn't factor in a significant number. I certainly wouldn't put in a three-digit number at this stage when you actually look at it.

In respect of the other elements, sorry, what was your third question?

Dave Lewis - *Tesco PLC - CEO*

Commercial income and profit rebound.

James Tracey - *Redburn Partners - Analyst*

Well, essentially, what bounces back in the second-half margin for the UK.

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Alan Stewart - *Tesco PLC - CFO*

Look, we've run through it, and I think for us, you're getting into a level of detail which -- and we've given aspirations; we've spoken about where we are. But I think to get into more detail, you're really, really going to get into line by line how we're trading and how we're seeing it.

Dave Lewis - *Tesco PLC - CEO*

And, look. It would get us into that place of giving competitively sensitive information that we are being really clear about we wouldn't. I think the important improvement for us versus the second half-year.

James Tracey - *Redburn Partners - Analyst*

Cost program?

Dave Lewis - *Tesco PLC - CEO*

Definitely, cost program, there's no depreciation in the cost program to your specific. Hopefully, a continuation of the volume improvement as we improve the offer.

And then we've got the variability of how successfully we renegotiate and put more of the margin back in to the front versus the back. And that's a process that nobody -- only a fool would predict exactly where that will get to, but it's the right thing for us to do. So that's our challenge. We're clear about what it is we want.

To your earlier question, look, in terms of -- we don't set our pricing strategy vis-a-vis anybody in particular. We've done some things very specifically against the discounters. So there isn't an index that you -- if there was, and nor would I want it quoted if there were.

I think the important thing is we look at the customer; we ask the customer how it is they relate to certain things. And where it is service and range, add something to do it. Then, yes, that's something that we offer that's unique and only available from us.

Where the things that we offer are not unique to us, then we'll be more competitive because that's the right thing based on what customers tell us. Hence the point the brands that we did in January, when we did those, they were price matching. In fact, they were 1p an item cheaper than at that time they were in Aldi. We didn't make a big deal about it vis-a-vis the discounter. We did that because we thought that was the right thing to do for Tesco customers.

And you'll see us continue to look at our pricing strategy very much through the customers' eyes. Okay?

James Grzinic - *Jefferies & Co. - Analyst*

James Grzinic, Jefferies. I had three quick ones. The first one is GBP22 billion. Clearly, you're not comfortable with GBP22 billion in terms of the [all-in] leverage. Where should it be? What's your ambition? So you can give us some scale in terms of the size of that challenge.

The second one, your commentary on margin. How dependent is that on really addressing the over-leased position you've got in the UK? Because 40%, you are massively below the rest of the industry, and there's obviously some structural issues that come with that. So where -- how is that dependent, that margin commentary dependent on sorting out 40%?

And thirdly, as part of that, what's the average lease life you have right now on that 60% of space in the UK?

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Dave Lewis - *Tesco PLC - CEO*

Right. You take the first and the third and I'll take the second one.

Alan Stewart - *Tesco PLC - CFO*

Yes. In terms of the leverage, what we've said is, look, it's not that we're uncomfortable with it because we have a funding position and a liquidity position which is strong. It's higher than we would like. One key element of it is the pension deficit, which as I've said, can fluctuate quite a lot. We've seen a lot of fluctuation. If bonds were to change, then that pension deficit could close very rapidly. It could close; there's an asset side as well. But the important part of that element of our leverage is actually the cash that we're contributing, and over time, the risk that we're running within that.

The lease liabilities, clearly directionally, we're wanting to take more ownership onto our properties. And then the bank debt is something which is very specific at the GBP8.5 billion.

So giving a specific target I think is quite difficult when something is going to be changing quite a lot, but aspiration, we do want to see it coming down.

What is important that we're very transparent with the way we look at it and that we're very clear that we're not trying to say it's only GBP8.5 billion. There are other elements with which we factor into when we look at our balance sheet and our performance.

James Grzinic - *Jefferies & Co. - Analyst*

And [as part of that] on the average lease lengths?

Alan Stewart - *Tesco PLC - CFO*

We don't split that out. Clearly, we have a number of assets with very different leases. Express convenience stores tend to be on shorter leases. Superstores tend to go on much longer leases.

Dave Lewis - *Tesco PLC - CEO*

And to your question about the -- we have a -- at a Group level, we talk about an upward inflation of around GBP200 million, a lot of that driven by leases, so that's the impact that would challenge any margin recovery. But we've also got productivity and other things that we want to bring in to offset that. So that's all built in to the aspirations that we have, but it's about that level.

James Grzinic - *Jefferies & Co. - Analyst*

Thank you.

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

Rob Joyce, Goldman Sachs. Three areas from me, firstly just on Asia, which is clearly pretty important now. Seeing similar levels of sales decline there, as we see in the rest of the Group, but we don't seem to be seeing the deleverage in terms of the margin. Can you give us a little bit of background on why that one is and how we look at that in the future?

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Second one, you mentioned deflation a fair few times, and some -- your own deflation. Can you give us an idea of how much deflation you think you need to enter into? And just more broadly, how we should be thinking about deflation and volume, given we've seen 2% deflation for 1% volume, how we look at that going forward?

And final one, I don't know if you're going to give me this, but in terms of looking at how that leverage feeds the business, what percentage -- sorry. What's the total UK rent burden at the moment? And can you give us how much of that is in the Extra stores?

Dave Lewis - *Tesco PLC - CEO*

So third answer first? No (laughter). Just in the interests of time, on the first one, I'll give you a very simple answer. Where's Trevor? Put your hand up at the back. See that gentleman over there? He is responsible for Asia. So if you get him in the coffee break, he'll give you a bit more.

But what I would tell is the way that we go to market in the Asian markets and the way that our business is structured is different, so the way the leverage model is different. It is different. So I'll let Trevor -- it's a really technical bit, but I'll let Trevor talk to you about that really, because it --. And if anybody else is interested, we can share it some more.

What was the third one, middle one?

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

The second one was on deflation, just the level of deflation you want to do and how that should look volume wise.

Dave Lewis - *Tesco PLC - CEO*

So an answer, but also a glancing blow, which is, look, when coming in, we talked about, or external markets talked about a basket premium for Tesco versus principal competitor of around 7%/8%. I think that's too high. If you look at it now, it's 2 points lower than that. I think there's more that we should do.

But it's about -- the important thing -- the reason I don't want to say it, it's not just from a competitive point of view, is I'm desperate for us as Tesco to be thinking now about how it is we improve our business, how it is we improve our offering and keep doing --

Actually, if we can just keep making Tesco better tomorrow than it is today, we'll be fine. We'll be absolutely fine. I don't want us to get obsessed about what that means vis-a-vis --

Actually, when leaders lead in their own business and they're making themselves better each day, we'll be fine. And that's the more important thing for us. And we'll do it in a commercially sensitive way. We'll do it in a customer orientated way. And we're not going to do it in a slightly silly but dogmatic it's this and therefore -- because I could burn an awful lot of value doing that, an awful lot.

Mike Dennis - *Cantor Fitzgerald - Analyst*

Mike Dennis, Cantor Fitzgerald. Just a question. I'm just trying to understand your UK margin, and I don't. So there's GBP900 million of prior initiatives which we're lost on as to why the previous management had that amount of prior initiatives. And GBP467 million of UK trading profit I assume includes Dunnhumby of GBP100 million. I'm assuming also that it hasn't got Blinkbox in it this year but had Blinkbox in it last year. That's another GBP80 million positive to it. And I'm assuming that your fuel business makes about a 2%, maybe 2.5%, trading margin, and your UK business had a 1% trading margin.

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So trying to understand how you're going to get to an Aldi-esque 5% trading margin from a what looks like 0.5% UK trading margin. And, therefore, the question that's been asked before about your trading income, surely there's a massive deferral of trading income somewhere. And if it is not appearing next year, then where's the cash? Because your debt's gone up?

Alan Stewart - *Tesco PLC - CFO*

Look. We can debate as to whether Blinkbox isn't quite as large as what you say it is, but Dunnhumby, ballpark figures. But you're right. What you're pointing out is that the core UK business is under a lot of pressure. But clearly, we believe that we can and we aspire to get that back. We will get it back. I don't believe that there's a massive deferral; if the deferral is there I haven't seen it. What we need to do is to change the way that we engage with our suppliers and get the margin back.

Dave Lewis - *Tesco PLC - CEO*

I think that's right. One thing, because there is a lot to what you just said, and we should sit down and walk it through with you; very happy to do that. I think the one thing I would say to you is -- because every talks about the bounce back. I think conceptually what I'd say to you is this. We had, in the last two or three years in particular, got ourselves into a place where a level of profitability was being generated by things that we don't want to repeat going forward. Right? It's as simple as that.

Everybody will want to try and triangulate what that means, and I do get where the question comes from. I think where we are at the moment, just so you know where our mindset is, this is our reality today, and we're going to rebuild it from here.

Do we think we can rebuild it? We do. And there are different elements that we'll rebuild towards it and different times in which we can realize some of that. That's our job; that's what we'll do.

But trying to triangulate some of the things that we've stopped, that we won't repeat and what that means for commercial income, honestly, you can spend an awful lot of time doing it, and we have done it. But actually, it's not a metric on which I will manage the business, going forward. Right? That's the important thing. We're going to rebase. We've rebased the business and we're going to rebuild it from here. And what you should be interested in is how quickly we can rebuild it from where we are, because that's what we're obsessed about.

Mike Dennis - *Cantor Fitzgerald - Analyst*

Maybe I'll ask the question a different way then. So if the margins are low in the UK superstore business, why today are you not closing 200 or so underperforming supermarkets given the margins are endemically quite low?

Dave Lewis - *Tesco PLC - CEO*

Quite simply, because we've taken a view -- we looked at all of our property and we looked at 43 stores and we've said they're not cash positive even before we charge them rent. So we took a view and said we can't see a way where we can improve them to a place where we would -- and so we took a very painful decision to close them.

Do we have some other stores that are not making a profit at this moment? Yes, we do. Do we know which ones they are? Yes, we do. Do we as a team think that we can change that position in the foreseeable future? We do. And because we do that, we haven't done the thing that you've just suggested; simple as that.

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Simon Denison-Smith - *Metropolis Capital - Analyst*

Simon Denison-Smith, Metropolis Capital; a very simple question. What proportion of your online sales are collected in store? And what are the trends as you grow the online business?

Dave Lewis - *Tesco PLC - CEO*

So looking to Robin, the numbers that I have in my mind in terms of grocery -- general merchandising online, it's between 65% and 70% are click and collect.

Simon Denison-Smith - *Metropolis Capital - Analyst*

Okay. And what are the trends as you grow the online?

Dave Lewis - *Tesco PLC - CEO*

Yes. It's increasing. Actually, what you find is that, particularly in that sector is for a lot of people, people find click and collect really quite convenient, because actually, I can go when I want. It's there. I can go when I want as opposed to sometimes having to stay in in a particular period in order to receive it. So actually, we've seen an increasing trend in click and collect.

Xavier Le Mene - *BofA Merrill Lynch - Analyst*

Xavier Le Mene, Bank of America Merrill Lynch. One quick one actually from me. You said that you are ready to invest more in the UK, if need be. But what is the key catalyst and how you look at that? Is it your relative performance versus the market? Is it your absolute performance? Are you looking at volume especially? So what is the key catalyst for you to potentially invest more in the business?

Unidentified Company Representative

I think the key catalyst is -- I suppose what I've been trying to illustrate all the way through is getting volume back into our business and the benefit of that, given our operating model and given our scale, is significant.

So the catalyst for us is first and foremost: Can I do something more for a customer tomorrow than I do today that he or she appreciates in a way that they give us our custom? Therefore, I need to be looking at that as a business opportunity. If there are things that we can do there, then we will seek to find every way to can to be able to offer that to our customers.

In terms of what it is we prioritize against investment and make those decisions, yes, that volume and the number of transactions are the key leading indicators, as I said a little bit earlier. So it will be on that basis.

Stewart McGuire - *Credit Suisse - Analyst*

Stewart McGuire, Credit Suisse. Just do you see an opportunities to renegotiate your leases? Now that you're closing some of the stores, perhaps the landlords are a little bit more scared than they were in the past. Can you give us an idea of --?

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Dave Lewis - *Tesco PLC - CEO*

I think, Stewart, it goes this question -- the answer I gave to David as well, which is I think the property market, given everything we've seen in the retail industry, is going to be quite dynamic going forward. If we see an opportunity for us to renegotiate, given how important it is to our business, you can be sure that we will.

Bruno Monteyne - *Bernstein - Analyst*

Bruno Monteyne, Bernstein. Four questions, if I may. The first one is: When you talk about cost savings, GBP250 million and GBP400 million, they sound almost a little bit puny in the size of Tesco. But obviously, you work on much more. You work on the pension scheme, the range simplification, the vouchering. So can you talk a little bit more broadly about the real portfolio of cost savings you're working? Surely it's a much bigger number.

The second one is: In terms of phasing of your price investments, clearly, different [ways, those] brands. We see some of the fresh. Can you indicate how far and how long it will take? Do you think [it won't fit in] for about a year, or is it --? Give a bit of a sense of phasing.

The third one is maybe for Trevor on international. Is it the beginning of a long slide, or do you already see some of the volume and transaction recovery, meaning you already invested in that big margin loss? Or do we need to expect worse before it gets better?

And last but not least, Tesco in the previous management used to have some objectives of owning about 3 times their annual wages in stock in the Company. Is that still there and is the management team investing in the business? All right. Well, simplified, are you investing in the business?

Dave Lewis - *Tesco PLC - CEO*

Okay. No, indeed. Okay. I think I'll remember. So, look. I think what you should say, Chris and I have this conversation about do we talk -- I think our competitors always talk about cost savings over a three-year period or a five-year period to make the number larger. I think at the risk of -- it's GBP400 million a year. You can decide how many years you want to apply that to. We'll leave that with you.

Is it everything? No. It's not everything. We're looking -- the review we talked about is everywhere, is absolutely everywhere. But what we will be is when we're clear about what it is we want to do and we can demonstrate that we know that we can deliver it, we'll put it on the table in the way that it is. But we will be good leaders of the business in terms of being very, very, very rigorous on cost going forward given the situation we find ourselves in. So point number --

Point number 4. Yes, we still have exactly the same incentive and requirement of senior executives to invest their stock in the business. So that's not changed. In fact, I think, it might have increased for people like myself. But no problem. If we're not prepared to invest in the business that we lead, then I think -- so simple answer.

What were the two in the middle?

Alan Stewart - *Tesco PLC - CFO*

Asia.

Dave Lewis - *Tesco PLC - CEO*

Asia? So, look. No, actually. I don't think it will get worse. And you can, and you probably should -- I'm setting the line-up for Trevor. He can get you both later. But actually, Central Europe, we saw at the end of last year like-for-like sales growth. We talked about it in fourth quarter. We saw a positive move in Central Europe. And I don't mind saying that that's something that we're happy to see that continue. So actually, there's some improvement.

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The issue there was actually the profitability, and Trevor's taken some very decisive action on that and I'm very supportive. And I think, I suppose what I was saying before is, in Asia, I think Trevor's had to deal with helping the Group, and now he's in a place where, actually, he's started some investment programs in Korea 10 days ago. I think it was Thailand last week. So we'll see. And look, in four, eight, 12 weeks' time, we'll see whether we've had the impact of that investment. But we're still investing in those areas.

Alan Stewart - *Tesco PLC - CFO*

And the second question, I can't remember.

Bruno Monteyne - *Bernstein - Analyst*

Phasing of prices.

Alan Stewart - *Tesco PLC - CFO*

Phasing of prices, yes.

Dave Lewis - *Tesco PLC - CEO*

No, look. Conversation -- as I say, customer driven; category by category, opportunity. And as we negotiate and we change the relationship with our supplier base, we give the benefit to the customer.

I don't believe -- it's a bit like the question earlier. Setting an artificial bang this is it, everything the same. Actually, that's not how customers behave. That's not how we need to behave. So we'll be very thoughtful and mindful, but we're clear about what the direction is.

Edouard Aubin - *Morgan Stanley - Analyst*

Edouard Aubin, Morgan Stanley. Just one question, so I'll be quick, on SKU rationalization. So you gave us an update on timing. Can you just give us some rough ideas in terms of SKUs at your hypermarkets, supermarkets (inaudible)?

Dave Lewis - *Tesco PLC - CEO*

I can. And I'm looking at Jason just in case I caught -- of the ones that we've done since the last ones we've talked about, I think ready meals was a net reduction of 20%. I think frozen food was 10% to 15%. I think oils was between 15% and 20%.

So, actually, in the ones that we've done since the last time we've spoken, I think on average, there's been a lot of change. There's a lot of new -- but net-net reduction between 15% and 20%.

Unidentified Audience Member

Just linked to that, actually. When you started you talked about a 31% increase in SKUs across the store. Where are we now? How far has that gone down? What is the reduction from when you started?

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Dave Lewis - *Tesco PLC - CEO*

In terms of total, I'd have to go back and recalculate, and I won't guess at the minute because we've done a portion of the stores to different degrees. So I'd have to come back. So can we --? Chris, can we come back? I'll give you an update on that specific number. It's too complicated to estimate off the top of my head.

Unidentified Audience Member

Okay. And the last one was: Given the historic lows in interest rates, is there any way you could give us a sense of the sensitivity of the pension fund deficit to 100 or 200 basis point increase in [loan rates]?

Alan Stewart - *Tesco PLC - CFO*

We can come back on it. I think the market -- coming back to the market estimates, we had an 80 basis point shift down year on year, and that really drove it, but offset by asset performance. But we can come back and we disclose the gross liabilities and assets.

But I would just answer that that's not the measure that I look at, because that's an actuarial measure. That's an accounting measure driven by IAS 19. For me, the important thing is what's the actuarial measure and that commitment to cash.

So I recognize why you ask it. It will shift the balance sheet and the numbers and our total indebtedness calc, but it's not important for the cash in the business.

Andrew Lim - *Societe Generale - Analyst*

[Andrew Lim, SocGen]. You operate all your store formats in the UK under the Tesco brand. Do you see any inconvenience or any inefficiency linked to this strategy in terms of store differentiation or price perception?

Dave Lewis - *Tesco PLC - CEO*

One small correction. We have a format in the UK, a store which is One Stop. So it's not all under the Tesco brand. But I think people ask me the question around what are the pros and cons of segmentation and what the different offerings could be. And for sure, it's an element that we will consider as we talk about strategy.

At the moment, I see a huge benefit from being part of Tesco. The reorganization that we've put in place, the one thing that I'm looking for us as a team to lead for is actually getting the benefit, going back to getting the benefits and the synergy, the scale of operating Tesco as one. There's a big opportunity for us to do that.

We've grown this business very well and very strongly, and I have no problem with it, by keeping them separate; verticals, as Tesco will talk about it. Given what's happening in the market, the opportunity for us to think much more deliberately about actually the benefits across our organization is something that we're doing, and that's the reorganization that we're implementing now. So against that, the benefit of running our stores all as Tesco is significant to us at this point.

Rickin Thakrar - *Espirito Santo Investment Bank - Analyst*

Rickin, Espirito. I have a couple of questions. First, can you explain the GBP350 million difference between your cash and -- your cash tax and your cash financial charges versus your EPS version? That seems to be about half of your [9p] in EPS.

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Secondly, can you --? The profitability decline in the second half in Asia and Europe seems to be fairly strong. In Europe, is there -- are there any other countries other than Turkey that are loss making now in Central Europe?

Third, on your UK margins, they're now at zero, or less than zero in the second half, but you seem to be a little bit more cautious on going forward the profitability for the Group. Is that principally driven by some of the UK investment, or is that Hungary investment? Where exactly is that kind of tone coming from?

And finally, just on the Asian assets. You've mentioned you didn't want to sell them, and I can understand why; the cash flow is important. But what happens if the profitability continues to decline and you can't sell those assets?

Those are my questions.

Alan Stewart - *Tesco PLC - CFO*

In respect to the first one, can we just take that offline? And if you wouldn't mind talking to Chris. There's a lot of technical stuff, but I'm sure we can give you the answer on that offline in terms of the EPS.

Dave Lewis - *Tesco PLC - CEO*

So the challenge in the UK is very specific to the UK. Also, the activity that we've taken and we've announced is also significantly weighted to the UK. But we do want to rebuild the UK profitability, but we want to do it in a sustainable manner. And I can't reemphasize enough that, actually, we will do that by rebasing the business model of Tesco. We believe in it fundamentally that if we run it in the right way, it's actually a good model. So we'll do that.

And I suppose it's still consistent with the tone I tried to set from the start which is not to promise before it's done; share what the delivery has been after we've done it. And I think I'd like to keep that as a way of operating, both inside the business and out.

I think one thing you said, which I'd just like to be really clear about, we've not mentioned anything about selling or not selling any part of the portfolio. So I don't want you to take anything out of that. It's part of the review that Alan and I will continue to do; so just to keep everything completely neutral as it relates to that.

And there was one more question which I thought was one of yours.

Rickin Thakrar - *Espirito Santo Investment Bank - Analyst*

Europe.

Dave Lewis - *Tesco PLC - CEO*

Oh, in terms of loss making. No. The significant delta was Turkey. The challenge that we have going forward, let's be clear, will be Hungary given the changes in legislation, both tax and opening in Hungary. So Hungary will become a new challenge in Central Europe, but principally because of that.

Ladies and gents, can I --? We've deliberately tried to exhaust all of the questions. We don't want you to leave here not having had a chance to ask us anything.

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I'll go back to where I started from, the three key messages from me. Look. It is a very big number. It's a very big statutory loss. It's driven by a series of one-offs. We think that's us facing into the realities of the market and our relative underperformance. We've done that very objectively. We've done it very openly. And I suppose the thing that we would emphasize in that is that less than 10% of it is a cash impact.

The second thing we would talk about is that story I talked about in the beginning, which is we've set about running particularly the UK business in a different way. We've invested in ways that I've shared with you. And you see some early signs that are encouraging for us, given that's what we were looking to do.

And the third thing is, and I will say this and I mean it wholeheartedly is at a time of great change, the people that work in Tesco, and I can say that only having been there seven months, are really, really, really good at what they do. They care about the business that they're a part of. And they have engaged with this change program in a way that you just wouldn't believe. And I'm indebted to them today and all the time that I'm here.

So please take that third one away with you as well because it's really, really important to the recovery of the Company.

Right? Thank you very much indeed.

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