Tesco Fixed Income Investor Call
With:
Alan Stewart (CFO)
Shubhi Rao (Group Treasurer)

Operator: This is Conference #: 952855

Thank you for standing by and welcome to the Tesco Fixed Income Investor call. At this time all participants are in a listen only mode.

During this call there will be a question and answer session at which time if you wish to ask a question you will need to press star one on your telephone keypad. I must advise you the conference is being recorded today, Friday 24 April 2015.

And I would now like to hand the conference over to your speakers Mr. Alan Stewart, CFO, and Ms. Shubhi Rao, Group Treasurer Tesco PLC. Please go ahead.

Alan Stewart: Good afternoon, everybody and welcome to this call. As the introducer said I'm Alan Stewart and I'm here with Shubhi who's Group Treasurer. Our results which we announced on Wednesday have obviously had a lot of coverage and I didn't propose going through everything there but I thought it'd be useful just to set a bit of a scene behind what we reported and then really come and open it open to questions.

So, in terms of the headlines that we've announced our Group trading profits came in in line with our expectations at GBP1.4 billion which was a significant reduction particularly driven by our U.K. trading profit as previously announced. And we were clear in our communications that in the second half of the year in the U.K. we made a slight loss.

On the positive side, what we have seen and this is encouraging for us we've seen like for like sales volumes up for the first time in over four years and the drivers for those are very much the same as what we spoke about in our eight of January update following the Christmas trading where we've looked at

availability, we've invested in service and we've made selected investments in price.

And we also saw a continuation in Q4 as a whole of the improvement in the trend in like for likes. So whilst the minus one percent we are still declining and remember there is price deflation in the market as well as our own deflation.

Our overall minus one percent was slightly off what we'd reported for the Christmas period but it represented a significant shift over the previous quarter which was of itself better than Q2 last year. In our overseas markets we continue to see tough trading conditions and particularly in Korea driven by a continuation of restrictions on Sunday trading and store opening hours which is, we've spoken about it and it's known in the market, it's the DIDA Regulations. And then in Europe, we saw disappointing performance and we can come back and answer questions on that.

More significantly, and this is something which I think the markets on an individual level was aware of, but the quantification of all of it is something which we went through in some detail. We reported an overall reduction in our – of one off items, a charge of GBP7 billion and predominately non-cash around GBP600 million of that is cash the rest is non-cash and there's a GBP4.7 billion fixed asset impairment.

And we can go into some detail about that. There are two elements, GBP925 million of it related to the work in progress that we previously announced we we're not going to continue with. The balance of GBP3.7 billion is store impairments across the whole of our state again predominately in the U.K. The other items we sent out in the release and I'm happy to answer any question on them.

From a cash perspective and a pension perspective we announced the agreement of the triennial evaluation with our trustees. Our triennial valuation as at the end of March 2014, which was the time that it was struck is something which we've now reached agreement on and that was at GBP2.8 billion valuation deficits from an actuarial basis.

We’ve agreed a deficit funding plan with our trustees of an additional payment of GBP270 million per annum. So whilst they won’t – we won’t be working as we have in the past I think quite often we’ve had large one off payments.

The way we are approaching this now is a regular and consistent cash flow which we can look throughout triennial valuations and increasingly fund our commitments.

The other side of our pension work that we’ve been doing is obviously and previously announced that we’ve started the consultation on closing the pension scheme both to service accrual and to new members. So totally closing the pension scheme. We will replace that after consultation with a defined contribution scheme the exact shape of that is something which we will work through with consultation with our colleagues and then come back in due course when that’s been agreed.

We have no final dividend, that was announced in January and we’ve confirmed that. We’ve also reconfirmed that our CapEx for the year is going to be GBP1 billion which reflects the significant reduction that of itself is down year on year from GBP2 billion last year and in prior years a significant number.

So, overall we’ve adopted a strong and disciplined approach to our overall business. The results we announced reflected the approach. We’ve taken an objective look at the challenging conditions that the market has and also our own trading conditions.

And in respect of the current year, we’re very clear that our priority is to continue to manage the business to drive volumes. We saw volume recovery in our business for the first time in four years as well and we’ve seen also the best increase in transactions for two years as well. So we’re seeing volume and transaction improvement in our business and we’re beginning to see that feed through in terms of our momentum in the business.

That's what we'll do during the course of the year to the extent that we have got savings from the restructurings we've announced, to the extent that we get trading benefit we will reinvest in the customer and drive the business harder from that perspective. That's it in terms of the overall highlights.

The final thing I'll say before I open it to questions is that we have a very strong liquidity and funding position. We've highlighted this before but just to reconfirm that we have bilateral facilities of GBP2.2 billion they expire in November 2017. So we've got the best part of three years before they expire.

We then have, on top of that, GBP2.6 billion of revolving credit facilities they run through to November 2019. So they were five year facilities with a plus one plus one extension beyond that and both of these are undrawn – all of these facilities are undrawn and are spread across a very wide and supportive group of banks.

Our leverage overall, we've – which for us leverage we define as total indebtedness is a function of the elements of our on balance sheet debt at discounted operating lease commitments and then our IAS19 pension deficit and at the year end this was GBP22.7 billion made up of GBP8.5 billion of net debt within the retail business excluding the bank which has got a very different balance sheet of course, discounted operating lease commitments of GBP9.3 billion and a pension deficit of GBP3.9 billion on an IAS19 basis.

So, we believe that we've reflected the trading conditions. We believe that we are facing into the operation activity we have. We're very, very busy on transformation and we've begun to see the volume driven recovery and we're focusing on the customer and the reinvestment in the offer from the customer perspective.

Very happy to open it up to questions now.

Operator: Thank you. As a reminder if you wish to ask a question please press star one on your telephone keypad. If you wish to cancel your request you can press the hash key. Once again that's star followed by one to ask a question.

Your first question comes from the line of Thierry Anid from Barclays London. Please ask your question.

Thierry Anid: Yes, hi, thank you for taking my questions. The first one was just wondering how should we think about leverage going forward? Do you have a target for the next year or two? I mean obviously earnings are going to face some headwinds due to the competitive environment. Should we think about potential or possible deleveraging through cash generation in the coming year?

And my second question is on the Dunnhumby disposal can you just give us some more color why its taking time to close and is it more about the valuation? If it's the correct valuation? And if you can comment on the Telegraph valuation of GBP2 billion is it close or on the higher end of estimates? That's it, thanks.

Alan Stewart: Right, Thierry, thank you for that. In respect of leverage, very good question, the – what we've said very clearly is that the leverage is higher than we would like. We're comfortable with funding and the financing because our maturities are well-spaced in time and they're also well-spaced in terms of content.

And as I've said we've got undrawn – just under GBP5 billion – well actually exactly GBP5 billion of facilities today because what I called out added up to GBP4.8 billion there's another GBP200 million of a two year facility which we are busy extending into bilateral as well on a three year basis.

So the way we think about leverage is that we need to generate free cash flow in our business that's the key first part of it and that's why we focused on no dividend, that's why we focused on CapEx which is significantly down year-on-year. That CapEx is sufficient to invest in the business and it's sufficient to maintain the business.

So, it's not as if we're cutting in a way that's damaging from a longer term perspective. We really are just prioritizing our CapEx on where we can get a return and that will be primarily driven by productivity improvements rather than space. In some markets where we see growth opportunities we will still

add space but very, very significantly we've shifted from a space driven CapEx program to one which is focused on improvement and productivity.

Overall leverage, we – once we get into a position where we are in positive cash flow then we clearly can see potential for the business to recover over a number of years. We don't have a specific leverage target as such but we do recognize that what we would want to do and believe we should be operating at some stage in the future with an investment grade profile. And we recognize clearly how that profile is calculated different agencies have different views on it but essentially it's – we understand the metrics and those are ones we'd like and would seek to be operating within those metrics.

So the question for us is how do we get to that? And we could run through a period of time but we also believe that time – there's risk involved in waiting and we would seek to bring leverage down more quickly. We address that in this feeds into the second part of your question by the first instance putting the Dunnhumby business up for strategic review which clearly is a disposal.

And that's something because of the interest we had in the asset and we were very clear that it was and potentially didn't need to be owned by us for us to realize the competitive advantage and benefit we get from it. We're prepared to take to retain a residual stake in the assets but that very, very much will be up to whoever's interested in purchasing it.

I don't really want to comment on the valuations because different people have different views and we're involved in the process. We're on track with that process. I think there was an implication, Thierry, that you feel we might have taken some time.

All I can say is that we're really – we're perfectly on track with the process given the – a lot of businesses think about putting assets publically up for disposal once they've spent some time working through on a pre basis. We dealt with it very differently because of the situation and because of the fact that we wanted, given the interest levels we had we wanted to make sure that the asset was very publically known to be available then in order to continue

to keep the interest. So we're on track with it and we're happy with where we are.

Overall, we continue to look at the strategic review of the business and that strategic review is one which Dave, myself and the Board will continue to look at. As and when we have something more to say it will be focused on business opportunity and it will be focused on deleverage and those are the things that we factor in. But as and when we've got something to say we'll come back and talk about it.

Thierry Anid: Thank you very much.

Operator: Thank you and once again as a reminder that is star followed by one on your telephone keypad to ask a question.

Your next question come from the line of Karan Samtani from BNP Paribas. Please ask your going.

Karan Samtani: Hi and thank you very much for taking the question.   There's just one question for me. I understand as you mention on Wednesday that Tesco needs the financial flexibility to turn around its business. Would you be comfortable with a credit rating below BB plus to provide this flexibility?

Alan Stewart: It's an important question and I think for us the it's really important that we don't get caught in any particular metric because the metrics are what the metrics are and it's the important thing for us is to build, rebuild the business from the base that we've established. And that we're beginning to see signs of clearly the U.K. is an important part of it but the other markets also there's, in various markets – all of our markets actually if you look at it across the world, face some particular headwinds last year. And therefore across the world in each of our markets we're focused on improving the business.

We won't be driven by particular metrics. We'll be driven by doing what's right for the customer and what's right for the business in the medium term and that's not to say that we're not aware of them and that we don't give consideration to them but we won't be driven particularly into any one band

within them. In the right time, we would intend to operate in an investment grade basis.

Karan Samtani: OK, just one follow up question in terms of accessing capital markets I know you have a strong liquidity position but doesn't sort of the rating determine where you can access it in the cost of funding. So, what's you're sort of view on that?

Alan Stewart: I think that's right. Clearly the rating impacts the cost of funding. I think also we have to take into the account the ability to fund because it's not only about cost it's about ability and those are factors we'll take into account. In the – as I say our maturity profile is actually a number of years out. The first maturity we have is …

Shubhi Rao: September.

Alan Stewart: September.

Shubhi Rao: Next year, 2016.

Alan Stewart: Next year 2016, it's relatively small and beyond that we have relatively small maturities. So we'll address those as we come close to them because of the size of them it's not the ability to access the market isn't something that's – at this point causes us any concern.

And the relative difference in funding is something which we believe from the overall perspective of the business and the health of the business if we have to absorb higher funding we'll absorb higher funding costs. Shubhi, I don't know if you want to add anything.

Shubhi Rao: Well, I also think, you know, if you look at the present credit market we recognize of course as a high yield issuer the impact it would have on costs. I think the present markets would absolutely allow us to access and have the necessary funding if we choose to access it.

Karan Samtani: OK, thank you.

Operator: Thank you. Your next question comes from the line of Lisa MacLachlan from Fidelity Management. Please ask your question.

Lisa MacLachlan: Hello, thank you very much for hosting the call and for taking my questions. I have three please. Firstly you spoke on Wednesday about wanting to own more of your U.K. store base and I was wondering about how both your property bonds could be involved in that and the ABS particularly you have out there?

And then also how you, you know, is there a possibility for other transactions like your British Land deal. I mean who else does own your – the stores that you're currently leasing?

And my second question was on – you've made some welcome changes to try and be more transparent in how you report about debt and you said you're going to focus more on operating profit. Should we expect any more changes there over the next year or two?

And I guess my final one was on working capital and what – I mean I think you alluded there could be more to common stocks but how should we think about that when there is still pressure on the top line on an absolute basis? Thank you.

Alan Stewart: OK, thanks, Lisa, and three very good questions. In terms of the free hold and our overall and the British Land transaction one of the challenges which we recognize in our business is that by having stores which have been subject to sale and lease back whether that's individually or by virtue of specific structures and packages.

We lose – we have two impacts from that one is the fact that we have a rising rent burden because as you well know lease structures in the U.K. tend to be upwards only RPI linked lease structures and that creates a pressure on our business and clearly we've seen what historically has been a fundamental assumption of the food business which is that it was essentially RPI linked and therefore if you like inflation proof. Clearly that's not been the case in recent periods. So that's the first issue we face by having these rentals, we have an upwards pressure on our operating cost base.

The second is we lose some – considerable flexibility which we would have around operating the business compared with owning the asset where we can do more with it than if it's in a lease structure. So, the benefits of bringing more ownership back on to our balance sheet are that we have – we remove some of that pressure and we create some greater flexibility within our operations.

In respect of the joint venture and the structures which are asset backed we're very aware of them but they are very specific and they're very – and we will look at them each on a case by case basis. They may be they may not be but we're very aware that each of those bond issues is very closely linked with the structure and a package of assets.

The British Land transaction we have a number of other lease backs where, and there are the individually odd packages, where we will look to them but the unusual – and we will seek providing that it's the right investment in the – because remember we're using cash generally to – we would be using cash generally to come out of a sale and lease back.

The right thing to do is to work through the economics of that and there's no immediate pressure that we will do. We have to make sure that economically it's the right place to be putting capital.

The British Land transaction was relatively unusual to be both a buyer and a seller on two sides where effectively we could indulge – we could get involved in an asset swap whereby we swapped our interest in shopping centers which aren't a core part of our long term interests for their interest in 21 stores. And they paid us just under GBP100 million of cash as part of it.

So, it was a transaction which made sense to both parties in that sense relatively easy to transact. The other ones will be more – less easy because it's not – we don't have any other situations where there's that buyer and seller on both sides but we continue to look at them and there may well be others that we come back with.

In respect to your second question in terms of the operating profit metric and is there more disclosure coming what we've said is that we will – and changes, we will continue to look at improving disclosure. We have – the words we use will progressively enhance disclosure and we continue to look at that.

We took a lot of soundings from a number of our investors and our stakeholders as part of the process. We will publish our report and accounts in a few weeks' time and we'll then take more soundings and we'll see it come through to us. But a key part for us linked to the way we describe our business and what are the metrics in which we run the business is moving to an operating profit basis which will be adjusted for large and one off events. But essentially gives a much clearer line of sight between the published results, the way we operate the business and indeed then the structures on which we manage our internal delivery against our expectations.

The final question you asked was about working capital and it is an area as you say we spoke about opportunities in stock. We really are focusing the business on cash generation as we announced we have on our longer term basis our three year targets will be driven by a relative TSR performance. Performance as regard 70 percent and 30 percent will be cumulative cash generation including working capital movement and that's something which is a key metric for us.

In the short term, what I would remind all of you on the call is that we – within the current year there is around GBP600 million of cash charge which we took it through a profit and loss account but we haven't really spent that yet. So there is cost of the restructuring and this generally relates to the restructuring.

There is cost which will be an adverse pressure in terms of our cash flow in the year overall but we will focus and look on working capital. And wherever possible we will seek to realize turn what it is potentially an asset into cash on our balance sheet.

Lisa MacLachlan: Super, thank you.

Operator: Thank you. And your next question comes from the line of Ela Kurtoglu from JP Morgan in London. Please ask your question.

Ela Kurtoglu: Hello, thank you very much for having the call today. I have two questions please. The first question is about your working capital on Wednesday call you mentioned that you expect GBP200 million cash outflow I was wondering whether this is net of any expected underlying working capital improvement?

And the second question is would you be able to roughly provide a number around what the cash costs from moving from a defined benefit to the contributions scheme would be?

Alan Stewart: OK, yes, the GBP200 million was I think it was in the context of we spoke about there was a chart I put up in the presentation which looked at the retail cash flow generation and the uses during the year. And we had within that GBP2.3 billion, I think was the number that we showed, of cash generation.

And then we also had against that in the year GBP660 million – 2.5 was the number and we spoke about GBP660 million of other working capital movement. Within that I said that there was more than a billion of cash outflow relating to payment terms with our suppliers. So underlying there was around a GBP450 million, say, GBP400 million inflow of working capital through active working capital management.

I then went on to say that the impact in the current year in relation of payment terms changes would be around GBP200 million. So it was specifically in the context of those payment terms and if you like it's a drag against our cash generation in the year. Beyond that period, we will have going forward we won't be having payment terms discussions as part of our commercial relationships and that brings into what we've spoken about changes to the way we engage with our suppliers.

So that was the specific reference to the GBP200 million. I'm sorry, Ela, your second question was in relation to cash cost DB to DC?

Ela Kurtoglu: Yes.

Alan Stewart: Clearly we've got some expectations on that and we – but what we will be wanting to do is to consult and to hear what colleagues views are. We've got the pension trustees as well who have factored into their thinking the impacts of the change but as we move from that we will – I don't expect the GBP270 million to change but we need to deal with the cost of, if you like, moving from a DB scheme to DC scheme.

And I don't really want to speculate on what is still under consultation. Our intention is give colleagues a competitive defined contribution scheme and pension as a replacement for their defined benefits scheme. And we'll come back and talk about it once we've gone through it and got resolution of it which will be many months away.

Ela Kurtoglu: Thank you very much.

Operator: Thank you. And your next question comes from the line of Diana Tatarchuk from Talisman Global London. Please ask your question.

Diana Tatarchuk: Hi, thank you for taking my questions. I have three questions. The first is on the financials, you know, on my numbers if we take into account what you're saying in terms of, you know, pressure on the top line, net cost inflation, international are performing weaker but at the same time you're not doing an equity raise and, you know, you don't want to sell some of your major international assets. Isn't what you're effectively saying is that, you know, leverage will increase. You may draw on your liquidity. Organic free cash flow is potentially negative and what you're allowing is for a deterioration in credit metrics as you kind of work through the business.

The second question I have relates to the British Land deal. Can you just discuss the balance sheet implications of such deals because for example you make notes that you've assumed or you will consolidate an additional GBP500 million of that post this deal? So perhaps you could just walk us through how you think about these transaction because while it's great that you, you know, have more say with regards to the rent and these leases but at the same time you are continuing to increase leverage for the short term by consolidating this debt.

And then my third question relates to the valuation of the JV's. I'm just wondering whether you can discuss the property in the JV's and be a bit more transparent for us. So for example this GBP0.9 billion valuation of the property in the JV's can you confirm whether the methods of value the JV's is the same method that is used for the – on balance sheets properties or properties that you do own?

And for example, this GBP0.9 billion equity valuation does – can you confirm whether all of the JV's are positive equity or whether some of the JV's may already be negative equity? And for example are you able to disclose the valuations on a bond by bond basis for the various property bonds?

And kind of how do you think about those bonds? As to the question that was asked earlier, you know, a potential, you know, considerations with regards to the liability management because at the end of the day the bonds do account for a large proportion of the underperforming extra and superstores that you have?

Alan Stewart: You're right a number of questions there. In terms of the what I would say is I think the way you run your model is something which you have to do and I certainly wouldn't – the conclusions your work drew are not ones which necessarily I would draw in terms of deterioration. But I'm not – but I really think that's for you to work out.

We haven't said anything about that and we're not getting drawn into what that means. So that if – that's very, very much your view in terms of the your model I suspect. We certainly haven't said that.

What we've said is that we're focused on free cash generation in our business. We're focused on working capital and improving our own internal metrics and we're also focused on deleveraging our business in a way which looks first and foremost at the assets which our shareholders own today and that therefore a rights issue would be something which we would never rule out but we would come to it very late in any equation that we look at.

And we clearly believe that the business is if we talk about overall performance we've said that we see no reason within the U.K. environment

why the benefits of our scale wouldn't lead us to outperform industry averages in terms of performance over time. And we recognize today we're below that.

In respect of the balance sheet impact yes I can absolutely give you some more color on that and we called out specifically in the release on Wednesday the GBP500 million of net debt which will come on to the balance sheet. If you go back to the press release that we put out at the time that we announced the transaction and British Land equally announced the transaction, what we said is that this would also of course remove some of the capitalized leases and the net of that is – and the cash that we get is about GBP180 million of net debt movement.

So, whilst we're bringing on GBP800 – 500 million we're releasing of course some capitalized leases and net that's about GBP180 million. On top of that we then did get the one off of the GBP100 million. So overall that's the impact of it it's not as extreme as the GBP500 million.

In terms of the question on property valuations and how do we look at them the GBP900 million of JV equity, if you like, is the properties are absolutely being valued on the same basis as if we – as we've done our own estate and against that we've taken the indebtedness off which again is there and is known. And that gives a GBP900 million our share of the JV valuation.

We're not going to split that out into a specific structure by structure or unit by unit because in the net it's not but in aggregate it's GBP900 million. How do we think about those? We think about them as issuances which are issued by these vehicles. They very clearly are linked to the structures with them and our commitment is the rentals into those vehicles and that's the way that we think about those.

Diana Tatarchuk: And with regard to the last point, with the rest of the fact that you have a lot of underperforming potentially stores or at least the stores, you know, that are extra and superstore which, you know, are under consideration in terms of what to do with those longer term within these structures is there …

Alan Stewart: No, we've never said – we've never said that. I think you're making an assumption about that. We've never said that at all. We haven't said whether

they're underperforming what we've been very clear on in terms of our thinking about our store estate is that our store estate we've announced the 43 store closures.

Our job now is to work with what we've got and to improve what we've got, use the momentum we're seeking to build in the business and we've seen the early encouraging signs of that and to improve our business performance. We haven't said anything about these ones specifically or indeed anything else.

Diana Tatarchuk: Thank you.

Operator: Thank you. And your next question comes from the line of Stephen Wilson-Smith from M&G Investments in London. Please ask your question.

Stephen Wilson-Smith: Hi, there.

Alan Stewart: Hi, Stephen.

Stephen Wilson-Smith: I just wanted to – a couple of questions. First one was on the exceptional costs. I think you just said that you're expecting GBP600 million of exceptional cash costs to come through this year off set by some working capital improvements. I just wanted to confirm that and then ask about the working capital improvements.

You had a fairly big inflow on the inventories for this year as a result of improving your stock position I guess is that the only area in which you can improve working capital given that you're not sort of changing terms with suppliers anymore? And how much scope is there in that area because we expect sort of are you targeting the same again or just to get a sense of that?

The other two questions I had one was on I guess turning around the profit in the U.K. what are the main drivers for that. I mean I guess the three things that came through this year that reduce profit were the exceptionals, the price reductions that you've had and the changes in commercial income.

Will it be, you know, I'm trying to get a sense of what will it depend on? Will it depend on volume growth or getting back some of that commercial income that you lost and maybe a sense of those things?

And then the last question was on dividend. I know you've canceled the final dividend but how do you think about, you know, going forward, organic deleveraging versus paying a dividend and what would be the timing of any further dividend announcements?

Alan Stewart: Right, in terms of working capital I think, and I understand absolutely the reasons for the questions on it. I just want to be very clear we haven't given any specific guidance on working capital and what it means for the whole year. What we're trying to do is to call out some of the areas that we look at and some of the areas where we can see that there will be flows which we would want to call to your attention.

Clearly it's an area of opportunity and I think you're right the major area as we look at the business in respect of working capital is the area of stock turn and how quickly can we turn our stock. And at what – and how much stock do we buy at any particular time in order to make our stock turn real quick – turn more quickly and get stock off of our – either out of our DCs or sitting in our stores in a way that's tying up working capital.

And our stock balances are very large as you can see from our results so there is opportunity there. Some of it we realized. We will continue to work harder over the course of the year but we're not giving specific guidance in terms of what working capital is and what we expect it to be at this point in the year recognizing that we're very early into it.

In respect of the U.K. profitability, I think what I would just come back to is what we started and set out in October was that we see the three paths and the important critical elements to restoring the U.K. profitability and competitiveness in the U.K. is what we should say. Our availability, service and price and each of those of themselves are elements which will, we believe, improve our overall business performance.

So what we see is it’s very clear that if something which a customer wants is not available the customer is going to sometimes substitute but very often is going to go and shop elsewhere if it’s available at the time that the customer wants it then that’s a key driver of transactions and we’ve seen our transaction count improving. Service is something else which customers absolutely want and when we invest in staff and customer facing staff we can see that that gets a positive reaction from customers and again we can see that in the numbers.

So overall, we called out in the presentation on Wednesday, we showed how in the business and in the – despite the restructuring that we’ve had, despite the significant headcount reductions we’ve had in the office, since the first of September through to the end of February within our overall store count and colleagues we’ve moved an – we have an additional 4,652 people on a basis which actually includes around 2,500 – is net of 2,500 staff who left the business when we – in respect to the stores that we’ve closed because we closed the 43 stores that we announced that we would. And as is also net of around 2,500 staff who we have taken out of in store management roles because we want to invest in customer facing. So, net, we’ve got 4,600 – just over 4,600 more customer facing staff and we can see the benefits of that.

The third way, and this is equally important, is what we know is that customers value a pricing which is clear, transparent and which they can rely on because it doesn’t shift. And we started doing that and we will continue to do that in terms of giving them pricing which they recognize as great value and which is dependable from their perspective.

So those are the key – the three key focuses for how do we restore U.K. profitability and we’ll measure this primarily through volume increase because volume increase is a clear measure of what customers are viewing – of how well they’re viewing us. The other measure is transactions which again we called out.

In respect of the dividend, Stephen, we – the way we think about this is actually we’ve only spoken about it for the year that we’re in and we will look at it and think about it as we go through. We’re very silent on it at this point because we really think we have to be generating free cash flow.

We have to be generating and then having generated free cash flow that's when we start thinking about how do we deal with this from an overall leverage perspective, how do we deal with it from a metrics perspective and how do we deal with it from our shareholder perspective. But we're not in that position now and therefore – and we're not giving any specific guidance other than as we go through each period that's the way we will think about it.

Stephen Wilson-Smith: OK, thank you, and just finally that was correct that you did say it would be GBP600 million in terms of exceptional cash charges this year is that right?

Alan Stewart: Yes, that's right, yes. So of the GBP7 billion of one offs around GBP600 million is a cash element and you'd expect that to be paying out in this year.

Stephen Wilson-Smith: Right, OK, thank you.

Operator: Thank you. Your next question comes from the line of Toby Hanson from Prudential Financial. Please ask your question.

Toby Hanson: Hi and I just had a question on the CapEx and I know you've guided for no more than a billion and looking at the depreciation it looks like it's going to be running around 1.5 times and if you do it on a store basis a rough calculation is CapEx per square foot looks about two-thirds of your competitors. How long can this be maintained before it starts to impact the business?

Alan Stewart: It's a good question, Toby. And what we've said is that we certainly don't believe that we are harming our business at all in coming at this level. I think if, and this is something I've been in retail for many years, but whenever you look at it try to decide what the right level of maintenance CapEx is is something which is very difficult.

When you're trying to put CapEx into the absolute discipline and the spend of it the starting point is always gosh that's going to really cause the business to suffer. The reality is that when you go through that it's amazing how people find more efficient ways of spending money and still maintaining the business

and the fabric of the business and the way that they need to in order not to damage the business.

I think the GBP1.5 billion of depreciation this year if we just talk about how it might shift into – last year into how it might shift into this year, well of course we have the GBP2 billion of CapEx that we spent last year. If you assume that that's average spend equally throughout the year you've got a charge which will come through that in respect of the annualization of that impact into the current year.

In addition, we've got a billion this year and you'll have a half year effect of that coming into this year's numbers. Against that of course we've got the benefit from the impairments that we've taken and what I said in response to one of the questions on Wednesday was I think they might be a touch down in terms of CapEx but I certainly would be surprised if it's a three digit number of that.

Over time, clearly one would expect the depreciation charge and the investment and the CapEx to come closer as asset become fully depreciated. But you have to remember that if you look at the CapEx chart that we set out in the presentation what we've done is for a number of years we've been investing quite heavily and that will take some time to unwind because it's – these assets have longer lives and it will just take time for us to unwind.

So I would expect that for a number of years we would have a CapEx charge that's probably lower than our depreciation.

Toby Hanson: OK, thank you very much for clearing that and giving some more detail. There's one other question regarding Asia. It seems like, you know, previously these businesses being somewhat of a solid show relative to the U.K. but given their increased importance on overall Group profitability just wondering if you could give some detail on what's going wrong including there are some idiosyncratic factors but taking time out for instance, it seems like you have underperforming pairs there.

Alan Stewart: Yes, I certainly think that they've been a very important part of the business they maybe haven't been as important in the respect of – as compared with

overall group profitability. But if you look at our business in each of the countries we're operating in in Asia, we've got very strong businesses in Korea it's a very strongly performing business. It's got a commanding position in the market and it's got very healthy net margins.

It has been impacted, as I said in the introduction, by a continued pressure on store opening hours which I know has been around for some time and therefore one might question why it still exists and why in the third year that it's been there it's still an issue. But if you look at the competitors and there's a lot of transparency in terms of the two – the major competitors in that market, they're facing exactly the same pressures and calling out exactly the same pressures in respect of the impact of restrictions on opening, particularly on Sundays.

So that's been happening in that market and – but as I say it's a very healthy business. In respective of the Malaysian market it's been impacted by, and we mentioned this in the press release, it's been impacted by consumer reaction against some Western businesses.

It may seem surprising to us sitting here in London on this call but actually within the Malaysian market the linkage into the Gaza conflict which happened last year was very significant in Malaysia and businesses which were perceived to be potentially linked with Israel and anti-Gaza were impacted and we were one of those via consumer reaction. And that took most of the year for it to come back.

In Thailand, Thailand had a political issue which happened about a year ago and that has had clear impact in terms of the business response and consumer response in the Thai market. I don't recognize the fact that we're underperforming there. I think we've got very strong opportunities there and it's a market where we see a lot of growth opportunities.

So, that's the individually within each of our businesses in Asia the impact and then finally just to complete Asia we've of course got the joint venture CRE. And in that we moved our business and combined it with the Vanguard business and have a joint venture there. That's been subject to some very

public disclosure from CRE in terms of the impact of the integration on that combined with the trading position in China. And equally, there's a transaction which CRE have involved themselves in in terms of proposing selling their retail assets up into their holding company in order to turn their business into a beer only business.

We've reflected in our write down it's not a true pass through basis but pretty much the implied value of our 20 percent of their HKD28 billion proposed transaction value. So that's our Asian business.

Toby Hanson: OK, thank you very much.

Operator: Thank you. And your next question comes from the line of Charlie Watford from PIMCO London. Please ask your question.

Charlie Watford: Hi, thanks very much just a couple of questions from me. First of all on rent inflation, it looks to have been about three percent last year on an underlying basis is that the same level you're expecting for the next 12 months?

Alan Stewart: It's difficult, we talk about inflation of about GBP200 million to GBP300 million in terms of our rental – underlying rental bill. And it's difficult particularly to put it in specific terms because some of the increases will be RPI linked others won't. But the quantum is about GBP200 million to GBP300 million of rental inflation.

Charlie Watford: So, you're expecting rent to go up to about GBP1.6 billion, GBP1.7 billion next year is that right?

Alan Stewart: Yes, maybe at the bottom end of that range.

Charlie Watford: OK, I guess that sounds quite high given the sort of RPI at the moment so it must be to do with contracts themselves, is that?

Alan Stewart: Yes and remember we're talking global and you're talking U.K.

Charlie Watford: OK, understood. Just on the cost of the bank debt and your facilities have you seen – well how has the cost changed with the rating change and can you give us an idea of what sort of cost you're paying for the bilateral facilities?

Shubhi Rao: We don't disclose the costs of those bilateral facilities because those are facilities between our banking group and Tesco. But I can say that the pricing that we have achieved is extremely competitive and one that the business is area to pay. So we've been very pleased with both the quantum, as well as, the strong banking group that stands behind those lines.

Alan Stewart: And what I'd add, Charlie, is that I don't think you should worry about the impact of a downgrade in terms of our overall cost of debt.

Shubhi Rao: Yes.

Charlie Watford: OK, then sort of quite a simple question but on your price, service and availability charts I'm just trying to understand the – I mean they look very nice but they have five lines in them. What are the five lines each signifying? Or is it just a graphic to show that things are improving?

Alan Stewart: I'm just going to these specific charts.

Charlie Watford: It's page three, I think.

Alan Stewart: No, what they are – no they're not and they're not just to show that things are improving. What they are is they're an update of the charts that we gave in January in respect of the measures. And if you go back to the January presentation they've been updated to show right through to the end of February that the metrics have continued. And if you – when you get out your magnifying glass you'll see that in some cases they've flattened but what we're showing is – and that's pretty much what we'd have expected given that they show a very strong increase.

I think for us the important point is that, and you'll see this is very important in terms of our overall way that we trade, is we spoke in the past about how from a customer perspective, and this is something which the analyst community had spoken about, from the customer perspective sometimes there were elements of the way that we traded our stores, the way that we dealt with pricing which if you look at this were mapped very strongly to our period ends, our half year and our full year.

And that’s something which we want – we will not have because we want out yearend to be invisible to our customers. And that’s why it’s important that you can see the continuing trend in there because if you look at that in earlier years you’d have seen those measurements would have dipped off as we approached half year and full year. But for us the fact that we’re going through a February yearend our customers really shouldn’t see that at all and that’s what these metrics show.

Charlie Watford: And the fact they have five lines there does that just mean there’s sort of five different types of survey or something along those lines?

Alan Stewart: Those are our total business in different parts of the country.

Charlie Watford: I see, so the, I guess, the, you know, all them look fairly similar well the first two look similar and the price one looks more spread out. Is there anything behind that? I mean is it sort of more price cuts in one region versus another or?

Alan Stewart: No, not at all. It’s just I guess different people have different perceptions of it.

Charlie Watford: Or competition or something? OK. That’s it.

Alan Stewart: We’ve got a national pricing policy.

Charlie Watford: Yes, understood. Thanks very much.

Alan Stewart: OK.

Operator: Thank you. Your next question comes from the line of David Herrington from Insight Investment. Please ask your question.

David Herrington: Hi, Alan, thanks for the call. Most of my questions have been answered I just have one other. You play quite good disclosure on your free hold by region between U.K., Asia and Europe. Could you provide that in terms of your lease liabilities? So, how much of the (1.486) million lease expense is U.K., Asia and Europe? Or if you’ve got it the proportion of MPV from the three regions?

Alan Stewart: David, I'm just – I'm going to have to come back to you on that and just think about it but if we don't disclose it we'll put it onto the to be thought through disclosure.

David Herrington: OK, thank you.

Operator: Thank you. Your next question comes from the line of Rebecca Clements from BlueMountain Capital. Please ask your question.

Rebecca Clements: Hi, just a bit of a follow up to the previous questions about the rent inflation. Ideally what the primary way that you like to manage that on a yearly basis? Is it with cost efficiencies, et cetera?

And then my second question in terms of priority I wouldn't expect that you would take Dunnhumby proceeds and immediately go out and buy a bunch of property but how do you prioritize buying back these leases or this property in the grand scheme when you have all these other considerations like pensions and, you know, reinvesting in the business, maybe extra cash to reinvest in the business and your leverage? Thanks.

Alan Stewart: Yes, good questions, Rebecca. In terms of the rents pressure again we're not giving any specific guidance on this but the thinking that we would want to do is recognizing that there is upward pressure in our cost lines. We will always be seeking to meet those if we can through efficiency savings and other savings. Whether we do that or not we're not saying but that's the way we think about it. We just have to constantly improve our processes and our costs such that we mitigate whatever we can of these upwards pressures.

As respect – in respect of the thinking, you're absolutely right the way we think about the use of cash whether it's lump sum cash which comes in from an asset like Dunnhumby or whether it's free cash which we generate in our business the way we all think about this is what's the right return that we get from this and how are we improving our business compared with the other demands which that cash would have?

So what we're – it links back into the same element we have in terms of our assets and our strategic review. We have no imperatives to sell assets under any pressure. We will realize Dunnhumby at a price that suits us and at a time that suits equally we'll look at investing capital where it does the right thing in terms of the intention to bring leverage down compared with the cost to bring that leverage down. And it in many ways it's like a CapEx decision in that sense.

Rebecca Clements: And do you have any priority? I realize that to a certain degree there's a lot of unknowns here and, you know, you're not sure what kind of payment might be required from switching, you know, to a defined contribution scheme ex cetera. But I would assume that that would have to take priority over perhaps an opportunity to buy back a bit of property and reduce your lease burden?

Alan Stewart: On that one particularly the discussion given that we announced on the 8th of January that we intended to enter into consultation that whilst we haven't closed the scheme yet that expectation has been factored into what we've announced with the trustees. And therefore, we wouldn't expect there to be, as result of the closure of this scheme a payment to the trustees.

There is an element which, and again this was a question which I was asked on Wednesday, there is an element of expectation from the – as one moves from a DB to a DC scheme there is an element of precedent in the market that there are cash payments or payments that are required.

We need to factor those in. We don't know what those if any might be but that would be a – not a trustee payment I wouldn't expect it would be more something which if anything is agreed it would be to employees specifically but it would be a one off outflow in respect of the potentially if it came to pass in respect to working capital.

Rebecca Clements: OK, and but in terms of is that like high priority or is it?

Alan Stewart: I think it's very important for us to – from an employee perspective in terms of the risks potentially that they're running plus from our company

perspective that we end up with a defined contributions scheme rather than continuing to run the defined benefits scheme.

Rebecca Clements: OK, thank you.

Operator: Thank you. And your next question comes from the line of Tim Eklund from Royal London Asset Management. Please ask your question.

Tim Eklund: All right, thanks very much. I can see you've released your latest investor reports for the Tesco Property Finance bonds and the valuations there have had slight increases which is a bit of a contrast to what we're seeing with the on balance sheet stores. Given that difference would you all just confirm the valuation method you're using for the investor reports whether you're using a market value for Tesco lease or market value with vacant possession? Thank you.

Shubhi Rao: Yes so the way we look at the valuations for the property transactions is frankly based on the way the market thinks about it in the context of yields and rent, et cetera. So it's very different process, if you will, the way we look at the valuations for our properties on our on balance sheet or for impairment purposes.

So, yes they are done on a market basis and clearly we look at different factors primarily looking at yields and rents as we value those.

Alan Stewart: What I'd say is that within our overall impairment charge that we've taken there's a mixture of the two tests which one needs to look at in respect of any impairment a trigger having occurred. Or what, against the book value you compare the discounted future cash flows expected and the market value and ours is a mixture of that of each of those and that's something we've been clear on.

So on a store by store basis is a mixture in respect to the market value that would be a like for like comparison. But it doesn't track directly into our results because there's a mixture there.

Tim Eklund: Thank you.

Alan Stewart: Right, I'm afraid we've run out of time and it's the end of the call but thank you very, very much everybody for dialing in. I hope that we've been able to help you understand how we think about things. We intend to have fixed income calls as part of our regular updates and we will continue to have those after our results at the half and full year.

So, in closing, I think just to remind us that we've – what we announced was very clearly driven by the one off items, the cash impact of that we spoke about in the call; for us, we are focused on our three priorities which is restoring the competitiveness in the U.K., protecting and strengthening the balance sheet.

And from a trust and transparency perspective whether that's as regard to customers and ourselves as a business or as regard to the investor, the investment case and the engagement with our investors and stakeholders and we'll continue to focus on those.

In respect to the current year, we're going through a huge amount of change in the business and that change is something which we think about very, very carefully and we manage very, very carefully. And from a trading perspective and a customer perspective, our priority is to continue to reinvest in the business in order to drive those volumes because that's the way that we'll restore our competitiveness. Thank you very much.

Shubhi Rao: Thank you very much and have great weekend.

Operator: Thank you. That does conclude your conference for today. Thank you for participating. You may all disconnect.

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