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EDITED TRANSCRIPT

TSCO.L - Half Year 2015/16 Tesco PLC Earnings Presentation

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OVERVIEW:

Co. reported interim 2015/2016 Group operating profit of GBP354m.

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CORPORATE PARTICIPANTS

Dave Lewis *Tesco plc - CEO*

Alan Stewart *Tesco plc - CFO*

CONFERENCE CALL PARTICIPANTS

Edouard Aubin *Morgan Stanley - Analyst*

Bruno Monteyne *Bernstein - Analyst*

Clive Black *Shore Capital - Analyst*

James Tracey *Redburn - Analyst*

Rob Joyce *Goldman Sachs - Analyst*

Andrew Gwynn *UBS - Analyst*

Mike Dennis *Cantor Fitzgerald - Analyst*

Charlie Storey *Macquarie - Analyst*

James Grzinic *Jefferies - Analyst*

John Kershaw *Exane BNP Paribas - Analyst*

Stewart McGuire *Credit Suisse - Analyst*

Niamh McSherry *Deutsche Bank - Analyst*

PRESENTATION

Dave Lewis - ***Tesco plc - CEO***

Good morning, everybody. How are we doing? Good, good.

You know the drill as well as I do. So Alan and I are going to take you through our interim results, four very quick sections. I'm going to say something about one year on, just to put what we're talking about into some context, then hand over to Alan, who will take you through the detailed financial results. I'll come back and update you on the three key priorities and then give you a sense for where we see the outlook being. Okay?

So, look, it literally is -- so I'm 13 months in now. Alan is 12 months in. So one year on, where are we? We see our sales improving. I think the things that I would pull out of here, what we've done here is -- because you'll compare us to the first half of last year, I understand it, obviously for us it's about the trend over that last year. So from Q3 2014/2015, seeing a steady and consistent improvement in like-for-like, both in the UK, in Europe, and now thankfully just in Asia.

So, one of the things that we feel good about is that actually whilst the UK has been a priority for us, the activity that we've undertaken in Europe and in Asia is starting to bear fruit.

In the UK, though, we talked about a volume based recovery, and that continues. We continue to invest in driving volume. As we make improvements in the profitability of our business, we keep constantly reinvesting it in our business. We're doing that in a balanced way. It is working for us, and we'll talk some more about particular categories and things that we've done where we've made improvements, invested it in the customer, and we've seen that come back in volume growth. And that starts to kick in the virtuous circle that we've talked about, where our scale and our operational leverage allows us to be much more competitive.

And you see that in the growth in our transactions, so that growth in transactions continues. And you'll see as we go through that the feedback that we're getting from customers for what it is we're doing to our business, particularly in the UK but also in other markets, is really quite encouraging.

Give you the breakdown by store. I think the things that I suspect you'll pull out of this is we talked a lot -- when I came in, everybody was talking to me about extras and hypermarkets and these dinosaurs that were somehow a noose around our neck. And in fairness, in the first half of last year they were declining by around 7%. As we have invested in the customer offer, as we've invested in service, as we've invested in price, and we go back to these stores being the most convenient one-stop shop and making them worth the trip, we've seen the performance of them improve.

So in the second quarter we're talking about a like-for-like decline which is now just 1.1%. But at the other end, our express business continues to grow at above 4%.

Online sales growing still strongly in grocery home shopping. You've seen we've made some changes in the UK around delivery sizes and some of that, but the growth still continues very strongly and we still hold around 50% market share in grocery home shopping.

We've made some changes in general merchandising around making that a more sustainable, and by that I mean a more profitable model, and not just nakedly in the pursuit of growth, but still growing nicely given the changes we've made. And actually clothing has been quite a strong performance, both in store and online, but in online we're talking about a growth of 14%.

We've significantly reduced our costs. We talked to you about the GBP400m of restructuring benefits, and we're on track to deliver that. We've been active in all of our regions in closing stores that were unprofitable that we couldn't see improvement towards, and we continue to work very hard, very hard, in terms of looking at how it is we can extract more and more value from our asset base.

And we've taken decisive actions on businesses that were significantly loss making and were a bleeder to the business, and the best and biggest example of that unfortunately was Blinkbox. But we've been very active in our cost reductions.

And we're rebuilding profit. I completely understand, it's a bit frustrating sometimes, but I completely understand why all the comparisons are against the first half of last year. I think what I would say to you is it's very clear to us, as I suspect it was very clear to you, that that was a very unsustainable model for Tesco to be in in the first half of last year. We were declining very strongly, we were losing share, we were losing customers, and we needed to do something about it.

We faced into that in the second half of the year. It made a very dramatic impact in terms of profitability. You saw that. We faced into it very clearly. And so what I see and what we see is we look at the first half of this year against the second half and say to ourselves are we rebuilding our business? We're growing the sales. We're reducing the cost. We're growing the transactions. We've reduced -- I'll share with you later what it is we've done to reduce prices for customers. And we've managed to actually start to move the profitability forward by GBP354m.

I'll share with you at the very end how it is we're going to cascade some of this news into our business, and it might ask answer some of the questions you've got for me about where we are in our trajectory, but I'll save that to then. But we're rebuilding the profitability in line with or slightly ahead of where we said we would be at this point in time, but we've got more to do. And that virtuous circle is starting to work.

We've reinvested pretty much all of that benefit back into customers. Jason's in the room, if you want to get hold of him. He'll talk to you about any of the category research that we've done. But the volume leverage as we've gone through that has been really quite significant. I'll give you some examples when I come back later.

As a business, over the last year we've been very disciplined about capital, I mean really very disciplined about capital, including the 49 sites that we exited. You know that we did a deal with British Land to take back, land swap plus -- asset swap plus cash. And we're significantly -- significant reduction in our CapEx. And we were clear in the note that we think that this year we'll actually come in under the GBP1b that we had indicated at the start of the year, so very strong on capital discipline.

And obviously we've done a lot of work in terms of business review and portfolio review. So the biggest single piece of that was the sale, which has now been agreed by the authorities last week and also by our shareholders in an extraordinary general meeting to dispose of Homeplus. Has to say, a very good business, very good asset, so difficult to decide, but something significant in terms of making the contribution to the deleverage of the balance sheet that we wanted to do. So we've done that.

We took a decision with the Board yesterday to retain dunnhumby. We looked at all the options around dunnhumby, very extensive process. And actually when we looked at it and we looked at what it meant to retain that business and what we could see in that business going forward, we thought it was a more value creating option for us to keep it within Tesco, and I'm very happy that we keep it within Tesco. It was never a problem with the dunnhumby business; it was an opportunity to see whether we could raise funds from it, because we felt we could keep the competitive advantage and not own it.

But if the value that's available outside is not as great as what I can see inside, then, as I've been really very clear, I wouldn't dispose of any Tesco asset for anything less than the value that I think it's worth. And given what we've done in Homeplus certainly, and there's no pressure anyway, but Homeplus makes a significant contribution.

And significantly, a number of you were talking about it this morning when I met outside and on the call this morning is, and Alan will talk to you about it some more, we've generated cash from our business in the first half of this year for the first time in a long time.

So when it comes to the balance sheet, asset disposal reduces by a fifth total indebtedness. Pension, being clear about and consistent about what the calls are going forward and getting ourselves back to being cash generative is a key move forward for us as Tesco.

A lot of work around the team. Reorganization, for those who are familiar with it, three pillars within our business, the customer, the product and the channel. Putting together teams to work across disciplines in order to deliver against those three pillars. Much simpler, much clearer.

But for those who talk about it, just to be really clear, the people that sit in those jobs really were in those jobs from the end of May/June, so they're still very much new in role. So whilst I'm talking about a year, parts of this are obviously relatively fresh.

In terms of working together, I'll talk about it again later, but we brought together -- the picture here is when you want to have a staff meeting in Tesco, you need a very big place even if you only want to talk to a tiny fraction of your employees. So we brought all of our store managers together plus one, so two people from each store, and somebody from a representative of each of our business. That means 8,000 people in the NEC. And we talked to them about what the direction and what the purpose of the organization should be.

And we all came away, since that point, which given I'm standing in the UK I use this, is the whole purpose, absolutely everything, and anybody who was at the IGD yesterday would have heard me talk about it, the magnetic north for our business, for me and everybody that works in it, is serving Britain's shoppers a little better every day.

If you work in Thailand, it's about serving Thailand shoppers a little better every day. It works at every level for us. If you come back to the UK, if it's Reading, it's serving Reading shoppers a little better every day. And if it's your local store, it'll be that community, a little bit better every day. Being really clear about what this business is all about, and it's about serving. It's about serving customers.

Can we do something better for them? It's a purpose that allows people to make a decision when I'm not in the room, when their boss isn't in the room. If it's better for the customer, do it.

Supplier partnerships, lots and lots of press around this. Done an awful lot of work, led by Jason and his team, simplified the commercial approach from 24 down to 3. Eventually we got from 24 to 5 to 3.

Making it easier, helplines, protector lines. We continue to engage with our suppliers who are making it much simpler to do business with us. We made some announcements yesterday about what it is we're going to do to make that even more transparent and easier.

And we run -- we do -- most of you know about the customer viewpoints we do on customer satisfaction. We do one for colleagues as well, which is where colleagues tell us what they think about what we're doing. We also have a six-monthly supplier viewpoint, where we take the views of our suppliers, and that's an externally run thing for us.

And in the six months we've seen a very dramatic, in their view, never -- unprecedented move in that survey since it started of from 51% to 60% of suppliers saying actually they're having a very good relationship now with Tesco. And that's great credit to Jason and his team about how it is we're reinvigorating those and rejuvenating those supplier partnerships.

We've done a lot around price integrity. And the three things for that is you saw what we did on brands in January. It's really important. When you look to customers and you ask customers how it is they judge value, particularly between retailers, they look at brands. They're the easiest things to compare. And one of the bits of feedback they gave me when I first came was why is it that brands are more expensive in Tesco than X, Y or Z? And the answer is there really isn't a good answer. So we've addressed that. We continue to address that.

We have invested. We've moved and we've been moving for the last year from promotions into lower, more stable prices. And we've done that on key -- what we call lines that matter most to customers, and that's starting -- that's having really good impact for us.

And the other thing is consistency. One of the bits of feedback that we had as a business coming in was that there was a lot of pricing inconsistency, both promotional but also line pricing, that prices were moving more. And that was actually eroding trust perhaps more than anything. As a result of the things that we've done, we've reduced dramatically the number of price changes in our store, better operationally but much more consistent for our customers.

More for us to do, a journey that we're on, and as we go through the range resets it's much easier for us to address each of those. And we'll finish all of the first round of resets by the end of this year.

That's what we've been doing for the last year. So what I'm going to do now is pass over to Alan, who will talk to you about the detailed results of the first six months.

Alan Stewart - ***Tesco plc - CFO***

Thanks, Dave. Morning, everybody.

So as Dave said, the results are against last year's half-year results, and clearly we're coming off a different base. Make it clear that this is on a continuing basis, so Korea is treated as a discontinued operation. So all of the results you see here are excluding Korea.

Group sales are down 1.9%. This is in reported currency. And at a constant currency, because currency has impacted us, they're down 0.3%. Obviously, in the market constant currency is the most important measure, but from a statutory basis it's down 1.9%.

Next is our Group operating profit before exceptional items. This is a key metric for us going forward. As you know, we announced in September and we restated last year and we said this is the basis on which we're going to be measuring ourselves. So Group operating profit before exceptional items.

Exceptional items, there may be some. Last year there were some. This year there are none. And then we get to the statutory operating profit. And those measures are ones which we'll continue to come back to, but we're trying to make our headline performance measure as close as possible to the statutory profit.

And then the next measure which is important from an EPS perspective is our Group PBT before exceptional items, if there are any, and before pension finance costs. Pension finance costs are non-cash costs. They can fluctuate significantly, depending on how bond markets and yields move, and so we're going to strike those before the pension finance costs.

So those are the two key measures, operating profit before exceptionals and PBT or EPS before exceptional items and before net finance costs. Obviously, year on year they're significantly down.

Just a bit more color as to how we get from last year's measures and previous measures to currently. We had trading profit, last year we recorded GBP1.39b. That's the GBP1.4b which a lot of you talk about. We had some adjustments which are IAS and other property related items, which take us to the operating profit before exceptional items. We then have the impact of the Korea sale.

So on a headline measure, the aspiration for this year is around GBP940m, GBP950m, and the first half obviously last year was a very different number. So that's where we're going to go for and that's the bridge from last year's numbers to this year's numbers.

Turning now to the half year. Sales, we're showing here the UK and the ROI. We're segmentally reporting the way we run the business, and this is what we're going to talk about going forward. So the UK and ROI, actual reported 1.2% but underlying change 0.6%. Clearly the euro movement has impacted us.

And internationally, we've had some swings as regards the euro and also the Thai strength, so we've had some movement. Down 4.6% reported internationally, but underlying up 1.8% (sic - see slide 18 "0.8%").

And then the Bank results, sales pretty much flat, down 0.8%. Although from the Bank perspective, sales is not a real accurate measure of the way that the Bank runs itself, comes into our statutory numbers.

And then the operating profit, again, you've seen these. We've got GBP166m in the UK and ROI segment, GBP102m in the international segment, Bank at GBP86m, making the GBP354m.

So what's been happening in the business? And within the UK segment, we'll now focus on it. Across both the UK and the Irish businesses, over the last four quarters we've seen a continuing improvement. And as you can see, this has been building quarter by quarter in both of the markets. And it's this underlying rebuilding of the business that we're focused on. So we're building from a low point last year and continuing to focus on building the business.

Within the UK segment, one of the factors which is worth understanding, and many of you may already have got here, is the impact of increased space on our reported sales. So if you look back over previous quarters, what you can see is that we've had a total sales growth which has been impacted positively by the new space. New space is what we put in in the year, but then obviously as we go through maturity on the space, we do get some impact in the following year and in the years after that.

So, historically, we've had a gap between our total sales and our like-for-like. In the current year, in the first half, we've had about a 0.5% gap, and in the balance of the year we expect that really to be minimal. So increasingly you'll see our total sales in the UK segment being pretty much the same as our like-for-like, and this is a factor which you should just take into account when you look at some of the external metrics which are published on a monthly basis because they're obviously total sales. And for us relative to ourselves and also relative to others in the market, space continues to be a factor which has to be borne into account.

The UK and Ireland operating profit bridge, what I'd like to have done here was to produce a slide of the second half of the year, but I felt that given that this is a statutory number and given that there is obviously seasonal differences between first half and second half, the second half has got our peak Christmas trading period, it would probably be more helpful to go through from the GBP543m. And really it gives some insight into what we're doing in the business and how those changes in the business impact our operating results.

So we've got, and you'll get your slide rules out, this is around GBP70m or GBP80m, so you can use that to qualify and quantify the others. We've had lower sales, which impacts our operating profit. We've also had the impact of the lower prices. And that deflation is both external in terms of what's happening in the market and it's part of what we're doing in order to reset our business and build the volumes and the transactions underlying it.

We've continued to invest in service. And as we saw, and we've spoken about this really from January onwards this year, and it links absolutely to the purpose which we have, is we're investing in frontline service, in colleagues, in order to engage with the customers better.

And then we've had some benefits from cost savings. We expect to see more of those in the second half of the year. And we've got some other movements, which takes us from the GBP543m to the GBP166m.

So that's the bridge. As ever, it's not absolutely precise, but those are the key drivers from year-on-year movement. But for us, the important thing is the base of a loss in last year has begun to be rebuilt and we continue to expect that in the second half of the year.

If we now look to the international segment, the split between Asia and Europe, Europe slightly bigger than Asia, and those are the constituents. It's now around 21% of our Group total, so it continues to be an important and significant part of our business. With the disposal of Korea, which was our largest international business, obviously that's come down somewhat.

And earlier on I showed you the constant currency. These are obviously at actual rates. Constant sales are 0.8%, just to remind you. Asia's down 1.7% and Europe's up 2.5%.

The profit performance, at GBP102m for the half, has declined significantly at constant rates. A number of factors for that. The one that I would point out is the impact in our Hungarian business. So we have Hungary, there's a tax which has been proposed. The legislative impact is uncertain at the moment, because the EU is challenging this, but it's had a significant impact on our overall operational profit from our international segment.

Clearly, within the segment there's a lot going on. We've implemented the structural changes within the management for the European -- four countries in Europe. They're now managed as one team. We had some costs relating to that, but we're seeing some very strong improvements both in terms of the trading in that business but also in the cost management. And we expect to see those coming through in the second half of the year.

If we now turn to the Bank, as I said, revenue is down somewhat, but more importantly is what's happening within the underlying metrics in the business and we're seeing a strong and continuing improvement in that business. Customer accounts are up 6.2%. And lending, which is key to a Bank, is how much we're lending is key, is up 10.2%.

The operating profit has been impacted by the external changes in the interchange fees. Happy to talk more about those in the Q&A. We continue to see that in the second half of the year. Over time, it's less clear as to how the impact of interchange on the whole sector plays its way out, but in this year we're seeing some impact on the interchange.

Within our overall Group, what's -- an impact on the Bank as a negative is actually offset to a large degree within the retail sector, because that was a cost previously in the retail sector because a lot of our customers are buying with credit cards. So we have a Group offset in relation to that. But from a Bank perspective, it's impacted the first-half results and we expect it through the second half.

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And then finally, from a Bank perspective, very critical, of course, is that the capital and liquidity is very, very strong and our risk asset ratio has actually improved by 200 basis points to just over 19% in the half.

If we now move down the rest of the P&L, the JV, finance costs and tax lines, the total finance cost here is -- includes the IAS pension. The JV income has been reduced primarily because of the losses that we take account of in our China operation. We've had some change in ownership there but no change in operation from our perspective, and we continue to have our 20% interest in that very significant market.

The finance costs increased with, you'll recall, last year the committed facilities we put in place from September onwards. Those obviously had some costs. Those facilities were replaced in the second half of the year and we had some costs relating to that. And then, and this is a pretty technical point, through the finance cost line we have an unwinding of discount, the time value of the onerous lease provisions, and that comes through these lines. That's obviously a non-cash item.

If we look at tax, the full-year expected tax rate that we will get to is around 30%. I think the more important point for the current year is that we don't expect to pay any cash tax in the current year across the Group. And we'll talk more about the rate going forward when we get to April next year, but in the current year we don't expect to pay any cash tax, despite the rate from a statutory perspective being around 30%.

Dave has spoken about CapEx. First half, from a cash -- from a profit perspective, around GBP364m of CapEx through the books. The cash element was slightly higher than that. And we're on track for under GBP1b in the current year.

The allocation of where we're spending it is pretty much where we showed you that we expected to be spending it, and we continue to be on track for CapEx. Really important from a business perspective that we maintain the discipline on CapEx, and that's something which the business is beginning to understand and we can see some real benefits from that.

We've spoken about the importance of the debt position and the importance of generating cash, so I'm going to take a few minutes just to take you through the movements in our debt and how we look at it. So we generated cash flow from retail operations of GBP1.199b, and we did, in terms of the recorded numbers, have GBP194m increase in working capital, so we had effectively a cash outflow into working capital. But it's really important that we understand what's happening underlying that.

So we have GBP400m of the costs of the restructuring that we took as part of the one-off last year. The cash impact of that in the current year was around -- in the first half was around GBP400m.

We also had the balance of the unwind of our supplier payment terms. We spoke again about this back in April. And we had GBP230m of that unwinding in the first half of the year. That's supplier payment terms which we won't repeat. So you will recall that I said that I wanted our cash position to be invisible from a supplier perspective; we just pay our suppliers on the terms we've agreed and they roll throughout the year. In the year we had an outflow year on year of GBP230m, as we unwind the last of those differing treatments, which leaves an underlying improvement of working capital of GBP438m, taking cash generated from operations of just over GBP1b.

If we then move to the free cash flow, this is again a very important measure for us. Interest and tax take over GBP226m, and the cash CapEx is just under GBP500m. So, as Dave said, for the first time in many years we generated free cash flow from the business in this first half of GBP281m.

If we then move to the reported net debt, we've also had some further activities. The consequence of the asset swap with British Land, where we took the 21 stores, is we got just over GBP460m of debt that was part of those JVs onto our balance sheet. And we've had other movements, which take our movement in net debt over the six-month period from February to GBP107m. But underlying free cash flow has been positive.

Dave mentioned the pensions. This is another important part of rebuilding the balance sheet and the strength in our balance sheet. And we've now finished the consultation, and from November we'll be moving to a defined contribution scheme in the UK for all of our colleagues.

What this gives us is greater certainty on future cash requirements. What it gives our colleagues is greater security about the pension that has been promised and will be delivered in respect of the DB scheme, and it gives them a competitive pension scheme going forward. And we consulted very widely and actually made some changes as we went through that consultation.

The IAS 19 deficit, which again comes through the books, this isn't from my perspective a number that is really important. What's important to me is the GBP270m we pay in cash every year as part of the agreement with the trustees. But the deficit increased actually by GBP300m, primarily because of volatility in the equity markets towards the back end of the half.

So we continue to fund in line with our funding plan. And just to avoid any doubt, the disposal of Korea will give no change in respect of pension contributions. So the pension trustees will not be revisiting those contributions, despite the fact that we'll be getting GBP3.5b in from the sale of Korea.

Which takes me on to the next big change. As Dave mentioned, a very significant increase in cash and also a benefit from the lease commitments which we won't have as part of our total indebtedness. In aggregate, that's GBP4.2b that we'll get. There are some transaction costs, primarily relating to tax. The exit from the Korea on a tax basis is costing us around GBP650m, but we remove the GBP870m of lease commitments.

We've received all approvals. We're now on track to close this transaction towards the end of October and we'll receive the cash.

Which then brings us, from a total indebtedness perspective, you can see that our total indebtedness measured today around GBP21.9b. On a pro forma basis drops to GBP17.7b, with a very significant cash benefit from the end of this month. We have hedged all of those proceeds. We hedged them shortly after the transaction was announced. So we've got certainty as to the cash we'll receive in sterling terms.

So if we look to the summary of where we are at the end of the first six months, we've got a momentum which has been maintained in our UK businesses. Across the international businesses and in Ireland, we've got an improving trend and we've got like-for-likes really moving in the international markets. We've rebuilt the profitability from the second half of last year and we've made significant progress on our balance sheet.

I'll now hand over to Dave.

Dave Lewis - ***Tesco plc - CEO***

Thank you, Alan. Okay. So moving quickly into the three priorities, just to bring you up to -- bang up to date.

So, in terms of the UK, slides you've seen from me before, for the last year we've been keeping it really focused on investing in service, availability and increasingly on price. The good news is the metrics that we shared with you continue to move in the right direction, and so we see a very strong feedback from customer viewpoint. It's a measure that we track weekly in every store, to see what the feedback is of customers to the service that we're giving, and you see here that we continue to progress, left to right, improving.

If I look at it in two other ways for you, I think the way that we've talked to customers, the way that we've talked to colleagues about customers, if you remember right back to the very first week of my joining Tesco, there's only been one rallying cry all the way through, which is if every colleague, if every one of the 325,000 people that work for us in the UK were every day able to give one customer an experience which was better of Tesco than they expected, we start to rebuild the brand and the business. And that's what we've talked about all the way through. That's what we're committed to doing.

We put our business together, for those who are not so familiar in Tesco, in terms of trying to get parts of our business to work together very much more than they did in terms of that pursuit of that customer satisfaction. And we do that -- I think the place it becomes most noticeable, and I don't know if you asked these questions when you go before, so a year ago we would run Tesco stores in a way where all people who ran a big store, an Extra store, talked to each other and were part of an Extras group; the ones who run small stores, likewise.

We changed that organization under Matt and Tony's leadership, so that actually store managers in a region come together, in that town come together. And we make sure that the experience of our brand and our business is more consistent across anywhere you might want to touch it, be it a small store or a large store or any way. And that's about giving that consistency of customer experience.

And I have to tell you, there's been some really interesting things that have come out of putting that expertise together around towns in a way that we just had not done before. So those are things that are happening around that service agenda which are in addition to what we've talked to you about before.

Availability was a very big issue for us a year ago. We are now, across all three measures, at an all-time high. So we've never had a service level in the Tesco estate which is as good as it is now. On the 1,000 lines that we identified, if you remember, back in October, we now have a 96% level of availability. Dotcom is tracking significantly -- this is first half, at 98%. If I look at the last period, it's 99%. And that sales based availability, 9 o'clock at night, getting up to 96%. So the availability significantly improved and constantly worked on by us.

Those who have been around store with me in the last few weeks and months, I may have shown you some of the technology that we've used. We've taken the technology and applied it more to our retail estate.

So this is an availability app. It allows you, if you're a store manager, to intervene in terms of sales based ordering. So at the shelf edge you can get involved and be able to either serve a customer better in terms of informing them about availability, or indeed to intervene and make your own order so that you, as a store manager, have that influence over what stock you need at what time.

And all of that has gone around optimizing range, and I'll talk a little bit about some of the things we've been doing there in a second. But that improvement, taking away range that was there that was not what customers wanted to buy, increasing the space for things that they desperately wanted to buy has had a dramatic impact both in sales and indeed in terms of how it is we've run our stores.

I touched on price before. I thought I'd try and articulate for you. So I asked the guys to do one thing for me, take a typical basket back in September of last year. If you bought this basket in September, and I've taken out the promotion bit, just looked at the stable pricing, it would have cost you just under GBP47 in September of last year. If you buy the same basket, same rules apply, this year it costs you GBP45.48. So about GBP1.50 off in that period, so 3.2%, 3.3% of straight price deflation as we've repurposed the money.

Talked about leading brands and I've also talked about the fact that we're reducing the number of price changes in store. And as we speak now, that's about 21% price changes per period versus what it was we were doing a year ago. So that's starting to come through.

In terms of right range, 21 categories reviewed. Jason assures me they'll all be done by Christmastime in terms of that first set of range reset. The average range reduction stays around that 15% that we talked about last time.

But importantly, one of the things I thought I would put in here, because I'm conscious that we talk about reducing the range, a lot of people then go to does that mean there's going to be no range? Well, actually, you've got to remember we have a very much larger range than anybody else. So the reduction is not -- when we take it out, we still have by far and away the best range and best choice of any offering in the UK.

And the other thing that we have done but I haven't talked enough of is that we've used the range reset to introduce an awful lot of innovation. So, nearly 700 innovations have come in, so new things have come in. So range reset does not mean a lack of customer choice, doesn't mean a lack of innovation. Actually, it means quite the reverse.

The other thing that's interesting, and some of you know this, but having walked the store with more people now, I understand that not all of this is obvious, is that when we get the range right, people say, well, what does it really mean? I understand it from a customer point of view in terms of choice.

We measure something in our business. If you want to run the store optimally, we would say that ideally on a shelf you would put 40% of a week's sales, ideally. That's the rule of thumb that we would look to. And that's about how many people need to come to the shelf to replenish how many times during a period.

And if you remember, a long time ago I talked about that in paper, Chris's favorite example in terms of the impact on stock on shelf in paper. But before the range reviews, when we had too much range on, only 80% of our lines were meeting that optimal shelf capacity rule of 40%. As a result, in store then you're having to work much harder to keep everything fully available, fully faced and perfect quality.

As a result of the changes that Jason and the team have made, 92% of all the lines stocked now meet that. So it's a very tangible operational improvement from getting the right range in store at the right time.

The other thing that's interesting, and people ask me what's happened in terms of that simplification of range in negotiation and the volume that comes from it, 10% of the products after the range review, so in a smaller range, after the range review, 10% of the products that are in that range review on average have been 13% cheaper for customers. Okay?

So in terms of repositioning that, renegotiating in the way that we wanted to, focusing on the volume, it means not only have we got the choice much better for customers, actually, quite a significant part of the range that's there after the change is also significantly cheaper. And that's one of the things that's driving that deflation that I talked about before.

And the initial volumes that are coming from those changes are around 2%, so actually slightly above the Group average, which is what you'd expect. We're doing it in a very balanced way, which is through the range reviews. Range reviews are driving the 2% volume growth. And overall we're around the 1.4%, 1.5% as a Group.

And that's what we call the core retailing, getting the right choices, getting the right price, always available and driving the volume. We wouldn't say it's rocket science. We would say it's extremely to do in every store, every day, 365 days a year at a quality standard, but that's the challenge that we're in as a business. The satisfaction is important. If we get that right, the leverage is significant.

Protecting and strengthening the balance sheet. Alan's already told you the pension transition is underway. We work hard on property. We talked about the land deal that we've done already. We continue to look at all ways of realizing value from the property that we own. And we've done the Homeplus disposal.

I thought I'd spend a little bit of time, just before I close, on some of the things we've been doing on trust and transparency. We talked about transparency in the context of the finance and the investment case, and you've seen everything that we've done around trying to illuminate a little bit more the finances of Tesco under Alan's leadership. There's more that we can do, but I think we've made quite a lot of progress. Certainly, you tell me you think we've made quite a lot of progress in doing that, even when sometimes the numbers are difficult to swallow.

What I'm going to talk about now, though, is a little bit more in terms of the brand and just share with you a little bit about where our thinking is around the brand.

I said before that what we had chosen to do as a leadership team and as a total business was redefine the purpose of the whole organization. We've put ourselves very firmly and squarely at the service of Britain's shoppers. It's our core business. It's what we do. Everything that happens in our business has to be about serving Britain's shoppers a little better every day.

I'll tell you another thing, which is, for those who are familiar, Tesco for many years has had two values, two very important values that were created by colleagues over 20 years ago. And they were nobody tries harder for customers and treat others as you would like to be treated. A little while ago a third value was introduced, which was we use our scale for good.

As we worked with our colleagues on redefining the purpose that I share with you now, we also asked them about the values. And it's really interesting. The feedback from colleagues was unanimous, absolutely unanimous about those first two things. They said there's absolutely nothing wrong with the values. They did say, but we would prefer you, as a leadership team, to live them every day, not just in the good times but also when things are tough. So they gave us some feedback that there was no problem with the values, but we just had to live them more overtly in every situation.

When we talked to them about the third one, they said we sort of get it. We sort of get it, but it doesn't stand true. It doesn't ring true. It doesn't -- I can't recognize it in terms of how it is. But the thought was we're such a big business, we have to -- I'm very aware of how big we are and the reach we have and the frequency we have. So actually, when we do make small changes, they can make very, very, very big differences. So we're working with colleagues in terms of articulating that value. And the best articulation, which is still being worked on, is the point that every little help makes a big difference.

And what it is is about going back and embracing the proposition of the brand of every little helps and reinvigorating it, modernizing it and applying it in a way. And the value that expresses that, which is every little help makes a big difference, resonates very well with our colleagues and is very resonant with the brand.

So I say that because what I thought I'd do is -- because then what we do is we have a conversation with our colleagues about what are those little helps that make a big difference, that help us serve Britain's shoppers a little better every day. So here are a few. Here are a few, just in the product area. The trouble here is we've got so many of these now, trying to remember all of them.

So, in terms of product, real product, innovation of product. Who's had an Avozilla? Who's been in store and seen an Avozilla? Jason, I'm glad you put your hand up. I certainly have. Avozilla, unique avocados in Tesco. They grow up to one kilo in size. That's a lot of guacamole. It's a big, unique, very flavorsome but very unique Avozilla.

This is a Komodo Dragon chili. Who likes chilies? Okay. Who has Scotch B Bonnet chilies? Yes, at the back. My Chairman puts his hand up. So, John, apparently chilies are marked in their heat intensity by Scovilles. The Scotch Bonnet chili apparently on the Richter scale has 350,000 on that Scoville measure. Okay? Komodo Dragon chili, uniquely available in Tesco, is 1.4m on the same scale. So on your way home, pop in, pick one and see if you can eat it raw, and send me the photographs.

Large blackberries, the first snackable soft fruit, uniquely available in Tesco. We could go on and on. I could talk about the only asparagus that you can eat raw.

The point being, as we've changed our business model, and going back, the things that we can do and the things that we've done, particularly in the fresh food area around product innovation, is something that's unique to Tesco. It's a little help that is unique to us that can't be got somewhere else. And we've done an awful lot of work in that area.

We've also done an awful lot of work in terms of the health agenda. Over the last three years, the changes we've made, soft drinks and others, 4.5b calories, same consumption, 4.5b calories fewer. A little help makes a big difference.

Treats for all is one of my favorites. This is -- I don't know how familiar you are. Is anybody in the room gluten intolerant or food allergy intolerant? We're the -- Tesco is the largest free-from retailer in the country by a long way.

And what's really interesting is over here, and I've put this one on because I've personally been really impacted by some of the letters I get. I think we're the only -- in fact, I'm pretty sure that we're the only people that have a free-from ice cream range suitable for children. And I get mails -- I've had mails from parents who talk about watching their 8-year-old child, their 13-year-old child, eat an ice cream for the first time.

It's just one of those abilities of leveraging the capability which is in Jason's team to create products which are unique for Tesco shoppers, and they're those little helps that can make a very big difference. There's lots more. I could go on with lots of those.

In the supply chain, little helps in the supply chain. There's been a lot of talk in the agricultural base, be it around dairy, be it around everything. We've for the last seven, eight years paid a fair price in milk on the Sustainable Dairy Group. But the thinking around sustainable dairy is now in sustainable lamb; we're in sustainable potatoes. The idea for us is to have a sustainable agricultural group for Tesco.

We will relaunch the Sustainable Dairy Group in order to make it a much more productivity based and improvement based deal. But that's a level of negotiation and engagement with the farming community that carries on.

Everybody talks to me about small suppliers, and I'll talk about it again. The number of small suppliers that are coming in and working with Tesco and doing very good business is increasing. So this is a Welsh honey. I picked a Welsh honey, but it's just one of many. Welsh honey. The volume for this business has tripled in Tesco. It's now in 650 stores. A lot of discussion about how much honey is available, so Tesco supporting in that sense.

And again, the one on the right-hand side, over the summer holidays we invested about 13,000 hours teaching kids to cook in store, baking and others. One of those little helps that can make a big difference. We talked to people in schools. Educating children about their food is something that is a gap in the curriculum and we're helping there, and in somewhere else in a way I'll mention in a second.

With colleagues, little helps that make a big difference with colleagues. The going the extra mile. I've touched on that. I have to say, this is the one where the number of examples is just growing and growing and growing. And every day I'm blown away by acts of kindness, acts of service that colleagues do around the country against the proposition of serving customers a little better every day.

I spoke to a young lady from Cardiff last week, Gemma, who had without -- having spoken to her, almost without even thinking about it, she became aware through a customer that a customer's friend had been in a hospital, coming back from chemotherapy, had come back and come back to a house where it wasn't ready. The family weren't ready. They were sent home a day early. Doesn't really matter, but was there. And the friend couldn't be there to go shopping and provide for the person that had come from hospital.

Gemma had -- they'd called the store, and Gemma went and did the shopping, did everything, took it round to a customer that wasn't -- and provided it for this lady.

I think the thing that was interesting about that, what Gemma had done just quite naturally, without asking anybody, because she felt it was the right thing to do, she was somewhat blown away when 150,000 -- this friend posted it on Facebook and 150,000 people engaged in the conversation about, wow, what a fantastic thing that is to do. And it's just one of those things where small acts of service, small acts of thought from colleagues really can reengage the brand, and there are so, so, so many of them.

But also in the Bank. What does a little help look like in a bank? Well, foregone interest, first bank to show you where actually you could have used your money better. A traffic lighting system that shows you exactly how to relate one current account to the other.

And in mobile, okay, we're a service provider that's recognized in Which for the service we give. We're the only -- we were the first mobile provider to give 4G at no extra cost.

A little help I picked out here is we were I think the first, and I think we might even still be the only, I haven't checked, you can check for me, but gave parents the idea of capping contracts. So for children, I don't know if you've got any kids who may have spent a bit more on their mobile phone bill than you ever thought they could possibly get away with, you can cap. You can cap, but you leave an element of the cap which means they can always call you in an emergency, so they never lose that capability, but nor can they exceed and seriously overspend. A little help makes a big difference in a really customer appropriate way.

So I'm just trying to give you a sense for what it is and how it is we're building the business going forward.

And finally, around our values. Something I'm particularly passionate about, been pushing very hard with Rebecca and a few other people is the area of food waste. So we do in Ireland -- we have in Ireland a relationship with a business called FoodCloud, and that is direct to store to local charities, avoiding putting any food that can be safely consumed by you or I not into waste but into the community in a safe way.

We brought them together with FareShare, because of the size of it. FareShare are our partner here in the UK. And the three of us are now working on the commitment to eradicate any food waste from our operation that can be safely consumed. We think we can eradicate that to zero inside two years. 12 stores in the UK working on it. This is the application that makes it happen. Was with them last week, making really, really good progress.

We donated through FareShare, just as an aside, something like 30m meals so far, combination of food bank donations, our matching donations and this activity.

Farm to fork, I mentioned before the curriculum. We're approaching -- I don't know if you've ever been in a store when you've seen this happen. It's really quite phenomenal. We're approaching 1m children, 1m children who have walked the supply chain from farm to fork as part of the Tesco initiative, educating them about food and where their food comes from. It's absolutely remarkable.

And it's really quite surprising. You'd be very, very, very surprised to know how many children in the UK don't know where an egg comes from. Yes, it comes from Tesco. Thank you, David. But it's just again reengaging children with their food, educating them about the food chain and just -- I think it's 970,000, so very close to 1m children doing that. And just playing actively our role in the communities in which we're in.

And it's important to mention that our approach to the plastic bag levy is to take the 5p and to reinvest it in local community projects against the environmental agenda, selected by our customers. That's how we're going to use that money.

So our values are no one tries harder for customers, we treat people how we'd like to be treated and we believe that little helps can make a big difference. And it's on that basis. So if you want to understand the Tesco brand, it is every little helps, serve Britain's shoppers a little better every day, supported by those three values. And hopefully I've given you some indication of how those translate into more hard and tangible offers through those examples that I've given you.

And with that, I'll come to this. So those are the priorities. You know those. I'm going to break with tradition now or start a new one. We talked before that we want to present our results to you in how it is we run our business, the segmental review, the way that we're picking the KPIs. What I thought I'd do now is share with you what it is we shared with our teams this morning. So when we went to the market at 7 o'clock this morning, I also sent this to all of our colleagues.

We set ourselves six measures; the six measures that we thought would drive the turnaround. Three of them were financial. Three of them were not. Three were customer, colleague and about trust in partnership. And I suppose the reason I'm sharing with you is that we're sharing it with colleagues, but it also goes to that thing which is we set ourselves benchmarks at a quarter and a half and the next quarter and the full year around what it is we were trying to do in here.

You know that I'm not going to put those numbers in here, and I don't put those numbers in there for my colleagues because that would constitute guidance and the like. But we gave the feedback to the Group today that against the expectation and against the benchmark that we set for ourselves six months through this year, on all six measures, at the Group level, we're on or ahead of the target we set for ourselves.

In the UK, it's exactly the same; it's exactly the same. This has particular meaning for the UK, because those of you who are familiar, we put a turnaround bonus into our stores, so for non-managers in our team, which were generated by this. So they're particularly interested in this traffic lighting system, and they got that today.

So I suppose what I'm saying to you is you're seeing it in the same way that I give the feedback. It also I suppose in a subtle way says to you when you say to me, Dave, where you are versus where you expected to be, we're on or slightly ahead of the target in all the six key areas we set for ourselves.

So with that, we'll talk about the outlook. Look, I can never say anything about the industry that you guys haven't thought about before we come in. I don't see it changing much. Deflation, 2.4% in food; we talked about it yesterday. We still want to invest more in prices. You will see us invest more in prices. You'll see us invest more in the offer in the second half of this year.

We've still got a lot of things to anniversary in the second half year, which were things that I ideally wouldn't want to repeat, and we'll still have that volatility we talked about. We've still got six months of that to go and we're just going to stick to our knitting and do that. We think it's working for us. Everything we've seen so far is it's working for us. But actually, we've probably got -- we've got another six months of repositioning ourselves to go.

Our full-year expectations remain unchanged, exactly as Alan had said. The benefits we've taken, we get that in the second half, and we continue to reduce the cost base.

The one thing I would say, because I've been asked about it this morning already, is if you remember back when we were talking GBP1.4b, I was really very clear when we were talking GBP1.4b that that for me was a maximum. I thought that was a reasonable aspiration, to make the same profit this year as last in the turnaround year, given we made no profit in the second half of last year.

I also was really clear that that aspiration was also, if you like, a maximum. That if we did get ourselves to a place where we generated more than that, that would just be an opportunity for us to invest that back in the business.

I'll be really clear with you. Alan's just talked about the GBP940m when you take the adjustments of accounting and Korea. That's also a maximum. If we get ourselves to a place and we stay ahead of where we would want to be, I will reinvest that back in the business. I reserve the right, based on what's happening, if I see the need or the opportunity to keep investing in the business, to keep us the medium-term competitiveness I'm trying to build.

So I just want to be really clear about that. We're happy with the progress we've made. We really are happy with the progress we've made. We know we've got some challenges in the second half of the year. We're up for that, but we're also up for the fact that there's more that we would invest in our business if we had the means to do so. But we're going to keep it disciplined. We have to create the benefit before we invest it.

So doing the right things for customers, and I've said the last point already. So, with that, any questions?

QUESTION AND ANSWER

Dave Lewis *- Tesco plc - CEO*

I think it's a bit low down there, so you're better off standing up. Please, go ahead. Sorry, it's down there. Sorry, Alan.

Edouard Aubin *- Morgan Stanley - Analyst*

Sorry. Good morning. Edouard Aubin from Morgan Stanley. Just one question for me on your favorite topic, which is the balance sheet strength, the rights issue. So I think if you look at consensus expectation, I think for fiscal 2018 people are expecting around 2%, roughly, UK EBIT margin, again, fiscal 2018. Assuming a CapEx which is going to be at or below depreciation over the period, I think you get to roughly 4.5 times net debt to EBITDAR, roughly, give or take.

So you've talked this morning about wanting the ability to invest more, if need be, in the business. Do you think you have the -- the natural question is do you think you have the firepower from a balance sheet standpoint, and particularly if you assume that Asda stops protecting its P&L in the UK?

Dave Lewis *- Tesco plc - CEO*

I think what I say at a general level, and Alan can comment specifically, I think philosophically we're in exactly the same place. Our view hasn't changed. We do think that it's incumbent on us as management to try and delever the balance sheet through a series of things that we can help ourselves with. That's why we've taken the decision we have on Korea, that's why we're focusing on cash and that's what we've done on the pensions. And we think that we can make that improvement. We don't take anything off the table, but we've always been clear about what our priority would be.

I don't know if you want to say anything about this.

Alan Stewart - ***Tesco plc - CFO***

Yes. Look, of course we never say never, but the way we look at it is that we have our net debt at the half year is about GBP8.5b. Take off GBP3.5b of proceeds from the Korean sale, because that is cash which is coming in, we're at GBP4b, GBP5b -- GBP4.5b, GBP5b, if you then run it through to the end of the year.

So on that basis, from a net debt position, we've got full liquidity, we've got maturities on our bonds which don't really start until a year from now, and even those are relatively well spaced and relatively small. So from a financing and a liquidity perspective, no issues at all.

What we're focused on is generating cash from the business. We began to see that in the first half with the GBP281m that we generated. And free cash flow from working capital and from improved trading is really where we see this business going forward. But we can't rule things out, but that's the way we look at it. We're building that.

On top of that we've got the pension, which we've made progress on. What we've stopped is the increasing of that liability through daily service accrual. And we are then also focused on the property side of things, where where it makes sense we will invest in property in order to increase the ownership and remove some of that continuing potential pressure on our operating cost going forward. But with the sale of Korea, we've made very significant progress against that balance sheet priority.

Dave Lewis - ***Tesco plc - CEO***

Bruno first and then Clive.

Bruno Monteyne - ***Bernstein - Analyst***

Bruno Monteyne from Bernstein. The one main thing you didn't mention in the answer to Edouard's question was obviously margin, and about six months ago you said you'd expect to earn above industry average industry margins. Do you feel you're six months further towards that 3% to 4% target than you were six months ago when you said that?

Second question is you used cost savings in a confusing two different ways. You mentioned the GBP400m, which seems to be head office, fairly kind of an invariable cost, but in your EBIT bridge your cost savings are probably including productivity savings from the range reductions, the cutting of fuel save and many other things as well. So can you clarify how big the cost savings in the broader sense of the words, including efficiency savings, really is?

And the third thing is you stuck to your full-year guidance. You had about 0.8% margin in UK, ROI the first half. This almost implies about 1.7% in the second half to get that total number. Therefore, are you implicitly saying with the remaining cost savings you're about 2% higher for next year really, as your cost savings plans unfold?

Alan Stewart - ***Tesco plc - CFO***

Shall I take all three of those?

Dave Lewis - ***Tesco plc - CEO***

If you do, yes.

Alan Stewart - ***Tesco plc - CFO***

Right. In terms of margin, look, nothing's changed in terms of what we believe about the long-term outlook and the fact that we -- there's no reason why we shouldn't operate at above industry margins, and the scale that we have and the operating leverage that we have should work to our advantage. And we've never guided particularly to any level, and that continues to be the case, but we remain of the view that we will be above industry margins because of our scale.

In respect of the cost savings, obviously there are underlying cost pressures against some of the savings, and those are well known. We can see them and they arise in the areas that you know about. So for us primarily in the current year we've highlighted the cost of getting the savings and the benefits we expect to make.

In the first half, as Dave said, some of those only came in towards -- during the first half. We expect to see more benefit in the second half. But we're very clear that as we exit the year, we'll be on the run rate of the GBP400m savings that we'd make.

Within the business, it's always a question as to how much you take operational benefits. 21% price savings will definitely mean less work in stores. But those we don't really count as part of those specific cost savings. When we put them into the bridge, clearly there's some operational benefits which come through in overall costs as well.

And then the third one was?

Bruno Monteyne - ***Bernstein - Analyst***

In the full-year guidance you had about 1.7% exit rate in UK, ROI. Does that get you to 2% or higher next year?

Alan Stewart - ***Tesco plc - CFO***

We'll talk about next year, I think, Bruno, when we get to April and we look at next year. But what's important is the outlook for this year against where we are at the half and then that longer-term progression.

Dave Lewis - ***Tesco plc - CEO***

Bruno, to the second one, because I know it is a -- everybody asks the question and it is the right question and, trust us, it's one we lament on and think about a lot. I think the reason why we hesitate is -- comes back to where we are in the turnaround and just being confident about what it is, the changes we make and what the outcome can be.

So what do I mean by that? Are there more things that we would want to invest in in the second half of this year? Yes, there are. Do we keep the discipline that says we've got to create the savings before we can make that investment? Yes, we do.

What we don't know is, as we change our operating model, what the customer response to that is going to be, and particularly around the volume. And we've got some things that we need to change in the second half of this year. If you're, and you probably are, if you're close enough to what was happening in our business in October of last year, there was an awful lot going on which we're not going to repeat.

So to sit here at this moment, I think if you talk to my whole leadership team, our biggest, biggest conundrum is as we change that offer through such a year-on-year comparison, being really specific about what the outcome is, really hard. So to give guidance in that place to the degree that you would like it to be, we don't think that's sensible.

But we do -- that's why we're trying to say create the savings, invest; if it gets above a certain level, take that and invest, and just bear with us as we walk through that journey. And if we're more successful than we thought we would be then maybe next year will look different to what we thought it did a year ago, but we need to take that a step at a time. So it's not -- we're not trying to hide anything. We're just trying to share with you what it is we're trying to manage at the minute.

Alan Stewart - ***Tesco plc - CFO***

So, sorry, to that point, we spoke in April about volatility a lot. We haven't today, but that doesn't mean that there isn't potential volatility as we go through these changes.

Dave Lewis - ***Tesco plc - CEO***

Clive? I was trying to get the microphone to be efficient.

Clive Black - ***Shore Capital - Analyst***

Yes, thank you. Morning. Going back to Edouard's question, really, I'll try and start a trend of analysts only asking one question, what would be desirable solvency ratios for you in terms of net debt to EBITDAR, lease adjusted net debt to EBITDAR, in terms of taking this business in the long run to repaying a dividend? And in that respect, can you reach that position in a reasonable time without Edouard's rights issue?

Alan Stewart - ***Tesco plc - CFO***

Yes, Clive. So what we've said, and nothing changes here either, what we've said is that we would intend to be an investment grade credit. That's what we would intend to be. We're not putting a specific time on that. On the metrics that we've looked at, and we obviously take external advice on that, the sale of Korea gives us around 12 to 18 months, depending on which agency you look at, improvement in those metrics. So the sale of Korea, everything else being equal, brings us earlier by 12 to 18 months.

Now, it is still a period away, but that's what we're intending to get to. The improvement in the business and the cash flow will definitely help on that, and those metrics are ones which are pretty much the agency metrics because we're externally judged on that. So that's what we're aiming for. The time period is uncertain, but we're pretty clear now that it's 12 to 18 months earlier than it was back in April.

Clive Black - ***Shore Capital - Analyst***

Okay. Can I just come back on that then? Are you growing --?

Alan Stewart - ***Tesco plc - CFO***

What question is this?

Clive Black - ***Shore Capital - Analyst***

Well, it's the same question in terms of -- it's a follow-up. Are you increasingly confident that you can trade your way through the aspirations of investment grade rating?

Alan Stewart - ***Tesco plc - CFO***

I think what we look to is self-help in every area of the business, and that's a really important part of the way that we're operating. And this comes back to what we spoke earlier about. We do consider that we should look to ourselves, look to our performance relative to how we were doing, and improve on that. Clearly we have a market and we have a competitive market which remains external, and we'll have to adapt as we go through that. But we do believe that within our own operations we have the ability to get to those sort of metrics.

If there's benefit in doing things to get there more quickly, then we will do that. But we're focused on running the business the way we see it and improving that, and that's the mantra into the business and into the teams.

Dave Lewis - ***Tesco plc - CEO***

Somebody -- do you want to pass it down for me, Clive? Just trying to be logistical with the mic.

James Tracey - ***Redburn - Analyst***

Morning, Dave and Alan. James Tracey from Redburn. Two questions for me, follow-up -- the first one is a follow-up on Bruno's question. The guidance for the full year of GBP950m, it implies 1.7% UK margin. It was 0.8% in the first half, so effectively doubling in the second half versus the first half. So what are the mechanics of that doubling? Is it additional cost savings or is it some other technical factors? It would be good to get a bit more color on the confidence of the double. And then I'll save the second question.

Dave Lewis - *Tesco plc - CEO*

Well, look, I think it comes from a place which is -- again, the 0.8% comes from zero. So if you look at the trajectory from zero to 0.8% to your number, not mine, of the 1.7%, as we've made changes, as we keep saying, the second-half repeat of something that we've implemented in the first half year, we see those benefits carrying on. We see the benefit from the volume growth. We see the benefit from the savings that we've put in there. So that's built into us reconfirming that the aspiration is for us to hit where it is.

So we can see some of that. There's some volatility, and that's why we're really clear that if the market were to change competitively we might have to do something other than what we're currently planning to do. But we wouldn't be giving you that assurance if we couldn't see the model that we've just talked about playing out in the way that we've just been saying this morning.

Alan Stewart - *Tesco plc - CFO*

It is your number, James. But the other element is that we've seen real increased momentum in our international business, and the international business clearly we would expect to see improvement in the second half relative to the first half as well, indeed.

James Tracey - *Redburn - Analyst*

Okay. Thank you. And the second question is on the balance sheet, a slightly different question. If you look at the net asset value of the retail business, it's GBP4.8b. And then there's GBP2.5b of goodwill and intangibles, so GBP2.3b of tangible retail net assets. Is that a level that you're comfortable with?

Alan Stewart - *Tesco plc - CFO*

If you're ask -- in what way? I'm sorry. I'm not sure what you're asking.

James Tracey - *Redburn - Analyst*

Well, just relative to the overall EV. And then if you look at other metrics like lease adjusted net debt to EBITDAR, it's probably 5 times this year, or if you do gross adjusted debt to EBITDAR, 6 times. Clearly, you'd want it to be 3 times for investment grade.

Alan Stewart - *Tesco plc - CFO*

How can I answer this? Because the balance sheet value is what the value is; it's the function of the invested capital and the depreciation. So in the sense do we expect to see significant further investment in it, no, we don't. Do we expect to see impairment? Well, there are no impairment charges at the half year, and clearly that's something which we look at and we have to look at as we draw up our accounts. So in that sense, right now, we don't see any further need either to significantly increase those assets or to see impairments coming through.

James Tracey - *Redburn - Analyst*

I suppose the question is property values appear to be coming down in the UK sector at the moment, and if that's the case you may have to do further impairments on --

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Alan Stewart - *Tesco plc - CFO*

Yes, and if that -- I thought that's what you were maybe asking is about impairments. Now, just to remind you all, the basis on which the impairment charge is drawn up, there are two tests, each of which is relative to the carrying value on the balance sheet. There's discounted future cash flows expected from the asset and then there's the property value. And if either of those is -- if neither is higher than the asset value, then we take the higher of those two and we take the difference and write it off.

So today we see no change against that. But clearly, as part of -- and again, this is something we spoke about in April, as part of the impairment charge we took, some of that, a large part of it, it was about half and half, was property related rather than cash flow related. So in that sense, there is an external valuation test which may or may not have an impact. But they are moving parts and those we will assess as we go through at the balance sheet dates. Today, there's no reason to change it.

Dave Lewis - ***Tesco plc - CEO***

There was one more. Just behind you first and then we'll come here and then we'll move over to Mike's end of the room.

Rob Joyce - ***Goldman Sachs - Analyst***

Thanks. Rob Joyce from Goldman Sachs. Sorry, three from me, hopefully reasonably quick. First one, just on the supplier announcement yesterday about paying the smaller suppliers sooner, can you give us an idea if there's a working capital impact there, what size that would be?

Second one is just on the comment about reinvesting, where you'd like to put more funds if you could. Can you give us an idea of where you would actually look to reinvest further in the business, if possible?

And the final one is just on volumes. Can you give us an idea of what volume -- what lines are increasing volumes? Because Kantar would suggest it's more a non-food volume than a food based one. Thanks very much.

Dave Lewis - ***Tesco plc - CEO***

So, announcement yesterday -- why don't I take -- so announcement yesterday is net neutral, so actually short-term small investment from us because we're going to implement for small suppliers in October and the other changes in by June of next year. So what we were seeking to do is more important. So, financially, nothing to worry anything of the analysis that you have here.

But more significantly here is in the relationship with suppliers, things that all got way too complicated, lots and lots and lots of feedback from suppliers around that, and I said yesterday also part of that is one of the reasons why we get ourselves into potential difficulty around GSCOP. So we say, do you know what, that's not how we want to be. So this is about trust and transparency in the relationship.

So we published our trading terms, and we published our trading terms -- we commissioned a report with the Centre for Economic and Business Research around the supply chain in the UK. We looked at the profitability of the retail industry and, dare I say it, elsewhere in the supply chain, which makes interesting reading if you're interested.

But we then said, what's the right terms, what do we think the right terms are looking at specific categories, because they all have different dynamics and different supply chain cycles, size of business and a few other factors and said, do you know what, based on that, we think the right thing for us to do as Tesco is the following.

And we published yesterday, Jason will lead the implementation of it, is to say, look, very clear, we don't want to be negotiating on trading terms; we want to be talking about customers and innovation and all the other things we've talked about. And so we published them and we published standard payment terms by category. And we said if you're a supplier who is below GBP10m with us in one of those categories, against that standard, it's five days fewer. So we give some recognition for size.

In any category, in any category, if you're a supplier that has business with us which is less than GBP100,000, and there are a lot, irrespective of the category we would pay within 14 days. For that group of people that happens now, in October, and that's quite a significant -- for a small business, that's quite a significant improvement in the terms that they were getting.

Elsewhere in the supply chain, as we modify, because to be honest it's been larger -- perhaps sometimes larger suppliers who have negotiated on these particular things as we standardize, some of those do move up a little bit. But we're not trying to gain -- Tesco gains nothing from this either. So, no cost in terms of [looking at it], but no gain for us, which is unusual in trading terms changes by retailers, no gain. But we give them nine months to make an adjustment, because we don't want to have a financial impact for any of our suppliers in this move so we're going to give them nine months to judge.

So that's what it's about. It's about simplifying the arrangement, but no working capital impact for us.

Rob Joyce - ***Goldman Sachs - Analyst***

That's neutralized, because some larger suppliers are taking slightly low --

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Dave Lewis - ***Tesco plc - CEO***

Timing, yes, exactly. But the critical thing is that we've looked at what is the right trading terms within that supply chain, stock turn, stock holding, really quite analytical in that. And to be honest, we've also had a conversation with -- looked back in the supply chain and said what does our supply chain -- the real interesting thing for me is when I look at our trading terms and I look elsewhere in the supply chain and look at perhaps what my suppliers are doing for their suppliers, it's quite different. I was really shocked.

I had an interview with the Business Secretary about trading terms, because of all the things he had read in the paper. So my first question to him, so what do you think our trading terms are? And he said oh, well, industry, about 120, 130 days. Actually, we're 40, 42. Absolutely crestfallen. So the press, the press around what Tesco trading terms are is completely at odds to what the reality is. So we've just been really clear, transparent, everybody exactly as we want it to be. Okay?

So that was one. Forgotten the second one now.

Rob Joyce - ***Goldman Sachs - Analyst***

The second one was -- I've also forgotten it. No, where would you reinvest? You said you would reinvest if you could.

Dave Lewis - ***Tesco plc - CEO***

Yes. Look, there's a couple of things which is we still think there are areas where we want to invest in price. We're doing it through the range resets and the fact is we've still got some things to do. And that --as I say, the lay down of that is to the end of the year. So those are the things that we still want to invest in.

And there are still some -- there are some ideas and some creativity and some proposals that are sitting on my desk that we'd like to invest in, but I'm making sure that we're being good with our money before we pull the trigger on some of those things. And I'm not going to tell you what they are, because they'll be competitively sensitive.

Rob Joyce - ***Goldman Sachs - Analyst***

How much on pricing do you have to go?

Dave Lewis - ***Tesco plc - CEO***

I think, look, we track our pricing, and for us we have reduced -- you look at the indices as well. If I look at the price indices on lines that matter most, we're narrowing the gap versus our competition. In fairness, there's some reaction in the marketplace and we have to deal with it. That's the volatility that Alan's talking about. But we think that there are areas that we can responsibly and sustainably reduce the prices, but you'll only find that out when they're on the shelf, I'm afraid.

Rob Joyce - ***Goldman Sachs - Analyst***

Sorry. There was one on volume. Is it grocery volume or non-food volume?

Dave Lewis - ***Tesco plc - CEO***

For us it's grocery volume, actually by far and away. So the things that we've been talking about, if I talk about fresh produce, if I talk about grocery, we're seeing the volume leverage through pretty much all of the estate. But for us the food part of it is by far and away the biggest part of it. Okay?

I'm conscious of time. Yes, this one here I promised, and then we'll go that end of the room. Have we got another mic? That's good. That helps.

Andrew Gwynn - ***UBS - Analyst***

Morning. It's Andrew Wynn from UBS. I'll go for three questions, be a bit cheeky. First question is you paint a picture of everything's going to plan. Is there anything that is proving more difficult than perhaps you'd hope for?

The second question would be perhaps one for Alan, actually, just around payroll. Obviously we have two forces at work here. We have living wage, and we've not really commented on that, but then we potentially have a cost saving from the pension, again not quantified but it would be very useful if you could quantify both, or at least talk in general terms.

And then the third question is just on cash flow. We had a reasonable performance in the first half from cash flow, particularly given the payment terms. What should we expect for the second half? Is there anything particularly significant to flag there? Maybe even CapEx could be a bit lower than GBP1b?

Alan Stewart - ***Tesco plc - CFO***

Shall I take -- in terms of pension, I think it's really worth understanding that we haven't factored in a significant saving from the pension. What we were clearly wanting to do was to protect the position going forward, to protect the pensions that had been promised, and to reduce the potential for further significant cash payments to meet a growing pension liability.

So we don't know yet what our colleagues will do. From November, our colleagues will be able to elect to take a pension contribution of their own of between 4% and 7.5%, higher if they want. We will match between 4% and 7.5%. And we just don't know what our colleagues will do. So there's potentially quite a lot of variability in terms of the cash cost of that, which we'll see and we should have greater visibility as we get into next year. But this was not about saving money from the pension; it was about protecting and stabilizing where we were. So I haven't factored any pension saving into the thinking going forward.

In respect of the cash flow, I think clearly there's the payment terms with the suppliers, which we've mentioned. There are potentially movements within the cash flow. But on an overall basis, to help give some guidance towards the cash generation from the business over the second half of the year, I would expect that we'd be in the region of GBP400m or GBP500m of net cash generation in the balance of the year, which would bring -- and then of course you've got Korea coming on top of that. But please recognize that there is potential volatility as we go through the supplier arrangements as well in this (inaudible).

Andrew Gwynn - ***UBS - Analyst***

(Multiple speakers) living wage?

Alan Stewart - ***Tesco plc - CFO***

So the living wage --

Dave Lewis - ***Tesco plc - CEO***

Well, living wage, certainly in the short term. So GBP7.20 is indicated for April next year. We were supportive of that. We're supportive for that for a lot of reasons, but we're also already paying our people -- our colleagues ahead of that on a base rate. So in terms of short-term impact of living wage, tiny if nothing in terms of Tesco, given that we were paying ahead of that already.

I think the critical thing that we would say on the living wage, and we talked about it again as part of an industry review yesterday, is we're very keen that the discussion on pay is not just one which is about a base hourly rate. And yesterday, IGD, we showed what it is we give to our colleagues as part of their package, which is not just about a base hourly rate.

We're having conversations with our colleagues. They value those benefits. And if you put those benefits in and monetize them then on a non-London basis, because I've got those numbers in my head, we're about GBP8.80 an hour, which makes us quite close to the GBP9 of the 2020 aspiration.

So if you look at it on total package, that's where we are. We don't think that translation of that just into a base rate is the right thing to do. But we're in consultation with our unions now on maybe more flexible ways that we can present that package to our colleagues, so that they can take the benefits in ways that they would prefer. But that's where we sit on the living wage.

And to your first question about things that may not have worked as well, I think, look, behind the scenes there's loads of things that we've tried that didn't work well and we've just not repeated them and moved on. So it's not that I'm presenting a picture that everything's smooth.

I think the biggest single -- if I had to say, I think the two things is there have been a couple of things that I'd love to have moved quicker on, and Jason's smiling at the back, and then found actually there are some really good IT and technical reasons why perhaps we've not got there and I've been very wisely counselled to measure twice and cut once. So that's slowed me down in a couple of things. But I think we've got through most of those now.

And our biggest single challenge as Tesco is do we work as a team. Our big cultural transformation behind the scenes is it's been a very powerful business working in verticals and it's built -- I don't criticize it all. I think it was absolutely the right model for a time in the business. But actually now I need people to work more horizontally as a team, and that's quite a -- that doesn't happen like that.

To this end of the mic.

Mike Dennis - ***Cantor Fitzgerald - Analyst***

Yes. Mike Dennis from Cantor Fitzgerald.

Dave Lewis - ***Tesco plc - CEO***

It's when you mentioned your name it went off, Mike.

Mike Dennis - ***Cantor Fitzgerald - Analyst***

Maybe it's your system. I don't know.

Dave Lewis - ***Tesco plc - CEO***

We can hear you.

Mike Dennis - ***Cantor Fitzgerald - Analyst***

I just want to get to the bottom of the GBP166m. Maybe you can help us start by telling us what Ireland has done within the UK and Ireland. Only because last year Ireland made GBP66m of trading profit, and obviously what you've done in Ireland in terms of the investment and (inaudible). I'm assuming that Irish profits are down.

And where I'm going with this question is, is the starting point in the UK a lot lower, because you've now given us the petrol sales and most retailers know that petrol margins are more than double the margins you print. So, by definition, the underlying UK stores business must be very close to breakeven or loss making or somewhere around there. So maybe you could give us some sort of indications around that. That's question one.

Question two, what did you make in Europe in terms of profit or loss?

And question three, is 2% volume enough in the first half to offset your price investment where you didn't have a price investment from the supplier? So is 2% volume now enough to offset that price investment?

Dave Lewis - ***Tesco plc - CEO***

So I think I'm going to answer the first question really shortly but in a way that you're not going to like, so I might as well. We're not going to break down more than we have. I'm really very keen that we get ourselves to a place where we report in the way that we run the business. So we're reporting the UK and Ireland, we're reporting in international in the way that we did. We made the decision to do that, and that's what we'll continue to do now and into the future.

But one thing I would say to you is I don't think your analysis that leads you to the conclusion on the UK stores is correct, and maybe separately we can ask Chris to try and help you with that analysis. But we're not going to break down the countries in the way that you would like us to.

The second part of that, for me anyway, is the 2% volume. We had the conversation over coffee outside. We could drive the volume more. We could drive the volume more. We definitely could drive the volume more. But I don't think that would be a financially responsible thing to do.

We are very clearly and very deliberately, and get hold of Jason separately and ask him the question, which is we're moderating the investments we make against the volume, against the profit and recovery of profit. And that's the balance that we're making and that's the balance we'll continue to make, and I'm imposing a discipline which is get the benefit first and then reinvest it. And we feel that at the moment, against the turnaround plan that we did, that the volume improvement, which is 2% as we go through the range, 1.5% for the others, and recovering the profit is the balance that we're going to run for a while.

Now, could we do more? Could do more, but would it have a short-term impact on the profitability? Probably. Do we think that's the right thing to do, given where we've just come from? We don't think it is. And you might have a different view and your 4% volume growth target, I understand it, but with everything I see at the minute, if you were looking for a target like that, the impact on the profitability having been zero in the second half of the year, I don't think it's a sensible thing for us to do. So we're trying to be measured in the way that we turn around the business.

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

Alan Stewart - ***Tesco plc - CFO***

I think it's -- in respect of the international segment, it's the same answer. We're running the business as an international segment. The profits were GBP102m. They were down. We've highlighted the fact that Hungary was one of the key drivers. We're seeing benefit in the one-year structure and we're beginning to see benefit in our Asian business through the sales momentum in markets which haven't been easy over the first six months of the year. But that's really as much color as we can give in terms of those international profits.

Mike Dennis - ***Cantor Fitzgerald - Analyst***

But you can't say whether Turkey or Hungary are loss making?

Alan Stewart - ***Tesco plc - CFO***

We're not going to. I can, but we're not going to, because we're running the business as a segment.

Dave Lewis - ***Tesco plc - CEO***

What I think, to Alan's point, is we've taken a conservative view in Hungary, given the issues around taxation. If that were to change, that would change and have an impact, but we've taken the most conservative view. And if you want to have a look at international, you'd have to have a look at Hungary with that tax in and out to make a fair comparison.

Okay. Let's go to the back. We've been right down at the front a bit. So gentleman right at the -- I can't see. Yes, please.

Charlie Storey - ***Macquarie - Analyst***

Thanks. It's Charlie from Macquarie, Charlie Storey. Three questions from me, all relating to slide 40 or right range for customers. 10% of products, 13% cheaper; it's tempting to think that that is a discounter focused basket. You're shaking your head; it's not. Where would this potentially compare to where the discounters are? That's the first question.

Dave Lewis - ***Tesco plc - CEO***

Okay.

Charlie Storey - ***Macquarie - Analyst***

The second one, 2% volume growth on those lines you've invested in. There's a chart with an icon showing a nice smooth up to 2% graph. Is that an icon, or is it actually representative of increasing building volume growth on those lines?

And lastly, where are you with your number of category resets? You mentioned 33, a number of categories you're going for. Can you do that by the end of the year?

Dave Lewis - ***Tesco plc - CEO***

So 21 done, 33 by the end of the year, and I think I've said twice that he keeps telling me it will be done by Christmastime and so far he's been absolutely true to his word. So I think that's February. He's negotiating in public. So for end of the year -- sorry. End of the year, end of our financial year. Fair play. That's true. It is February.

The 2% is not an icon; it's what we're getting from the range resets. And the basket analysis you see is not a discounter basket. It's across the range reset that we've done. But I tell you seriously, if you want to have that detail question, I wouldn't do it here. I would get hold of the big fellow at the end and he'll tell you chapter and verse exactly what he's done.

Charlie Storey - ***Macquarie - Analyst***

Sorry, just on the icon question, it is a steep increase -- incline for the 2% volume growth. Is that what you're saying?

Dave Lewis - ***Tesco plc - CEO***

Yes. What we're saying is on the 21 categories that we've done, overall, we're seeing a 2% volume improvement in the categories we've done. And as a total entity, we've seen 1.4%, 1.5%.

Charlie Storey - ***Macquarie - Analyst***

Okay. Thanks.

Dave Lewis - ***Tesco plc - CEO***

Gentleman, I'm going to move that way, across here, if we can.

James Grzinic - ***Jefferies - Analyst***

Morning. It's James Grzinic from Jefferies. I just had a couple of quick ones. The first one, how many -- what proportion of the supplier base have you now transitioned to a proper front margin relationship? It would be interesting to know that.

And the second one, on the working capital side of things, what were the drivers to the underlying improvement? How much of that is left, going forward?

Alan Stewart - ***Tesco plc - CFO***

In terms of the working capital, the primary driver we're focused on is actually the stock and actually moving stock, which over time, providing we then get the purchasing right, will actually result in a faster stock turn. So it's about stock primarily. As we've said, and as we've been clear in terms of supplier terms, the change in working capital through supplier payment is not an issue, and for us the receivable side is really something that on a -- dealing with customers' receivables isn't a big part of cash. So it's primarily stock is the key area. And then we've also got in terms of the -- yes, I think that's it.

James Grzinic - ***Jefferies - Analyst***

And just in terms of how much is left, how much you can do more on stock, going forward?

Alan Stewart - ***Tesco plc - CFO***

I think there is definitely more that we can do, and we'll come back and talk about it. Clearly you're right; there is an element of which will be -- you can't do it every year, but I think there's a lot more to do and I'm sure we'll be talking about it for more than the next six months.

Dave Lewis - ***Tesco plc - CEO***

I think what we will try to do, and I think what we have a clear line of sight of doing, is resetting a level and then holding that level in the years ahead. So there's an improvement in working capital that comes from better stock management across all three parts of the Group. So we've made good progress, but there's more that we can do.

To your question around commercial income, I'm not going to give you the split between front and back. That's commercially sensitive. What I will tell you is we've made a significant move of back margin into front. And as we walk through the range resets and the renegotiation, that's something that we're committed to carrying on.

And I have to say in the vast majority of cases it's actually been something that most suppliers have been quite happy to come with. They've seen a different sort of leadership and a commitment. So really quite happy with the progress that we're making, but I'm not going to give you that numeric split.

James Grzinic - ***Jefferies - Analyst***

I was just looking more in terms of where you are on that journey. So I presume you're going to be done in 18 months' time.

Dave Lewis - ***Tesco plc - CEO***

Yes.

James Grzinic - ***Jefferies - Analyst***

Where are we? Are we at 30%, 50%, 60%?

Dave Lewis - ***Tesco plc - CEO***

Well, look, we are -- so we're on track with where we said we would be. It's difficult to give you what you want, because we do inherit a situation where some of the contracts we have with suppliers are two or three year contracts, and so we'll honor those and then renegotiate when they come up.

So I suppose the -- if you ask me the question, given where we were, am I happy with the progress that we've made so far this year, yes, I'm really happy. I'm really happy. There's still some things that we need to do, but that will be in the fullness of time as we go through the negotiations. And I said yesterday, at the IGD, we're looking to reshape all of our strategic supplier relationships and that will be part of that.

James Grzinic - ***Jefferies - Analyst***

Okay.

Dave Lewis - ***Tesco plc - CEO***

Sir, and then we'll come -- I think you're just about last, I think.

Alan Stewart - ***Tesco plc - CFO***

There's one more.

Dave Lewis - ***Tesco plc - CEO***

One more, was there? Sorry, am I --

Alan Stewart - ***Tesco plc - CFO***

There's one more down here, I think.

Dave Lewis - ***Tesco plc - CEO***

Okay.

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

John Kershaw from Exane. Glad the mic's working for me. Just what went wrong with dunnhumby? You've not said anything but the papers have said plenty, but presumably you're not getting the price that you thought it was worth. So what needs investing? What did others not like about it?

Secondly, in nominal cash terms, you said it depends what the required customer response will be to where margins will go. Hopefully, deflation doesn't persist forever, but what sort of nominal sales figure have you got in mind?

Just one for Alan; how have you accounted for the back margin in terms of -- there's no disclosure that I can see in terms of the commercial income, in terms of how conservative are you being in recognition of that back margin half one versus half two?

And just finally, we've not mentioned the big box. I know your like-for-likes got better, but any thoughts of where you might go on that?

Dave Lewis - ***Tesco plc - CEO***

Okay. dunnhumby, so we were very -- a year ago, or at the end of last year, in a situation that was very different to where we are today. We did recognize it was an asset that we could still keep the competitive advantage and not own, and therefore we asked ourselves as part of self-help whether we could realize value externally. There was an awful lot of interest in the asset, so we did it in a very full review.

Fast forward to now. Our position has changed somewhat; the sale of Homeplus, cash generation from the business, other things that have changed. And yes, we looked at some of the proposals that we got and yesterday with the Board, the proposal from Alan and myself to the Board was having looked at those proposals, actually, we thought the most value creating thing for us to do was to retain dunnhumby inside the business. And that's what we've chosen to do.

We never had a problem ever, ever with dunnhumby as a business. It's been a key part of what we've done. We only reviewed it for the reasons that we said. But if somebody doesn't recognize the value in that asset in the way that we do, I've been really very clear. I'll never sell an asset below what I think its true worth is.

So, very happy for it to stay within our business, very happy for us to invest in modernizing some of what it can do against both the customer offer within Tesco but actually more broadly. So we have some plans for what it is we can do. We've obviously looked at what it looks like against any option, and we think there's more value to be had internally so we've kept it. It's as simple as that. It probably won't be how it was written up, but it's as simple as that, really.

And I've forgotten your other five questions.

Alan Stewart - ***Tesco plc - CFO***

Well, there was one on commercial income. We've given on page 25 the same disclosure as we gave at the full year in terms of our commercial income. And the way that we look at it is in terms of the amounts that we have for which we're accruing, amounts received in advance for which we don't recognize income, and that very clearly is the same and we've given it for last August, February and this August.

Dave Lewis - ***Tesco plc - CEO***

Go on, remind me.

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

The big box and just what nominal sales growth delivers you your 3% to 4% margin (inaudible)?

Dave Lewis - ***Tesco plc - CEO***

So, look, not much more to say about the big box. I think I look at them as assets, not how some people were looking at them a year ago. I think our job as entrepreneurs in the retail business is to make them much more worth the trip.

I think the interesting thing for us is without -- I would say without doing anything that's completely different or remarkable, maybe some of those creative ideas I was talking about before that I've not yet spent the money on, we've actually improved the performance. And that's just by customers appreciating that one-stop shop, which is it is the most convenient way to get everything you want, if it really is good value and good quality. And that's what we've focused on.

And then there's a lot of opportunity for us to start thinking about how we might differentiate that. But, again, you know what I'm going to say. You'll see that when you next walk the store with me.

But the nominal sales, what a great question. We have a view about and we have a forecast about what it is the sales performance will be in the second half of the year. I'll be honest with you; it has for some months got the biggest delta in terms of potential outcome as we change our offer. And I'm not going to tell you what it was we did last year that we might not do this year and all of that, but we've got quite a lot of that to do. So it would be -- at any time, I'd be reluctant. At this time, sorry.

Sorry. Down here. Have we got a last question? You have the last question. Penultimate question here, Stuart, and then lady at the back.

Stewart McGuire - ***Credit Suisse - Analyst***

Morning. Stewart McGuire, Credit Suisse. Just actually one and a half questions from me. On store closures, you announced some store closures. Is that normal course of business? Can you give us an idea of what type or size of stores you did close, and are there more to come?

And then the half question is really a follow-up from Andrew's. There's a headline about the cost of the national living wage of GBP500m. What kind of phasing can we expect?

Dave Lewis - ***Tesco plc - CEO***

Okay. So, normal business on store closures. So we closed some earlier. Now, anything you hear now is about the normal churn of leases coming up and deciding whether we renew or not. So we have no -- as we stand here now, there's no plans for us to be doing anything more than normal business in stores.

Second thing is, lesson for me in terms of how these things can be extracted, yesterday was an industry debate. And if you take the full quote, I said if you took the very simplistic thing, which is just base, and you take GBP7.20 and you go to GBP9 by 2020, the total on cost for a business, if that were to be the simplistic thing you did for a business like ours, is cumulatively GBP500m. I then went on to say we're already paying above that rate now. And when you take the benefit package that we talked about here, it already takes you to GBP9.

The conversation we're having with our colleagues is do you still want that benefit package in its totality against the declaration, which is really simplistic. And if we're not careful, in my view, we'll have massive unintended consequences, which was the point in the industry thing yesterday, which is to just distill this down to a base pay per hour is ridiculous, absolutely ridiculous, and will have unintended consequences.

So, no issue from a financial modeling; no issue from a financial modeling. We'll just put our package together and it's already at the GBP9 thing. So the GBP500m was an illustration about how policy can affect industry if you don't get in there and affect it. So it's not a forecast of costs for Tesco. Okay? But thank you for giving me the chance to clarify that.

Niamh.

Niamh McSherry - ***Deutsche Bank - Analyst***

Yes. Niamh McSherry from Deutsche Bank. Two questions, please, or I could say one and a half. The first one is about online grocery. You made some comments about changes that you were making in order to improve the profitability of online grocery. So I was wondering if you could say what those changes are and whether that comment is forward looking or backward looking. So has profitability of online grocery improved either on H2 or H1 last year?

Dave Lewis - ***Tesco plc - CEO***

And the second question?

Niamh McSherry - ***Deutsche Bank - Analyst***

The second question was just a clarification on dunnhumby. Given that you have decided to retain it, can you just update on what we should consider the profit contribution? You gave a number in April. Is that roughly the right number, or has there been any change to that?

Alan Stewart - ***Tesco plc - CFO***

Shall I take the second one?

Dave Lewis - ***Tesco plc - CEO***

Go for it.

Alan Stewart - ***Tesco plc - CFO***

In terms of dunnhumby, within the results, and we did flag this, we've restructured the US operation and that's been taken through as part of the normal operating profit. So I think underlying dunnhumby is performing well and it's performing in line with our expectations, but there is a charge in the first half which year on year does make a difference. But underlying it's performing well.

It's part of the overall segment and we don't strip it out as a separate business. So I think going forward it's not something that we would talk about in the same way as we did when clearly it was under review.

Do you want to take online or should I?

Dave Lewis - ***Tesco plc - CEO***

Yes. I think what we've done -- so looking back, in grocery home shopping we've taken some action around delivery size, so we've raised the minimum order quantity from GBP25 to GBP40. That was something that we did a couple of months ago, and it's part of an ongoing play. So grocery home shopping for us is profitable, and the changes that we've made make it more so.

I think in other areas, being quite candid, I think we were pursuing growth at the expense of profit, and we've rethought that. So in some of the other areas around general merchandizing and others, growth per se is not the be all and end all. One of the things I was saying in this industry presentation before is I'm surprised there are so many models out there that pursue growth so nakedly and destroy so much value in looking after just growth.

And I think we need to be more tempered in the way that we do that, and we've taken some measures in our GM operation in order to start that particular journey but that will be a longer journey. All those measures make it slightly better, but certainly not yet to a place where the totality of online is accretive to profit.

Okay. Ladies and gents, that's it. I think we've answered everybody who had put their hand up. I suppose my parting -- apart from thanking you for your attention, my parting shot would be the top part of the press release, I think -- what do we think. We think it's a broad based improvement across a whole series of key performance indicators, both in the UK, in Europe and in Asia. The vital signs that we see in our business are responding really very well.

We will be measured in the way that we do it. We've been clear with you about the fact that we still want to invest in our business and we will continue to do that. If we were to get ourselves to a place where the aspirational level of profit at GBP940m was to be exceeded, I would take that and I would reinvest it back in the business. Because I can see lots of opportunities to invest and grow Tesco better for the medium term, and I think that's the most sustainable right way for me to be leading the business.

So, with that, I thank you very much for your time and your attention.