THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

TSCO.L - Full Year 2016 Tesco PLC Earnings Presentation

EVENT DATE/TIME: APRIL 13, 2016 / 08:00AM GMT

PLEASE NOTE, THIS TRANSCRIPT HAS BEEN PROVIDED BY OUR WEBCAST PROVIDER THOMSON REUTERS.

CORPORATE PARTICIPANTS

David Lewis *Tesco plc - CEO*

Alan Stewart *Tesco plc - CFO*

Matt Davies *Tesco plc - UK & ROI CEO*

Trevor Masters *Tesco plc - International CEO*

Steve Rigby *Tesco plc - Group Property Leader*

CONFERENCE CALL PARTICIPANTS

Sreedhar Mahamkali *Macquarie Research - Analyst*

Andrew Gwynn *UBS - Analyst*

Niamh McSherry *Deutsche Bank Research - Analyst*

Stewart McGuire *Credit Suisse - Analyst*

Bruno Monteyne *Bernstein - Analyst*

Clive Black *Shore Capital - Analyst*

James Tracey *Redburn Partners - Analyst*

Rob Joyce *Goldman Sachs & Co. - Analyst*

Nick Coulter *Citi - Analyst*

James Grzinic *Jefferies - Analyst*

Bilquis Ahmed *JPMorgan Asset Management - Analyst*

Dave McCarthy *HSBC - Analyst*

John Kershaw *Exane BNP Paribas - Analyst*

Xavier Le Mene *BofA Merrill Lynch - Analyst*

PRESENTATION

David Lewis - ***Tesco plc - CEO***

Good morning. Always a little encouraging for a little bit of audience feedback at the start of the day.

About 16/17 months ago, Alan, myself, and the leadership team of Tesco who are present here today set about trying to transform our business. Together with our colleagues, we set ourselves a new purpose and we talked about what it would mean to put the customer right back at the center of absolutely everything that Tesco does. [We write] that purpose in terms of serving Britain's shoppers a little better every day, and we use it to guide everything it is we're trying to do as a business.

I'm pleased to say that over the first full financial year where we've been following that trajectory that we've made a significant amount of progress, and what I'm going to try and do in the first part of this session is share with you why I think we've made a significant amount of progress.

And then, what Alan will do is he'll share the detailed results. I'll then come back and I'll share with you what I think the next step is on that journey, because its only one year of a journey of transformation. There's more that we need to do, and we'll give you some insight into how it is we're thinking about that given the market situation in which we operate.

What I'll then do, because every year I ask the exec team to come to the results presentation -- it gives you a chance to engage with them -- but what we'll do I'll invite the three CEOs to join Alan and I for the Q&A so that you can get a chance to ask questions, not just of myself or of Alan, but indeed of Matt, of Trevor, and of Benny, in case there's something in those particular operations that you'd like to ask for. And I'll try and curate that Q & A so we get the right balance of input and questions. Is that okay?

As I say, a year of some significant progress. If you've read the release, and I am sure you have, we talk about a broad-based improvement. You see the trajectory here over four quarters for the UK which returned to growth in the fourth quarter of last year on a like-for-like basis. Significant improvement in the Republic of Ireland. In fairness to Europe, four quarters of growth, but strengthening as we go through the year; and you see the turnaround that Trevor and the team in Asia have been able to deliver.

So across all geographical segments of Tesco, we made the UK a priority for reasons which we think are obvious, but actually, our improvement geographically is very, very broad based.

That means, therefore, as a Group, there's a turnaround in sales momentum. So in the fourth quarter, the Group like-for-like was 1.6% positively. We've improved -- at the same time as doing that we've improved the profitability, and you see here the trajectory from the second half of 2014/2015 through the first half and into the second half as we have systematically invested, looked for a return, and then invested again; that has been the cycle through the last year. That's the cycle that we see in our business going forward.

We've generated significant improvements in our cash. We talked about it at the half year. We've continued to do that. GBP2.6 billion of retail operating cash generation is up nearly 40% year on year.

Very, very, very important, the key stakeholders in our business, customers. Our measure of customer satisfaction is a full 5 points higher year on year as people respond to the improvements and the changes that the team have made.

And really significantly, colleagues. What I've shared with you here is our internal employee satisfaction survey. It's called What Matters To You -- we run it every six months and I've showed you the trend from 2014 to 2016 -- through a year of absolutely huge amounts of change, some of which had dramatic impacts in terms of colleagues, numbers of colleagues, entitlements of colleagues. Actually, what you see is the satisfaction of our colleagues in working for Tesco and recommending Tesco has improved significantly over the last year; very important for us in terms of the business.

And obviously, our suppliers, our partners. We run a Viewpoint every six months, and what I've shared with you is where we started from full year last year at 51% of our supply partners being satisfied with the relationship that they have with Tesco to a full 68% now saying, actually, they see a significant improvement in where we are and a greater level of satisfaction. More for us to do, but a very significant bit of feedback from our suppliers in terms of what it is they feel about working with Jason and the whole Tesco business.

As you know, we set ourselves three priorities on which to garner our efforts and focus our time: regaining competitiveness in the UK business, protecting and strengthening the balance sheet, and rebuilding the trust and transparency in the Tesco brand. So why don't I update you in the way that I've done a few times about how we've progressed on those?

We said our turnaround would be volume based. So here, you've got the volume since Q1 2010/2011 and you see the trajectory. So in Q4 in the UK, 3.3% volume growth continues the improvement since the second quarter of 2014/2015. So a very positive improvement in volume.

A very significant increase in the number of transactions in the Tesco business, and that's the reason why we talk so openly about more people buying more, more often in Tesco, being what's driving the turnaround of our business. But very happy with the trends that Matt and the team are driving in the UK business.

We've shown you these metrics consistently every time I've been on my feet. Our service levels continue to improve. Availability continues to improve. Our price perception continues to improve and our satisfaction with the ranges continues to improve. Right?

So a consistent set of measures that we set out at the start of that, how it is we would track the improvement in our offering in the UK business. Same questions, same consistency, tracked weekly, that's the improvement that the team have been driving through this first year of transformation.

The service comes from -- I've given you a new term here. Some of you are familiar with it. We talked about the 9,000 extra customer-facing roles that we invested in. It was the first thing that we did in the last quarter, the latter part of 2014.

Within Tesco, we take all of the hours that we invest in our stores and we turn it into -- with a number of other things, into what we call a productivity index. When we started this, the productivity index was 114 or so, which is Tesco -- 100 is supposed to be what you need for those who would take the model.

Historically, Tesco had always wanted to outperform the model, way before my time, and would target to be 104 and 105 as a good, lean way of running the operation. We've taken that all the way up to 114 or 115. The investments that we've made have taken us back down to that sort of world-class level of 104. So real progress there.

I've already said to you about what the colleague engagement is, and the interesting thing is what we see in terms of our customer feedback. Customer satisfaction full year full 5% better than a year ago. So the customer feedback about their satisfaction of shopping with Tesco is definitely, definitely improving. And I've given you there where it was in October of 2014 as a benchmark for where we started from.

In terms of availability, we have driven and the team has driven the availability to new heights. The sales-based availability, if you remember, first time I stood in front of you, we talked about the fact that we were always measuring availability from our availability for grocery home shopping picking, very robust base, but the question was, what does it look like in the evening on a Thursday?

So we talked about sales-based availability at a more challenging time within the year. When we started that, it was in the low 80s, and we've driven that to about 96%, and that's just about where we would want it to be. Any more than that we'd have unintended consequences around waste, but that's a significant improvement in sales-based availability.

All of the work that's been done behind the scenes to put efficiency back in our operation, we've done that whilst we've taken our stock down also significantly, and you've seen that in our working capital.

And part of that has been the work that the team have done around ranging has meant that -- and again, forgive the jargon, this idea of optimum shelf-fill capacities. So how many of the lines that are on a shelf have the right amount of quantity in order to have 40% of weekly sales available without it needing to be replenished? That was down at 82% before we did the range review, and it's now driven back 94%. So we're getting our operation to be leaner, to be simpler in order that we can serve customers better, and so really pleased with what the team have done on availability.

On price, I know there was and there always has been this desire in the industry to talk about hundreds of millions that you've invested in price. From day 1, I've always tried to share with you what I think is happening in price in a way that customers understand it.

So the basket that we talked about in August of 2014, typical basket in Tesco would have cost you GBP46.98. If I look at that same basket, same things in February of this year, GBP44.73. That's a little bit more than 4% reduction in prices in Tesco through the course of the change.

We said that we would take indirect money and we would put it into [shelf-led] prices. In the course of the last year, we've issued 37% less coupons that we did the year before. And interestingly, when it comes to multi-buy promotions, you see what we've been doing in terms of making our promotions more sparing and more specific, and in the fourth quarter, for example, we ran one-third less multi-buy promotions in our business than a year before.

Everything we said about to getting simpler, lower, more reliable prices is what's been driven through the course of this year and have got us to a place where shelf prices are more than 4% lower than they were in August of 2014.

We introduced the Brand Guarantee, and Brand Guarantee is unique; I'm sure you're familiar with it. But when you look at it through the lens of a customer, brands are incredibly important. You know how strong brands are in this market and, indeed, all the markets that we operate, we're a big supporter of brands.

And actually, for customers knowing that irrespective of what might be happening in some of our competitors they will walk out of our stores never having paid more for their branded shop is really important and really unique. And the fact that they get the discount immediately is seen as a very significant help and appropriate from Tesco. So we're delighted with how it's working. It's something unique and helpful from Tesco.

We talked about the range. We set ourselves 33 categories for us to review. We've done all of them on time and in full. The average range reduction that has come from that is around 18% -- is in fact 18% -- after taking account of a little bit more than 2,000 lines that are completely new and a new innovation for customers.

And as you saw in terms of satisfaction, actually, because we've thinned it out, because we've given more space to the things that really matter to customers, actually, their feedback on our range is that it's better, simpler to shop, and more appropriate for what they want.

And the final thing I thought I'd say in that sense was actually around Christmas, and I was thinking about how I could capture this for you. And every time I tried to draw it, it got -- it started looking like an electricity circuit diagram. But what we've done is we've thought very clearly and carefully about how it is we work with our suppliers.

So if I were to show you the KPI there, our forecast accuracy with all of our suppliers over Christmas was 10% better in Q4 this year than it was a year ago. As a result of that forecast accuracy improvement, the stock that we've had has been more appropriate for what it is we wanted. So as you walk through every single chain and piece of the supply chain into store and beyond, we've improved the operational metric.

Sales forecast accuracy up 10%; availability in store all-time high, a full 4% higher last Christmas than the Christmas before, with lower stock, with significantly lower stock; and, not insignificantly, delivering 500,000 more home deliveries as part of our Christmas offering.

So one of the things people say, what's driven it? The operational, the simplification of the operation, working with partners, flowing it through, has had a material impact in the numbers that you're seeing today with more for us to do.

Second priority is the balance sheet. You know we talked about the pension. The transition is complete; Alan will take you through the numbers in a second. But that is now complete. We've completed the sale of Homeplus, as you know, and we've being very disciplined in capital. We spent exactly as we said we would and driven a return on that capital much more aggressively.

Let me say a little bit more. The other thing that we've talked about is our strategy on product. You have a chance to talk to Steve if you'd like.

In March, we talked about the 21 superstores that we've bought back. In October, we talked about actually what we'd done in terms of selling some of those sites that we'd decided not to develop.

And in February this year, we acquired actually two joint ventures which brought another 36 superstores and another 13 Extras back into our own ownership. That allows us to control our future costs in the way that we've talked to you about before. And, in fact, over this period, we've increased in the UK the proportion of our sales space which is freehold versus leasehold by 6%. Right?

So we've invested in our future by buying back good stores so that we own them and give ourselves some insulation from those upward-only rent reviews.

With our suppliers, we announced during the year a transparent, open set of trading terms. We said for any, and we've got many suppliers who are [at GBP100,000], that we would pay them in 14 days. As of this last period, I can confirm to you that 100% of our suppliers who are at this size have been paid in 14 days.

Our on-time payment across our whole business in terms of numbers of invoices is in excess of 98%, significant improvement. So we've worked with every one of our suppliers to get this right. And that's part of Jason's push to simplify the commercial approach, a new partnership arrangement moving from back to front, moving from 24 forms of commercial income towards the destination of three.

We've built a supplier network. It has more than 5,000 suppliers in 50 countries. It's a way of suppliers being able to share their experience of working with us and actually sharing ideas. Much appreciated by them.

We also offer supplier training, a gateway into Tesco, helping suppliers understand how our business works. We are a big business; we need to recognize that. We help our suppliers understand it. And as I say, there's encouraging progress in terms of the supplier viewpoint in the last year. The feedback we're getting from our suppliers is significantly more positive than where we were a year ago.

When it comes to the brand and the trust and the transparency, you know about the charity partnerships. It's something that's very important to us at Tesco; every colleague very, very active. A very significant partnership we have with Diabetes UK, British Heart Foundation.

We've made a very big commitment in terms of our community food program The commitment from Tesco is that no food which is safe for human consumption will be wasted in our stores by the end of 2017. We're the only people that actually issue a food waste in our own operation report; we've been doing it for a number of years.

We're actually world class as a percentage, but a very small percentage applied to a very big business is still too much food waste, and as a team we don't want to do that, and we've built in a very innovative way a way of providing food which we can no longer sell because it's reaching the end of its code is donated directly to charity and, therefore, is not wasted and is safe for human consumption. We've rolled it out to 100 stores. It will be in every large store by the end of this year, and it will be through all the estate by the end of 2017.

And you will have seen our Bags of Help local community scheme where all of the money that comes from the bag levy is put back into local community projects, voted for and chosen by customers in that particular store.

Now people measure this in very different ways. I've seen a number of you use different sources. I've kept this consistent with everyone we've used in previous. It was all about the BrandIndex score, which is an overall measure of brand health.

If you remember, from January 2014, October is the dip, post announcements around the accounting issue that we've had. And what you've seen is through the course of this year all the way to February that we've managed through our actions, through the experience that people have had of Tesco, to start to rebuild back that trust, and we got ourselves to a place in February of this year where we're ahead of where we started in January 2014.

Lots more to do; lots more to do, but considering where we started this in October of 2014, actually, some indication that we're getting some things right some of the time.

So against those three priorities, have we regained competitiveness in the UK? We think we have. The transaction growth that you see in the fourth quarter one indication of that.

Have we protected and strengthened the balance sheet? Look. We -- Alan will take you through the numbers, but our total indebtedness is down by GBP6.2 billion in the year by about 40%, and that's after we took more than GBP1 billion onto the balance sheet as we bought back the properties that I've just talked about. So a significant, significant amount of work and good work in that space.

And in terms of trust and transparency, customer, colleague and supplier measures have all improved through the year.

So when we say in the announcement it's a year of significant progress, that it's broad based, it's the UK, it's international, it's all channels, and it's against the three priorities we [set] for ourselves, that's the basis on which we make that statement.

And with that, I'm going to pass over to Alan, who will take you through the full-year results.

There you go, Alan.

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

Thanks, Dave. Morning, everybody, and thank you very much.

So how do the priorities translate into the results? You've seen the numbers. I think first thing to say is that we're comparing against a 53-week last year, which was our [strategy] week, but wherever we need to adjust, we will compare on a like-for-like 52-week basis. But it is -- so, therefore, throughout all of this, we will compare wherever we should in terms of profit and loss against 52 weeks.

The other thing is, obviously, currency is part of our results, and where necessary, we will compare against constant currency. The main issue and weakness we had in currency was the relative sterling/euro change which happened during the course of the year.

So sales constant currency just up 0.1%, and our profits up 1.1% to GBP944 million. We have some exceptional items -- and I'll come back and talk about them -- a credit this year compared with a very significant debit last year. And then we have our statutory operating profit which is at just over GBP1 billion. The EPS we'll come back to as well.

So segmentally, we look at it across the three key parts of our business: the UK and the Republic of Ireland, the international business, and the Bank.

The UK and Republic of Ireland had a margin recovery. We had 81 basis points recovery from first half into second half. Again, I'll come back and talk to you a little bit more about that. And in the international, we saw an even stronger recovery in the first half to second half with 138 basis points improvement from H1 to H2.

The Bank results saw the impact, the beginning of the impact of the interchange fee; we did talk about this at the half-year. And this is something which will go into the full-year results and into this current year as well in terms of the impact of lower interchange revenue from the Bank perspective.

But overall, good performance across all parts of our business in terms of what we see.

Looking specifically at the UK and ROI segment, you see a strong trend, a continuing trend, which Dave has spoken about. We moved into a 0.9% like-for-like positive, first time in many, many quarters in the UK business. And equally, in the Irish business, we saw like-for-like positive for the first time since 2012. This is by focusing on what the customer needs, the issues that Dave has spoken about in terms of service availability, range and price, and a positive good performance in a market which continues to be deflationary.

We've spoken before about the format. We continue to see good format performance. The Extras were almost positive in the quarter. You'll recall that in Christmas they were positive; but almost positive in the quarter. Good performance across all other categories.

And our Express convenience format continues to show strong growth, albeit what we're seeing from customers is that when you give them the reason to shop in a single location, our Extra stores, that's where they very often choose to shop, and we see it in the numbers.

In terms of some of the other smaller parts of the business, the online performance we've split out here between grocery, clothing and general merchandise; and we are focused on getting the right value equation from a customer perspective, so the economics for us are important. And we're making it a more sustainable offer, which customers really value.

We've seen some impact in terms of the grocery growth; still healthy growth at just under 9%. General merchandise, we're focusing again on profitability in this sector; some small reduction year on year. And clothing, a good performance in a clothing market which externally we've seen challenges. But our clothing performance focusing on full-price sales, getting the right margin and availability right, we saw good performance.

If we now move to the profitability, you'll recall that we set out to rebuild the profitability in the UK, and this is the full-year build, trying to give you a sense of how we've -- the building blocks to rebuild and increase the profitability from the GBP498 million in 2014/2015 through to the GBP505 million in 2015/2016.

We have invested very significantly in prices. You can see that. This is always an estimate in your graphs. It's shaded out in terms of here. This is the best estimate we can get for what -- the lower prices that we've invested. Against that, we see volume and mix benefit, and we will continue to drive this.

We also will invest in the customer offer. A lot of what we're investing is in terms of service. We're looking at the costs of the offer. We took out fuel saved during the year; we took out some of the couponing, which Dave has spoken about; and we've also made some quite significant savings in our overhead costs. So net-net, we get a small increase in the profits, but a very healthy underlying.

In the other column, that includes the Dunnhumby business which you'll recall we restructured in the beginning of the year with the change in the arrangements in the -- with Kroger in the US.

So overall, a good year-on-year performance with some very significant price investment. Much more importantly though is how did that move in the second half, because in the second half of last -- of the prior year, we made a loss, and it's that base that we're coming off.

Continued investment in prices. In the second half, a positive volume and mix benefit, so we're beginning to see some rebuilding of profitability with the investment in price. We saw some good cost savings. The GBP400 million cost savings we set out a year ago, we've delivered what we set out to. We're on track for the full GBP400 million. We got about a GBP300 million benefit in the year. On top of that, we also see some benefits in terms of some of the marketing spend where we're putting our money in terms of the costs.

And in other, we do get some small benefit on the retail side from the interchange fee. So we pay less in -- we earn less in the Bank, but we pay less in the retail business. But overall, from a GBP45 million loss to a GBP339 million profit [in a] half on half. And this gives us confidence in terms of our longer term profitability and that we're doing the right thing, not only for the customers, but also for the shareholders and the business.

Internationally, very, very much the same performance. We saw market share gains in five of our seven markets. We're doing the same things. And Trevor can talk about that in the Q&A afterwards.

We saw strong volume growth and we saw strong cash generation. Cash has been a key part of our overall business focus this year. Operating cash is up 87%. And in the international business, we took six days out of our stock by focusing on the stock that we're holding, where we're holding it, and how we're buying to replenish.

Again, looking at the two different segments in the international business, the same trends. European business good like for like from a low base in third quarter of 2014/2015. We see continued growth in like for like. And in Asia, a very strong performance in those markets, Thailand particularly being the market which we've seen a very good response to the focus on fresh, focus on availability, and focus on the right product for the customer.

Overall in Q4, we've seen a continuation of those trends in the international business.

Looking at it again by format across the international businesses, we look at store formats slightly differently: hypermarkets and superstores and convenience. The hypermarkets internationally are around 75% of our business, so internationally, that's really where the bulk is and you can strong growth there. The convenience sector is by far the majority of the balance; superstores are a small part of it. But across both large segments, hypermarkets and convenience, good growth, and superstores also.

In Thailand, to pick out one market as an example, we saw double-digit like-for-like growth in that market where in 100 lines we invested strongly in quality and customers. And you'll recall at Christmas we spoke about achieving the highest-ever market share in Thailand in Q3, and we've continued to hold our position in that market.

If we look at the profit build internationally, we've also seen an increase in profitability. We've again invested in price; we've seen lower prices. We've seen a volume in mix benefit. This is on a full-year basis. We have invested in customer -- in the customers, whether that's in areas like communications, whether it's in the way we engage and target our loyal customers. We've had some investment and we've taken costs out of the business.

Very significant restructuring in [One Europe] where we're operating now, and we've spoken about this a number of times over the last 12 months. We now are operating as one management team running those four markets. And in Thailand, we're also focusing on efficiencies within the Thai operation.

The supply chain is again an area where we've seen opportunity and we've seen some cost savings. And then in other, we have had some investments in some restructurings, particularly in the Turkish market where in the head office we took out about 50% of the people in the head office operation.

So focusing on efficiency and -- but at the same time investing in the customer and driving volume and mix.

The Bank, which is the third segment I called out, a good performance. We have seen the profitability go backwards, but the underlying performance of the Bank remains very, very strong. We're also, as ever, focused on the customer. We launched an engagement and communication with the customers where we show them how much interest they've foregone. We were the first bank to do that. We've given them free access to a credit report.

We've won a number of awards from external commentators, from Moneynet to Your Money in terms of customer service and how the Bank is viewed. And increasingly, we're very clear that in the Bank, the purpose is to be the bank for Tesco customers. Active customers are up 1% in the year, and lending has increased by just under 11%.

At the same time, the core capital ratio, which in the Bank is a key part of it, has continued to strengthen. We're now well ahead of 16% in terms of the core capital ratio.

So overall, in a challenging and challenged banking environment, the Bank is delivering what for our customers what we set out to do with a very strong balance sheet and funding behind it.

Tesco Mobile is a business which we haven't spoken about before and I think it's important for you to understand that it is a valuable asset. It forms part of our business. It's the largest MVNO, Mobile Virtual Network Operator in the UK. It's grown very significantly over a number of years. And it's a successful joint venture with 02.

We saw 5% growth in customer numbers. We're now well over 4.5 million customers in the UK. Again, from an external perspective, it gets very strong recognition. It's the recommended provider by Which for the fifth year running. And it's got a good balance of business between the pay as you go, which is the historic way that mobile operators worked. And increasingly, and now more than 50% of the customer base is the pay-monthly market, which is where the long-term value is from customer.

It's operated through more than 400 stores in our network. Clearly, there's an industry which is going through potentially some significant change, and we're very well positioned within that industry, not only to protect the business, but also to grow the business, and that change creates options and potential for Tesco Mobile.

If we now move to below the operating part of the results into the finance income and costs, I know this is an area where a number of you will ask questions. The interest payable is down year on year. We saw a reduction in the interest paid on our bonds, so a good reduction in interest paid on bonds. That's offset in accounting terms by the interest element of the onerous lease discount. It's very technical; very happy to take it and talk to you about it behind, but the -- what you see is a GBP30 million reduction is an underlying stronger reduction in terms of cash, but there's an accounting element which masks some of that.

There is movement in terms of the IAS 19 and IAS 39 -- IAS 32 and IAS 39 numbers; not a huge movement. And then we get to the pension deficit finance costs. This is set by reference to the deficit at the start of the year and the rates, market rates at the start of the year. So we saw about a GBP20 million increase in that year on year.

As we go into 2016/2017, which we've now started, I expect most of that increase we saw last year to come back. So it's about a -- and maybe even more in terms of because we've made significant reduction in the deficit. So we should see some reduction in the pension interest finance cost as it flows through our results. It's not the number I focus on, I focus much more on the cash that we're paying to the trustees, and we're going to come on to that.

And then finally in terms of the movement in the net finance costs, finance income came down by about GBP50 million, primarily because of the way that swaps, which are part of our hedging for our bonds, but the swap accounting for that impacts through this line as well.

So some movement within the overall interest finance cost line. Underlying it, interest payable was down, and that's an important message.

The other point I would make is that within the results today, in the exceptional item we've recognized an accounting GBP220 million charge on the translation of the sterling, the proceeds we received on the sales of Korea. It's a non-economic impact; it's an accounting technicality. But it is within our results overall and there's no economic cost to us within the Group.

Tax line. Again, the interest here really is what's the cash we're paying for tax from your perspective, and it's masked by, I'm afraid, a number of different movements.

So the profit before tax, before exceptionals of GBP280 million saw a 2.7% effective tax charge. Why is that so much different from the underlying rate? Well, we had a number of things that changed.

The UK future rate for corporate tax has decreased to 18% and we have to take that through deferred tax as an adjustment; it comes through in the annual charge and that's impacted. More importantly, we sold assets which had a higher tax value than a book value, so we have a differential between the book tax and the tax that we're paying and being charged on it, and that gave us a benefit in terms of the effective tax rate.

And then finally, in respect of the exceptional item, we've closed a number of earlier years and we've agreed those with the revenue, and that gave us a benefit, not only in terms of the rate, but we also got -- we managed to carry back the losses that we had last year and we've got some cash in terms of the tax cash.

So looking into this year, best estimate I have today with, as you can see, a number of moving parts, and we still have some years open, but the best estimate we have today is a 30% underlying tax charge for the year that we're now in.

The exceptionals against just under GBP7 billion of exceptional write-offs last year, we had few. And you'll remember that what we set out to do is we don't want to be operating with exceptionals, but if there are items which are significantly large and significantly material enough to call out, then we will treat them as exceptionals.

We have a GBP408 million net impairment. By far the majority of this is around GBP270 million is moving to the single online platform. From a customer perspective, we've looked at the way we operate our different websites and we've decided that it's much better for a customer and for us to operate off one website. That's resulted in a GBP275 million write-off.

We've also continued to look at some of the work in progress and we've got GBP133 million write-off down in the carrying value. These are non-cash items, I would stress, in respect of that.

And then, the property transactions, which Dave has mentioned, have generated a profit against the book value that we were carrying them at of GBP156 million.

Finally, we got a non-cash credit of GBP480 million because of the way that the actuarial deficit is now calculated on the CPI, consumer price index, as previously calculated on the RPI, and that's a non-tax credit. But again, as I would say, it's very much an accounting entry, but a recognition of that change.

So net GBP102 million of exceptional items as a positive this year compared with GBP6.7 billion last year write-off.

If we move to total indebtedness, and I'll take us through a number of different ways of looking at that, overall, we've seen a GBP6.2 billion total reduction indebtedness, as Dave has said. And the elements of that are the change in net debt, change in the discounted operating leases, significant reduction in the pension deficit. We sold Korea; we had the property transactions. And we end up with closing net indebtedness, total indebtedness of GBP15.5 billion compared with the opening GBP21.7 billion, but there are different parts moving within that.

The way that I think about the indebtedness, and I think this is important that you understand the way that we look at this, is that there are three different parts of it. There's the pension deficit, there's the discounted operating leases, and there's the net debt. And each of those we've seen a significant improvement year on year.

So the pension deficit is down GBP1.3 billion; the discounted operating leases are down GBP1.5 billion; and the net debt, which is the balance sheet net debt, is down GBP3.4 billion.

The movement in net debt, which is the GBP3.4 billion improvement, comprises the cash we generate from our retail operations, the improvement in working capital, and then what we pay it off on.

So we generated GBP2.2 billion cash from our retail operations. We generated a GBP350 million improvement in working capital. But within that, there were some elements which were negatives and really one-offs. We spent GBP91 million of cash on the exceptional charge we took last year.

You'll remember at the interims we spoke about the change in the supplier payments and that the final part of the unwind of those reciprocal deals was a GBP230 million net outflow at the interims. No change in that, but we had an underlying GBP230 million outflow.

Within the Korean business, we sold -- we generated up until the point of sale, GBP280 million of working capital, and then -- which means that the net underlying working capital improvement from our business operations was just under GBP400 million in the year, which gave us the total of GBP2.6 billion, GBP2.581 billion, retail cash generated from operations.

We spent just under GBP300 million on interest and tax, and we spent GBP1 billion on our CapEx, consistent with what we set out to do. And then, from the Korean disposal, we raised GBP3.3 billion net in terms of the sale of that business.

We brought onto the balance sheet GBP1.6 billion of liabilities, of debt, with those properties that we [brought] back; economically the right thing to do. We saved GBP150 million of current value of rent, and we've protected the business from the future RPI or upwards-only rent reviews on that. And overall, we generated GBP3.3 billion reduction in net debt.

So the property metrics. We haven't got a specific target in terms of improving the freehold-leasehold mix, but whether you look at it by the selling space owned or whether you look at it by value, and both of them are measures which I think are important to us, we've seen a really strong improvement.

Dave referenced the 6% improvement in the UK business in terms of the property ownership, and as I say, whether you look at it by space or by value, we've seen a strong underlying improvement. And that's the case internationally as well with the sale of the Korean business, we've improved those metrics.

So heading in the right direction, good progress to make, but as ever, we will weigh the economic cost of what we're doing compared with the benefit of the rentals that we're saving.

The pensions, we have closed the scheme. We've protected the benefits that we have promised in the past, and we've introduced the new defined contribution pension scheme. We saw an overall GBP1.3 billion reduction in the deficit and that's a combination of the credit, which I spoke about, GBP480 million net in terms of the payments that we made on the transfer. And it's also to do with the asset performance and the way the liability is measured.

We're working with the trustees to ensure that the risk of the deficit widening over time is significantly reduced. So we're trying to ensure that the assets that we've got will not significantly widen against the liabilities as we go through time, and that will mean that there's a much greater predictability on the cash flow contributions we make. And one year into the pension deficit funding plan we agreed with the trustees, we're pleased with the progress, they're pleased with the progress, and it feels as if it's working out well.

We've got a strong liquidity profile. Again, we've spoken about this in the past. At this year end, we've got GBP4.4 billion of available cash. In the balance sheet, you will see more than that; you'll see about GBP5.7 billion of cash. The way we look at our available cash is we've got around GBP500 million of cash in the Bank, and we've also got about GBP750 million of cash in our float in the tills around the business, and which is cash in transit. Whether it's in the tills or whether it's cash in transit, we've got about GBP750 million.

So we view our available liquidity as about GBP4.4 billion, and on top of that, we've got GBP5 billion of undrawn facilities: GBP2.6 billion of revolving credit facilities, and GBP2.4 billion of the bilaterals.

And then, if you look at the debt repayment schedule, we've set out here in a graphical form where the bonds that are on balance sheet fall due for renewal, and as you can see, they're well spaced in time. There isn't a significant amount of liquidity that we have. We have what you'd expect; an element of debt which falls due over the next five years or six years, and then the balance is well spaced out. But all of those are well capable of being funded either from the liquidity we have or by going to the markets.

And we've seen an improvement in our underlying debt metrics. Now we remain of the view that we would want to be an investment grade credit. We haven't put a specific time on that, but that's the way that we view ourselves. And we recognize that the two ways of improving these ratios are by reducing the indebtedness and increasing the profitability in the business.

The one which has the greatest impact on the ratio is the business performance, but we will continue to focus on both elements of that in equation.Whether you look at it as total indebtedness or as a fixed charge cover, we have made improvement year on year. Underlying, the 1.9 times is a slight improvement.

These are our numbers and the way we look at them. The rating agencies have their own ways of looking at them, but this is the way we look at them. And they're seeking to address the same calculations, albeit clearly slightly different methodologies.

So if we look at the financial summary over the year, we've seen positive sales momentum across the Group. We've rebuilt the profitability, particularly if you look second half into second half. We've seen a strong and improving cash generation. We've made significant progress in reducing our total indebtedness. We've got a strong liquidity position, and the summation of that is that we've got a strengthening balance sheet.

I'll now hand back to Dave.

David Lewis *- Tesco plc - CEO*

Thanks, Alan.

Okay. So as we -- I suppose just to round that up, we have in the last two results announcements shared with you the Big 6 and the performance of the Group in exactly the same way that we talk internally inside the business. It's something that is all the way across the Tesco business globally, with Trevor reviewing with his team individual countries.

But at a Group level, I'm absolutely delighted, absolutely delighted that on the six things that we said, either sales, profit, or cash flow, or what it was we were doing for customers, colleagues and the partnerships with suppliers, we met or exceeded the targets that we set for ourselves in the year.

I'm delighted for the colleagues inside Tesco that that is what together we've been able to achieve. And that's what we're sharing with our teams today and over the next few days in terms of the review of the performance of the business.

So that's why we started and that's why we said in the results presentation we think it's a year of significant progress. It's very broad based across our business. It's volume driven by putting the customer at the center of everything that we do and re-gearing all of our business to serve them a little better every single day. Right? And that's what we'll do going forward as well.

What I thought I'd do now against that is tell you a little bit about what the next step looks like, and I'm sure you'll ask me questions about outlook statements and [Alan will outline] the outlook statements in a second, so let me try and lead into that.

The one thing that you must, and the reason I started this presentation so deliberately is, in an uncertain market, whatever happens, whatever happens in the markets we operate, the one thing you need to understand from me and my direct team and everybody that works in Tesco is the customer is the number 1 priority always. Everything we do is geared by how it is we can serve them a little better irrespective of what is going on in some of the macroeconomic arena.

What we're trying to do, and this is the reason that I keep saying that what we're doing is focusing on Tesco -- everybody asks me competitive questions; we focus on Tesco -- is that actually, what we're trying to do is remove any reason for anybody who shops with Tesco currently shopping anywhere else. That's the lens through which we looked at it last year. It's the lens that we'll look at it through this year for sure.

And we're looking for those things that make Tesco more unique. I'll say a little bit about that in a second. And as we do that, we'll rebuild the profitability in the way that Alan's described this year. And it's important, and we can see how we rebuild that long-term profitability, but we do need to still invest in the business in what is still a very challenging -- there are people in this room who have been in the retail industry much, much, much longer than I. It's a very challenging, uncertain situation. There's a period of deflation which is unprecedented. We don't see that going away from a macro point of view or indeed the need for us as Tesco to invest.

One of the things that we did last year, and you came with us on that journey, was we had to make some investments in order to drive the recovery. We're still very much, still very, very, very much in that space, and we'll continue to be so.

Now what I thought I'd share with you is what we're doing in that particular space, because that's probably the most material thing we've done recently and will impact in our business in the year ahead.

When we talk about serving Britain's shoppers a little better every day, our value equation, the value equation that we really want to build is a combination of the following.

Brands, those things which are consistent, wherever it is you might choose to buy them, we guarantee that Tesco will always be competitive on price on the things that are the same across the industry. That's why Brand Guarantee is so unique and that's why we give that reassurance to our shoppers about things that matter to them. And we differentiate ourselves in the unique Tesco offering.

Now part of that is obviously our own label; you can only buy it in Tesco, so that range is very important to us; the service that we give, very important; but also, a range of exclusive brands that are not available where else. So that combination of if it's the same, be the best in the industry at it, and then differentiate yourselves on those things which are unique in Tesco is what we're trying to do.

Now I've not shown a chart like this before. Right? If I go back for a second, if you remember when we talked about what was going to be the turnaround, we talked about the reasons why people were not shopping with Tesco when we arrived, and we talked about poor availability, poor service, poor range architecture and poor price. We've put all of our effort into doing that first.

The other reason why they weren't shopping with us was inconsistent pricing, particularly around brands, because they could understand what the price relativity was because they knew the brands were the same. So we dealt with one bucket, we dealt with another bucket, and then we come to the third which was there was a certain set of categories.

What this chart does is it looks at what, to use jargon, over and under-trade. So these categories that are in green, Tesco as a business, we over-trade. We have a share in excess of the average, in excess of [others] in those categories. So that's for us to protect; that's where we do better.

There are four categories on there where against a couple of competitors actually we under-trade. That means that our customers have chosen to buy those categories somewhere else. And this is us trying to be very specific in saying these are customers that shop with us already who have chosen to take part of their shopping mission somewhere else. How is it we can address and make it more convenient and bring that back into the Tesco basket? Serve them a little better every day; time-starved people needing to shop in two locations, we want to do so something about that. And that's why we did this.

It's a very important set of categories for customers. It's a place where we were under-trading, particularly against the different set of the markets, and we've set ourselves a challenge to say what can we do about it.

For those who have been following closely, the first thing we did in the fourth quarter of 2014 was focus on fresh produce. The examples I gave, I remember them all, were all about lettuce and what it was we were doing to get that supply chain right. We've worked with that supply base in advance of everything else; our supply base been really involved in creating these brands.

So one of the results of the supply partnerships that we've set up has been to sit down with our farm and produce suppliers and say, how can we reconfigure what it is we do together to increase crop utilization, to increase the efficiency and translate that into an offer that can be consistent and great value for our customers? So we launched these seven exclusive brands.

Now I'm not shy about the fact that all good marketing will always polarize. So I've heard some of the debate. I've read some of the debate, I've listened to some of the debate that's involved, and I get it. I understand it.

The only thing I would say to you is, for somebody who I think can say has been involved in marketing for a reasonable amount of time, whilst people will debate, the most important thing is what do customers think. So we developed these with customers. Right? We developed them with customers and our partners.

So let me tell you a little bit, just so I can inform you in this particular space, because I do get some questions about it -- I'm sure Matt does and you can ask him a question directly yourself when you get a minute -- is when we talk to customers, what do they say? They tell me that they -- because I think some of the commentators don't really give credit for how marketing savvy UK customers are.

It's, I can say this with some certainty, by far and away the most developed marketing understanding audience in the world. Do they know that one single farm is not big enough to be able to supply Tesco (laughter)? They do, they really do. Do they know that one single farm does everything across all product forms? No, because they know something about what the crops are.

So what they say to us when we developed this and we had the conversation that everybody's talking about, which is, actually, what was really important to them is do they come from farms. Well, clearly, they do. So the intrinsic -- to use the marketing jargon, the intrinsic product truth is all of this produce comes from a farm. Right?

Second thing that's important, and about the marketing savviness, is actually, when you look for a brand name, you look for something that can stand for a consistent offering of quality and value. And here is where I make an industry comment which is we're not the first, and I suspect we won't be the last, where we've chosen to use a brand name. We've been very open about the fact that this is creation; we're creating and launching these brands -- and what we're doing is in some cases, we've used brands that were owned by our suppliers to create this -- is to make Rosedene stand for a level of quality that is consistent. And any of the farms that support and provide for that Rosedene brand name must hit a quality specification that we set.

And if you think about a lot of food brands, if you think about the history of food marketing in this country, that's exactly the model that allows for a consistent branded value equation in how you build brands. That's what we did here despite what you might read in some places.

And more than 95% of all the commentary by customers is neutral or positive about what it is we've done. And, yes, there are a couple that are asking why did we do that, and the only thing I'd say to the detractors is, please, and if you have a chance have a look around in what we've put outside, on every single one we are absolutely clear about where that product is sourced from, absolutely clear. So customers definitely get it.

So I thought I'd say that so it might answer some of the questions you're going to ask later, but if you want to ask Matt as well, you can get his point of view on it also. What I thought I'd share with you though is, because I'm always struck that people struggle to see the before and after in a way that's easy to compare because obviously we replace one with the other. So what we've done, everybody talks about the farm brands and I get it. They're a significant investment; I'll give you a clue to that in a second. But what they don't talk about is what we've done here.

So the architecture in Tesco which is good, better, best, is an architecture which served us well and it will serve us well into the future, but as we've worked with our supply-based add value in terms of Redmere Farms here, we've also invested in our own core, own-label line in the way that you see here.

So basically, I'll show you a series of pictures, they're all set up in the same way. What was everyday value in terms of exclusive farm brand, what it was in terms of our core in terms of the relaunch that we've done. OKAY?

So that's carrots, potatoes. Now if you really want me to, I'll go into the marketing about the design, but I don't think we've got time. Where we are in terms of mince, where we are in terms of apples. And what customers are saying to us is they understand both of those expressions. They understand the care that's going into the core. They understand what it is we're doing in terms of Rosedene Farm, and they see the price tiering much, much clearer than it was before.

Around meat, in terms of pork in this case. And then, what I thought I'd do, I'm going to introduce this chart very specifically. There are 76 lines that we've introduced as part of this exclusive farms range. And what I'm going to do in a minute is I'm going to show you a basket, and I'm going to show you a basket which takes, I think it's 51 of those lines for which there is a direct competitor alternative in our cheapest competitor. Okay? And I'm going to show you what that looked like before we made this investment, before we launched this range and what it looks like now.

So before, if I take the everyday value in the range that we had, those 51 lines, if you bought every one of those lines, would have been GBP103.11. Nobody buys 51 lines. This is hypothetical to give you a sense. If you bought that in our cheapest discounter alternative, those lines would have been GBP89.06. If you take the 51 lines and you look at what we've now offered as a result of the partnerships with our suppliers and the unique brands that we've put in, actually, you could buy that basket in Tesco at GBP86.35.

I've always resisted to talk about the investment we've made in price in tens or hundreds of millions and always wanted to talk about in terms of what's in it for the customer. This is what's in it for the customer in those two categories where I showed you we under-trade historically. And we're trying to deal with that in a way that allows our customer to shop those categories with us in order to make it more convenient. So we've designed a range with them and our partners to meet that opportunity.

We've just done it. It's by far and away the most significant thing that we've done so far. We're a few weeks into it. Results are encouraging, but we've got to see how customers behave on a longer-term basis.

All parts serving Britain's shoppers a little better every day, and my last slide is to summarize, which is broad-based improvement across the Group. I hope you'll agree with that. I am pleased. People ask me, am I pleased? Yes, I'm pleased. As a CEO you're never completely satisfied; my team will tell you about that as well. But we have made significant progress across all of the key priorities.

We've delivered or exceeded on everything we said we would do. and as we want to build confidence in our business, that's an important step for us. More customers are buying things more often in Tesco. And I've given you some of the stats.

Our team are reinvigorated around the purpose and the direction that the leadership team and myself are asking them to support, but the market is challenging, it is deflationary, it is uncertain. And as we keep making the investments we think we need to make, what we're trying to do in sharing with you about the business is to be considered about actually what those investments return and the timing with which they return.

I think our biggest concern here is that based on what I think everybody would accept is a lot of progress in one year that we draw that wonderful smooth, straight line of improvement as we go ahead. It won't be like that. It's never been more challenging to be in the market and we're investing in that deflationary cycle. So what the outcome is the uncertainty, and we're just sharing that with you.

What we are doing, and the most important thing is that we continue to invest in a way which we think for medium and long-term shareholder value is the right thing to do and is a sustainable model.

Right. That's is from Alan and I. What I'm going to do now is ask Matt, Benny and Trevor to join us. Take a seat fellers and we'll do some Q&A.

QUESTION AND ANSWER

David Lewis - ***Tesco plc - CEO***

Now why don't we do it this --? What I'm going to suggest is we've had some feedback from other previous questions which is the positive was you liked the fact that we answered every question there was in the room. The negative was maybe it took a little longer than it might. So what I'm going to try and do is I'm going to try and curate. If it's a question for me, I'll take it. I'm going to give you some experts, if that's the question, I'll pass it to them.

What I am going to suggest is if it's a question of a very technical nature, if you are sitting there desperate to know what the IAS 19 impact on the numbers Alan said were, I may in the interests of time park that with Mr. Griffiths because he'll be better able to do it, but I won't -- for those sorts of very specific technical questions, I'm going to try and channel those to Chris and allow us to talk perhaps more at the strategic questions elsewhere.

Is that --? People are nodding, because that's the bit of feedback you gave us. Maybe we got a little bit too technical in that.

So I'm going to ask you to try and keep it to one question, please, and then I'll direct it to the person. That's the hardest bit of this [for us]. And I'll direct to who I think is the best person, either the guys here or, indeed, any of the other execs who are in the room. Okay? Cool.

Sreedhar Mahamkali - ***Macquarie Research - Analyst***

Sreedhar Mahamkali, Macquarie.

So one question it is then. Alan, I get where you're coming from in terms of the profit bridge and I can see, David, your points on the investment you're making in farm brands and stuff, but help us perhaps reconcile second-half profit bridge. Why is that not a good representative way to think about for 2016/2017? What am I thinking about specifically? I'm thinking about the [PI] you've talked about which is where it looks like it should be.

Your volume growth is continuing to build. You're continuing to do pricing, but to me, designing something for a lower price doesn't necessarily equate a price cut. Correct me if I'm wrong.

So why isn't that --? And you're cost saving continue to come through. So why isn't second half the right way to think about 2016/2017? That will be my only question.

David Lewis - ***Tesco plc - CEO***

It's a great question. I think the significant difference, I think -- so first of all, our aspiration to grow profit year on year is absolutely there, absolutely there. So it's a question about what the degree is. And it's also about what the shape of that is.

I think to the point about the investment that we've made now, which I've said is one of the most significant we've made, I think it all depends on what the impact of that is. And you might design for it, but you don't always get it initially. It depends on what the volume and the outturn is.

So that's why the uncertainty is actually what does the market and how does the market react and what will the mix be across the different layers, so that's where we need to see what the impact would be. So it's right what you say. It's just maybe there's an issue in terms of the timing of how it's delivered.

Alan, I don't know if you want to--?

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

I think that's it. If you look at what we've said in terms of the outlook, we've spoken about the longer term; we've spoken about the current year and we've spoken about the first half. And those are the elements of it. And there's a wide range out there. There is a wide range out there.

Sreedhar Mahamkali - ***Macquarie Research - Analyst***

But is there anything specifically you're seeing in the first half that we should perhaps pay more attention to?

David Lewis - ***Tesco plc - CEO***

Well, the continued investment that we have in the offer. The farms brand is by far and away the most significant but there are other things that we want to do and continue to do. And if you track what we did last year, we made a whole series of investments and choices. And we had to repurpose money and it was always -- we talked very openly volatility last year and that was about how we changed the promotional mix and what have you. We have a different sort of uncertainty as we change the offer and we invest.

So Matt and the team have other things that they would want to invest in but we have to make sure that we generate the space to be able to do that so longer term we have a trajectory of profit we think is the right one. So it's more about timing and certainty of delivery rather than medium-term ambition.

Sreedhar Mahamkali - ***Macquarie Research - Analyst***

[Many thanks] for your time.

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

Andrew Gwynn, UBS. I suppose 1A and 1A, very cheeky, presumably (laughter) --

---

David Lewis - ***Tesco plc - CEO***

I'm not surprised. I'm not.

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

You expect no less. Presumably, it's nothing to change on long-term view of an industry-leading margin.

David Lewis - ***Tesco plc - CEO***

No.

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

That's 1A, so that's easy. 1B would be just in terms of the gross margin outlook. I get what you've just said to Sreedhar is maybe a little bit of investment here, but what's a long-term view on gross margin? What are the key moving parts?

David Lewis - ***Tesco plc - CEO***

Well, look. We don't give any sort of guidance on gross margin. I suspect Matt's not going to change that by attending today. I think the critical thing for us is the mix around price and the ability we're able to negotiate for the range and the way we work with our partners.

And we've started a whole different way of doing that, so for those who are long-term studiers of Tesco, this ability to work with partners to reduce cost that allows us to invest that back in the customer is at the very center of what we do, and that's what we're going to carry on doing.

So price, working with partners and the store operating costs are our three big levers, and we've got some things that we will still want to change in the way that we do that.

I don't know, Matt, if you want to add anything at all to that?

Matt Davies - ***Tesco plc - UK & ROI CEO***

I think you've covered it.

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

How far are you through that program of renegotiating with suppliers?

David Lewis - ***Tesco plc - CEO***

Well, look. We've -- you saw some of the feedback in terms of their satisfaction of it. I think in certain areas we started at different times in different places. To be honest, we're never through. If we do this right, they're long-term relationships where we commit ourselves to long-term improvements.

And I've been -- honestly, I've been delighted with the way that our suppliers -- particularly because we started there in terms of produce, and you see some of the results of that, they've worked with us hand in glove in terms of thinking about how it is end to end we can reduce supply chain waste in order to be able to put that into an offer for customers which is more compelling and more competitive than in the past. So we'll continue to do that and we'll never get through it. I hope we just continue to do it year after year after year.

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

Niamh McSherry, Deutsche Bank. Given I'm limited to one question, I'm going to ask about a path to reinstating a dividend. I think you've mentioned before that investment grade in itself is not an absolute necessary for reinstating the dividend, but now that the balance sheet is stronger and the business more stable, maybe you can give us some criteria that you might look at for that.

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

Yes. Look -- and it's a great question, because the dividend and the investment grade, it should be absolutely clear, one doesn't have to follow the other, and the other way around. But they are linked because we have shareholders and we have investors. And the one thing that we wouldn't want to do is to get into a position that we're paying a dividend which is then damaging the long-term health of the business because of the capital structure being inappropriate.

So we balance those, and we've seen really good progress in terms of the balance sheet strengthening. We've seen the rebuilding of the profitability, particularly in the UK business in the second half. and we feel the building blocks for both of those elements are ones which we've made good progress on. But we'll get to those at the right time to talk about them.

So I can't be more specific, but we absolutely keep both of those in mind as we think about it.

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

Okay. So even though they're not dependent on each other, you might consider the Company, the metrics to be in a similar place perhaps when you're --?

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

Yes. Just to add, one of the metrics - one of the decisions is within our control, one of them is absolutely outside our control. We put up the way we look at the metrics, but ultimately the rating that others give us is a function of their view of us. Now we can have our own view of us, and we can try to do that, but it is, and rightly so, it's the rating agencies who determine that view.

We look at the commitments we've got, whether that's the lease commitments, the pension commitments or the net debt. We look at how those are viewed, and we look at the earnings and the cash in the business and the liquidity, and those are the things that we factor in.

But we are wanting to be in a position where we are viewed externally as an investment grade credit. It doesn't have to follow that dividends and investment grade credit follow in a particular order.

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

Thanks.

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

Stewart McGuire, Credit Suisse. Like for likes in the UK are up 90 basis points. Well done. When I look at the breakdown, extra, superstore and metro all negative like for likes in Q4. Can you give us some color as to the way customers are shopping, why Express is driving those like for likes, and the online business, which where does the online growth get counted? Does that get counted within the separate stores, or is that separate?

Matt Davies - ***Tesco plc - UK & ROI CEO***

Firstly, let's take the formats. And you're right in terms of what you say around the individual formats, but let's not lose perspective, especially from an Extras' perspective in terms of where Extras were and where Extras are now. So we don't need to go back too far, and right at the start of that chart, we see a format which is going back at the rate of 6%. We actually drove positive growth over Christmas and we're very close to positive now.

So we're really comfortable with the progress that we're making of re-establishing our Extras as a destination for people to shop at, and a lot of the work that we're doing is all about supporting our customers being able to get everything they want under one roof.

You then move through to convenience and we continue to generate good single-digit convenience market -- convenience growth in a market which is actually pretty tough. There are some operators out there that are doing a really good step change job at operating a convenience business and delivering a convenience proposition.

And then from an online perspective, as we talked about, we are very much balancing the growth that we are aspiring for against the long-term profitability that we're looking to achieve in that channel, and you see that very clearly coming through in terms of our non-food performance online where some balancing is going on, and that's causing us to be less aggressive around some categories that we were more aggressive about historically. So you're seeing a little bit of a negative growth coming through there, but online remains a fundamental part of our proposition going forward.

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

A clarification. It's not a second question; it's the same question (laughter). So does online get allocated to the Extra stores? Is that where the sales are counted?

Matt Davies - ***Tesco plc - UK & ROI CEO***

Yes.

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

Okay. And -- okay. I'll stop there.

David Lewis - ***Tesco plc - CEO***

You'll stop there. That's very good because I was shaking my head. You don't get a second one. There you go, Bruno.

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

Bruno Monteyne, Bernstein. If I think about the last 12 months, you did price investments, loads of staff investments initially in very tough conditions. You also had cost savings and good volume growth. And it allowed you to have two consecutive half years of 80 basis points margin improvement twice in a row.

This year, from everything you've described, isn't really that different; might be a little bit less staff investment but more in the farm lines, and you have material tail winds. You have less rent to pay because the leases you bought back, you did some write-downs; you probably have lower operating costs from the smaller ranges, higher volume growth. So how come is you suddenly go from two, twice, 80 basis points up sequentially to going flat? What has really changed in the next 12 months that suddenly stops that margin improvement coming forward, and why would it suddenly come back later again?

David Lewis - ***Tesco plc - CEO***

Why don't I start and then I'll pass to either Alan or Matt who might want to add to it?

I think -- Bruno, I think it all comes down to timing and ease. So I think -- I don't think we feel that the headwinds have got less. I think we would add to your list. We talk about where wage inflation is coming in. We talk about what the rates review may or may not happen. We would see a need for us to offset some of the investments we have by further cost initiatives, but they're not as easy and as straightforward and as quick as the GBP400 million that we delivered this time.

So it's a question of investment ahead of being able to generate the return in a time period that you might like to report on, and therefore, we're just being clear about the fact that we're not waiting. We're going to start the year with a quite significant investment. It is a significant investment, and that will have an impact in terms of the delivery.

So it doesn't change our aspiration to grow the profit, but the range that's out there in terms of your views about the profitability I think is one bit of feedback that says, actually, the market understands that there's quite a lot of uncertainty about what the investment return would be. and we've just tried to give some contribution to that debate in terms of we don't think it's a straight-line improvement in the way your question suggests.

I don't know if Alan or Matt or any of the other guys want to add to that.

Matt Davies - ***Tesco plc - UK & ROI CEO***

I pick up your word feel and talk about the three emotions that I feel sat here today. Number 1, I feel immense proud for the 0.5 million people across Tesco that have worked relentlessly to deliver the numbers that we're talking about today.

David Lewis - ***Tesco plc - CEO***

Hear hear.

Matt Davies - ***Tesco plc - UK & ROI CEO***

Number 2, I feel very confident actually around a lot of the initiatives that we have underway across the business to support what we're talking about. But then the other emotion is one of wariness, because the market is incredibly competitive, it's deflationary, and we're very, very clear that we are going to continue to do what we believe is right for our colleagues and our customers because we believe that's the right route to drive medium and long-term sustainable value for our shareholders. So that's where we are.

David Lewis *- Tesco plc - CEO*

Very well said.

Clive Black *- Shore Capital - Analyst*

Clive, Shore Capital. Can you tell us what your strategy is with respect to non-food at Group level?

David Lewis *- Tesco plc - CEO*

I think -- well, I'll give a little and then I'm going to ask Trevor and Matt to speak about it.

Look. We're really clear that what we want to be is an offering which is food, and to use your words, non-food. So, actually, we think we've got a very good business there.

I think, Clive, if this is where your question is going, are we happy with the profitability that's in that part of the business? No, we're not. Do we think there's more that we could do in the way that we buy and the way that we operate? Yes, we do. It's some of the improvements that Matt was talking about.

So it's a big and important part of our business, but it's also a place where we think that there's more that we could do to improve it.

Trevor, why don't you say a little bit about --?

Trevor Masters *- Tesco plc - International CEO*

Yes. I think there's two things. So in international, there's definitely an opportunity of buying [GM] more with the UK, and in Malaysia and Thailand actually buying a lot of that together. So I think there's some real buying synergies still to be had.

The second thing is we've done quite a lot of work understanding where the growth is going to be on non-food and how do we go faster with that; and also, where the growth is going to deteriorate. So we actually need to make sure we correct the size and get that part of the size in the store, just to make sure we get the right profit mix.

David Lewis *- Tesco plc - CEO*

And, Matt, from the UK?

Matt Davies *- Tesco plc - UK & ROI CEO*

We're working collaboratively across the global Tesco business on delivering the right non-food proposition for our customers. A lot of that flows through an offer that we'll deliver ourselves, and there's some finessing going on there. Another element of it flows from some of the work that we're doing around repurposing in some of our larger stores.

And you look at some of the work that we're doing with Arcadia and how we're supplementing, and the F&F business in our stores, that's also part of how we're thinking about our overall non-food offer going forward because that's what customers are telling us that they're looking for.

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

James Tracey, Redburn. The question from me is on operating cost. Could you please tell us what your UK operating cost base is and also where the biggest areas are to reduce that in future?

David Lewis - ***Tesco plc - CEO***

No (laughter). Might as well be -- I'm not. You should know by now anything that I think is competitively sensitive I'm not going to talk about in the context of here, and I certainly wouldn't ask my colleagues to either.

Do I think that there are opportunities for us to lower our operating cost base? Yes, I do. But consistent with that we've done over the last 16 months, we'll deliver and then we'll report, but I'm not going to give anything out that I might think is competitively sensitive. So I'm sorry. It's not a number I'm going to give.

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

Thank you.

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

Rob Joyce, Goldman Sachs. So my question is on the long term strategy for the bigger stores; just a clarification, basically. It looks like you're buying back some of the bigger stores, but then the press are reporting that you seem to be looking to exit the stuff that you were going to put in the bigger stores to drive footfall. So I'm just wondering what your vision on the longer term is of how these big stores will look, and whether you'll have the same number of those stores in, say, five/10 years' time.

David Lewis - ***Tesco plc - CEO***

I think there's two parts to it. So, actually, the gentleman in front of you to your left is Steve Rigby who is our Group Property Leader. So let me tee up something I'd like Steve to talk about, and then we'll come to the mix of what's in the store from maybe Matt, because I think your question is more a UK-driven one.

So, look. The first thing is, consistent with all we said 16 months ago, is we need to think about property differently. It's been a very significant part of what we've been doing over 16 months. We've brought to that a completely different, commercially savvy lens in terms of investment and return. We have been prepared to walk away from things which were not profitable or couldn't be made profitable. And that means --

So some of the dynamic that you see in terms of buying back stores and closing others is about the team, principally led by Steve, looking property by property and saying, what is the value of this store? And, actually, if it is something that we've leased, sold and leased back but actually is a store that we'd ideally like to own, for the right consideration we're interested. Right? That doesn't mean that actually when we have a store where we can't make that work we're not prepared to walk away from it. We think that's a different approach.

I don't know, Steve, if you want to say anything more in terms of how it is we look at the buying and the selling part of the property portfolio?

Steve Rigby - ***Tesco plc - Group Property Leader***

In terms of buying back our stores, we're clearly looking at the profitability of those stores. We're also looking at how long the lease is and the rent review mechanisms, whether they're fixed [uplifts], RPIs, or open market in terms of determining which ones we should buy.

This year, we've spent a lot of our focus on buying joint ventures which have -- the stores in those have those qualities, and also, that helps to simplify our business operation.

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

Sorry. Just one quick follow-up, quick come-back. Are there many stores that still have that kind of profitability that you had when you (inaudible)?

Steve Rigby - ***Tesco plc - Group Property Leader***

Well, we obviously have a significant rent roll in our business, and there are many more stores that are leased that we would like to buy. And we'll buy them as they become available and as we have the money to spend on them, so we constantly look at that.

David Lewis - ***Tesco plc - CEO***

And as long as the deal is attractive; if it's a good financial deal is the other side of it. And, actually, I'm going to go --

Trevor, in terms of how it is we use the space, do you want to say a little bit about some of the stuff you've done in Thailand in terms of repurposing large stores? Because you've actually got more large stores as a percentage than anybody else. And then, Matt, if you want to make a comment on top, then great.

Trevor Masters - ***Tesco plc - International CEO***

Yes. The history in international is that when we opened the first hypermarkets, or the first 15 years' worth of hypermarkets, they were always big stores with big warehouses, because actually, a lot of the deliveries were direct. And now, 20 years later, it's all centralized so we don't need the stores or the backrooms to be so big.

But also, we've spent quite a lot of work in international looking at the way we do the supply chain. So by half year of this year, probably about 67% of our SKUs will be single picked, so where you've got a slow-moving line, things like health and beauty, we'll be single-picking, which is a big change in international because the case sizes tend to be twice the sizes of what you'd see in UK and Ireland.

So the infrastructure-wise, there's lots of opportunities, and we've got about 1.8 million square feet of space that we think over the next two to three years that we can actually repurpose. So what we've been doing in Thailand is we've done about 22 stores now, we've got the ideal store size which is around 60,000 square feet. That frees up about up to 40,000 square feet per store.

And we've done some -- two things really. We've got a little bit of a partnership with Decathlon. So they have come along and taken 40,000 square feet of the store. It's a really good rent opportunity for us, but actually, what's really important, it gives us the opportunity to use a really big player to bring a halo effect to the store.

So what we're seeing is a halo effect to the overall shoppers to the mall. We've got some big malls in international. We say a halo effect onto our own store. And what we're fast seeing is the customers are seeing a really good Tesco store, the right size, and a really good anchor, more anchor tenants in the mall all comes together with more income as well as more customer satisfaction.

So as I said, we've got an opportunity for about 1.8 million square feet, and that's in Central Europe, Malaysia and Thailand.

David Lewis - ***Tesco plc - CEO***

And, Matt, for the UK?

Matt Davies - ***Tesco plc - UK & ROI CEO***

It's about supporting the destination status of our largest stores; focus on food and freshness and loving and living food. And then two words, both end in ship. One's ownership, one's partnership. And we're very, very clear that we don't need to own everything to support the destination status of our stores.

So we'll continue to explore partnership opportunities as well as ownership, and that will help us provide [and] the overall compelling proposition that our customers are asking us for.

Nick Coulter - ***Citi - Analyst***

Nick Coulter, Citi. Could you talk about how you see the hierarchy of own brands evolving? I don't know if Jason's here today, but I think he recently spoke on that. I'm guessing your thoughts are aligned. He certainly commented that he didn't see it as simplistically as good, better, best going forward.

David Lewis - ***Tesco plc - CEO***

He's actually the one of us who's on a much-deserved holiday, so he's not here. So to sit in for him, I think the thinking, we use good, better, best on the point that says, actually, we think the segmentation is right, but how it is we've satisfied good, better, best, we think there are different ways of doing that.

So will we develop uniqueness in partnership with our suppliers in order to replace where we think we think we can do a better job than where we were in value? Yes, we will. Will we continue to invest the finance at the other end? Yes, we will.

So we do see that there will be three tiers in the own-label offering from Tesco. We also see that we will look at exclusive brands like F&F which are unique and differentiating for the Tesco offering in total. So that's where -- and that's what Jason was saying in the presentation you're talking about.

Nick Coulter - ***Citi - Analyst***

And do you see the balance between those brands or levels changing?

David Lewis - ***Tesco plc - CEO***

No. As I said, the value equation for us will be a combination of brands which are consistent and readily available everywhere. We'll be very competitive. And then, we'll develop our own unique offerings, and then depending on what customers and [store], the mix will be different depending on -- but that's the way we'll put our value equation together. Okay?

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

James Grzinic, Jefferies. I had really a follow-on clarification from Nick's question so I won't count it, and then I had my own question (laughter).

David Lewis - ***Tesco plc - CEO***

But we might.

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

Okay. Fair enough. The tiering on price and what you relaunched, how did you change the better and best? Because you said you made [it] a lot clearer. Be great if you could be a little bit more specific in how the pricing gap has changed, what's changed.

My own question was, can you be more specific about the Phoenix and the BA transaction dynamics because they were very different from the British Land one? Basically, that's buying back an annuity as opposed to the British Land. [Actually], you surrendered some development potential, and presumably, there was a knock-on impact on the yield you got for that.

David Lewis - ***Tesco plc - CEO***

So if you do the farms brand and I'll do the --

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

Yes. Why not?

David Lewis - ***Tesco plc - CEO***

Look. I think -- so what we did in the seven brands that we talked about, a rough average if you take the basket I gave you, it's about a 17% reduction on our entry tier exclusive brands. That's what we did. We kept about the same the investment in what we call better, so the core, and the ranges that I've told you around where we were before. So we opened up a gap that was not as wide, historically, by the launch of a cheaper exclusive farms brands range. That's what we did in those cases of the 76 lines.

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

So in terms of the properties, you're right. They were different. But the way we think about them, thought about what we are acquiring, is really the same. So the British Land we happen to have -- there were two JVs. One had predominantly stores, one had predominantly shopping centers, so we did a swap. They paid us GBP100 million and we got 21 stores, and we disposed of another JV which had predominantly shopping centers with, I think, nine stores in it.

But the way that we started by looking at them is exactly the same is that we -- it starts with, as Steve and Dave said is, is this a store which we would want to be owning or want to be trading from for a long time because it's a successful store? If the answer to that is, yes, and it's subject to upward only or RPI link rentals which over time will potentially put pressure on the operating performance of our business, and we can buy it back at an attractive rate, then we are interested in buying it.

With the two that we did in February, they came -- because they were bundles of assets, they came with some existing debt against those assets. So we brought onto the balance sheet, and we were conscious in this that we did bring on to the balance sheet GBP1.5 billion of borrowings which were sitting behind that asset base.

Now it's a very conscious decision. We're swapping in this case GBP80 million of rental savings on those two assets for bringing on longer-term certainty as to no more rent, but some debt which sits against the properties. Now the properties have value; because we are going to trade from them they have value.

But that's -- it's not an easy necessarily simplistic equation that we're making because you are trading short term with potential upwards-only rents for debts which over time will also be need to be repaid and/or refinanced.

But that's the way we look at it and we're very clear that economically we've made the right decision for the business, even though there is a GBP1.5 billion.

Flipside is that the GBP6.2 billion of reduction in total indebtedness would have been GBP1.5 billion less had we not brought that debt -- greater had we not brought that debt on. So the underlying improvement in the absence of that would have been a lot stronger.

So we're making long-term decisions for the good of the business and the good of the shareholders at the expense of short-term indebtedness in that equation.

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

So the two sides of the equation are GBP80 million and GBP1.5 billion. Is the GBP1.5 billion the full EV for those two transactions? So it's around 5% yield. I'm just trying to understand. And I know that in time that yield will go up inevitably because you are avoiding future --

David Lewis - ***Tesco plc - CEO***

What I am going to suggest is why don't you pick that up with Chris and go through the detail in as much detail as you like. He likes that detail (laughter). So we'll let you do that, Chris. But in the interests of time I'm going to ask you to pass the microphone.

Bilquis Ahmed - ***JPMorgan Asset Management - Analyst***

Bilquis Ahmed JPMorgan Asset Management. I was just wondering a clarification on the farm brands. You said that suppliers have to match a certain consistent quality specification to be included in those farm brands. Can you just give a sense of whether that quality specification is the same as the previous quality specification for the opening price point products, or whether it now matches Aldi and Lidl on the one avocado or whatever that they have?

Matt Davies - ***Tesco plc - UK & ROI CEO***

Effectively, we've started from scratch and we've challenged ourselves as to what is the right specification and what is the right price point looking across the market, and then delivered products accordingly.

David Lewis - ***Tesco plc - CEO***

It's a competitive benchmark.

Matt Davies - ***Tesco plc - UK & ROI CEO***

Yes.

Dave McCarthy - ***HSBC - Analyst***

Dave McCarthy, HSBC. I'm interested on how you measure deflation because your answer is going to tell us some very interesting things about your Company (laughter). Where do you include the impact of brand match? Because every measure of inflation that's done externally, every one by your competitors, doesn't and is unable to take account of any rebates that you give at the till.

Last year, you were giving vouchers. 25% reduction I think was the figure you gave. Now you've got 100% reduction effectively for that rebate. So are you understating what your true level of deflation? Or if you've included it, then clearly, it doesn't have that big an impact on the basket.

David Lewis - ***Tesco plc - CEO***

Yes. Understood.

Dave McCarthy - ***HSBC - Analyst***

You can't have it both ways, is what I want to say.

David Lewis - ***Tesco plc - CEO***

So [you do] brand, [Matt], but Brand Guarantee, do you want to say a little bit about how we account for it and how it impacts on assessment of deflation?

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

Yes. So Brand Guarantee is money off at the till so it's effectively a reduction in the revenue. We're paying -- what you would have paid is effectively just never there because it's a reduction and so it serves -- what we don't do is to work out -- is to gross up and say that that's an element of it because that's -- you're getting into a world which is a bit like an opportunity cost.

So it is a reduction. We know what we are paying. We do know what we are paying, clearly, because we can track that. But it's important.

And I think the important thing about the Brand Guarantee is that before we launched it, what we wanted to do was to ensure that we were competitive. So the important thing in launching it is not to show how much we're giving back; it's how much -- how well we are doing competitively in any event.

So to get the product pricing right beforehand, then to give the underpin of you won't get this brand more cheaply elsewhere on the day that you are shopping is the important thing. So it's that trust in terms of the brand that Dave speaks about rather than the quantum that we are not recognizing through revenue, which in a coupon accounting world would get into all of those IFRIC 13 adjustments and all of that.

David Lewis - ***Tesco plc - CEO***

Anything you want to add?

Matt Davies - ***Tesco plc - UK & ROI CEO***

Just the power of Brand Guarantee and how valued it is by our customers. So the frustration of 50% of the time losing that coupon and moving to a point where all the time customers understand the Brand Guarantee is there as a defensive mechanism.

So our focus is being right to start with in terms of the pricing of brands across our business, and we're doing a really good job of that, but because of the way promotions move all the time, what customers are telling us they really value the fact that they don't have to go and shop across different stores to get the best promotions because it's all available in one shop at Tesco.

David Lewis - ***Tesco plc - CEO***

Does that give you specifically what you are looking for?

Dave McCarthy - ***HSBC - Analyst***

No, it doesn't, because I get all that and that's well understood. But what I want to know is that reduction that the customer gets, they've got a bill for GBP100, say it costs GBP98 in Asda, GBP100 with you, you're giving them GBP2 back, Asda are looking at this and saying, hey, we're cheaper than Tesco. Your customers are saying, no, you're not, and it's great for us because it's GBP98.

Last year, you didn't do it the same way, but it's got to be accounted for in some way because you're giving more. So is it in your -- are you understating your volume because your inflation is not the right figure? Because as you just said, Alan, it's not allocated anywhere. And I think it's a really important point if you're understating your volumes.

David Lewis - ***Tesco plc - CEO***

And I think what we should is again give some real detail. But what we see and what Matt sees is we see what the cost of Brand Guarantee is. So the customer sees it [as a] revenue reduction, but we actually track it as a budget inside in the business in terms of how much we're having to invest at any one period of time depending on what the baskets are that we're selling.

But I think there's a bit more technicality behind it so I'll point you in Mr. [Griff's] area.

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

I think the short answer is it's deflation.

David Lewis - ***Tesco plc - CEO***

It is deflation but --

Dave McCarthy - ***HSBC - Analyst***

Is it included in your deflation number?

David Lewis - ***Tesco plc - CEO***

Yes, it is. Yes, because we're looking at what's actually paid.

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

John Kershaw, Exane. I'm going to do the same follow-up and ask a question. Can you tell us what percentage of baskets actually qualify for Brand Guarantee? Because, obviously, you need 10 items, so just to follow up from Dave's question.

Coming to the farm fresh, the farm brands, talk us through a bit more big picture on it. First of all, is the 76 items it or is there much more to come? And it looks very much targeted at what Aldi and Lidl, particularly Aldi's push in fresh, but in many ways you need to go up the basket to cover off your A and B competitor sets. So talk more broadly on how you grow that rather than just -- or is farm just it?

David Lewis - ***Tesco plc - CEO***

I don't think we've ever said -- I'm looking, but I don't think we've ever said about the number of baskets that qualify for Brand Guarantee, have we?

Unidentified Company Representative

No.

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

That's why I'm asking.

Matt Davies - ***Tesco plc - UK & ROI CEO***

For me, it's commercially --

David Lewis - ***Tesco plc - CEO***

So no to your first question.

Matt Davies - ***Tesco plc - UK & ROI CEO***

It's commercially sensitive. All I would say is --

David Lewis - ***Tesco plc - CEO***

It would be commercially sensitive, I think, so I think we'll reflect on it. If we come back, we'll make an -- but I don't think we will (laughter). I'd just rather be straight with you, John.

Look. I think what I'd answer to this, just in the interests of time, I think we'd say it's the first step on a journey. I think it comes back to the point which is we see ourselves wanting to offer. John, it's customer centricity. I showed what it was we were doing in terms of under or over-indexing. We clearly had an issue in terms of the entry price point in these particular categories, and they're big categories, so we've started there.

And what we have, first in the UK but Trevor would the same for international, do we have a commitment for investing in our own label so that we can offer to what you call the AB customer as well? Absolutely.

By the way, there's actually quite a lot of the AB customers buying the farm brand. Right? So it's not as linear as price to social class. I know you know that but it's just worth saying. But will you see us invest in the things that differentiate us as Tesco and are unique as us? Absolutely you will.

So that's the bigger picture, and we'll take it step by step. It comes back to the comment I was making before. There's more we'd like to do, but the timing and the sequence and the deliberateness with which we do that is one of the things that we'll be navigating.

Xavier Le Mene - ***BofA Merrill Lynch - Analyst***

Xavier Le Mene, Bank of America Merrill Lynch. One question actually on online. It seems that you have been increasing the basket to qualify for low delivery prices. You're also increasing the prices of delivery. So it seems that all the signs we've got imply that it's not a profitable business and you're trying to make it more profitable, potentially at the expense of the customer. So what are you trying to do here?

Matt Davies - ***Tesco plc - UK & ROI CEO***

We are balancing growth and profitability to support a sustainable medium and long-term business. So I think the three things you're talking about is, yes, we have introduced a minimum around click and collect. Yes, we have put a revised minimum in place, GBP30 minimum around a grocery basket. And we've also done a very, very small amount of finessing around our pricing architecture. But we'll continue to challenge ourselves as to what's the best way of operating that business, supporting customers, get incredible service, but at the same time making sure that it's sustainable for us as a business.

Xavier Le Mene - ***BofA Merrill Lynch - Analyst***

Just maybe one quick follow-up. You're doing that at a time Amazon seems to be pressing more on the full market.

Matt Davies - ***Tesco plc - UK & ROI CEO***

Sure. So I think it's a great question, which is why I very deliberately used the word finessing. So if you look at what we are doing around our pricing architecture on deliveries, there's some very small finessing and we will clearly reflect the overall competitive environment as we take that business forward.

Xavier Le Mene - ***BofA Merrill Lynch - Analyst***

Does finesse mean up or down?

David Lewis - ***Tesco plc - CEO***

It means both, actually.

Xavier Le Mene - ***BofA Merrill Lynch - Analyst***

Okay.

David Lewis - ***Tesco plc - CEO***

It does. It means -- the finessing is --

I suppose just to supplement what Matt says is, left to our own devices, and your second part of your question means that we may not be left to our own devices, do we think that there's a simpler, more straightforward value equation that should go across whether customers come to our store and do the shopping themselves or whether we pick it and deliver it at home? Yes, we do.

So we want to get ourselves back to being clear about what the value equation is to customers across the whole offering, and that's the finessing and changing that Matt talks about. But that's notwithstanding there may be competitor -- it's a very dynamic market. Things change an awful lot.

I think what we did say is, left to our devices, a single-minded pursuit of exceptional growth in that space in a way which maybe is not adding to the profitability of the business is not something we're seeking to do. We're trying to be much more measured about how it is we do that. Right?

Unidentified Audience Member

A quick question for Alan on cash flow. So in the first half of the year, you had a fairly significant improvement in terms of your working capital. I think it was above GBP400 million, much less so it looks like in the second half. If you could just come back as to why so and what should we expect in terms of working capital inflow for next year -- or this year, sorry.

Alan Stewart - *Tesco plc - CFO*

Yes, [Edward]. A couple of points in terms of the working capital. As you can see, there are different moving parts in it, and in the first half, we did still have the GBP280 million from the Korean business in that working capital, which was a benefit.

And what we've seen across the business is the combination of the business performance combined with the stock improvement, and that's effectively getting a better stock turn. And that's where we will continue to focus. We do believe that there is opportunity and good opportunity in working capital management in terms of the cash generation.

The one thing I would point out though, and this is just a function of the way that the accounting works, is that because we have certain onerous leases which shield our profit because we took the impairment last year, our profitability and our cash generation has got a drag on it. So cash generated isn't necessarily the same as profit because of that onerous lease within our operating profit line.

Against that, of course, if you're growing your business, what we all know is that we're in a business which has got a positive working capital cycle so important that we grow the business from an overall working capital perspective.

Net-net where does that end up? Good and continued focus, not only on cash from operations but working capital, and it's a key part of the business focus, not only in the UK business but international. And international, as we saw, had six days stock turn improvement in the years, so a real opportunity.

Unidentified Audience Member

And in terms of figures, sorry, for the current fiscal year?

Alan Stewart - *Tesco plc - CFO*

Look. Last year was a good year. We had a good business focus. We had a good performance. I think, it will -- in terms of your model, it will really depend on what you put in for your own parts of the business, but we're focused on it.

And you'll remember, it is one of our long-term measurements is cash generated, which is a function of operating and working capital. We made good progress in the first year. We're not going to take our foot off that particular focus as we go into this year.

David Lewis - *Tesco plc - CEO*

Okay. Thank you, guys. Thank you very much. Benny, nobody had any questions for Benny, but I've got a few for you, but I'll ask you later (laughter).

Look. Thank you very much indeed. What would I say in summary? I think where I started from really.

I think we do think -- in fact, we [know] it's a year of significant progress. We've put the customer at the heart. Volume has recovered. We've allowed ourselves to grow our business again, recover our profitability, generate some cash, pay down our debt whilst protecting a little bit the future of the business, and we continue to invest.

Now we've been considered and deliberate and wary, to use Matt's word, about what the next few, next six months holds for us. Our aspiration has not changed. We do want and we are confident that we can be an industry-leading margin again. But we're just being really candid and objective with you about the investments we're making and what they can mean to the trajectory, the gradient and the speed of that recovery, as we seek to invest in what is a challenging, uncertain and deflationary marketplace.

Final thing I'd say, I hope it gets picked up, is 500,000 people have worked really, really hard over the last 16 months to deliver the results that you see there, and it would be completely inappropriate if I didn't finish by paying tribute to every one of them in a year of massive transformation. It would not. We would not be sharing these results with you if they hadn't been quite simply outstanding.

So thank you very much and we'll see you soon probably.