Tesco PLC – Half-Year Results 2016/17 Webcast

Wednesday, 5th October 2016

The Three Turnaround Priorities: A Final Update

Dave Lewis

CEO, Tesco PLC

Introduction

Good morning everybody. How are we doing? Thank you very much for being here. I suppose before I kick onto the presentation, I think, you know, as I said on the Wire call for those that were there or heard some of it this morning, you know, I think Alan and I reflect on the fact that it's almost two years to the day that we stood in front of you sharing our very first initial views of the business. Alan had all of four weeks' experience and I had the grand total of seven. We were clearly a business that faced a huge amount of challenges at that point and we set out for you three priorities that were going to guide all of the actions as we tried to stabilise the business before then obviously looking to drive a recovery.

What we're going to do this morning is share with you a little bit of what's happened against those three priorities. You would expect it to be so because that's what we've done every time we've met up to this point. But actually that'll be the last time that we talk about our business in those three priorities because what we're going to do also, after Alan's shared with you the detail of the results, is share with you the lens actually that we've been looking at the business through since that very first day. And we're going to do that because we feel that we've got our business to a place where it is stable and competitive again. And we want to share with you what the ambitions are of the business that we're trying to build through the lens of those four key stakeholders on which everything we've done as Tesco has been built since that time two years ago.

Agenda

With that as an introduction I will touch very briefly on those three priorities. Now it was across all the plan the three things we picked out that we needed to demonstrate and do something about. Alan will then take you through the detailed results before I'll come back and I'll talk to about how it is we're trying to build long-term value into and for those four key stakeholders. And it's through that lens that we want to engage with you going forward as we move from that period of crisis into stability and how it is we want to grow the business going forward.

Our Three Turnaround Priorities

So hopefully by now you're familiar. It was about competitiveness in the UK. It was about strengthening and protecting the balance sheet. And it was about rebuilding trust and transparency in our brand and our business.

Competitiveness in the UK

Volume Growth

You saw today we announced our seventh competitive quarter of volume growth, the UK clearly the priority. We talked then about a volume-based recovery. This is the long-term trend. It's the same chart that you've seen every quarter that we've announced and every results presentation we've made. That volume growth has been really quite impressive. It's been a fundamental bedrock in which we've been able to turn around the business and we see that being driven by the transaction growth, right. So across that period again seven quarters of increasing the transactions that are going on inside the Tesco business.

IRI

A slightly different measure, if I look at the first half of this year and I look on IRI and I look at all the categories in which we operate, this is the market outperformance. Volume, stronger as you would expect it, but also some value improvement in different categories in different mixes. And we'll talk in the future – give you an insight in terms of how it is we think about the mix of products we sell, the categories we sell and indeed how it is we sell them and how it is we serve customers. But I thought it would be useful to you as you look at the performance that we've announced this morning to see that across our whole business we've been actually really very competitive across all the main categories as judged by the IRI retail analytics.

Lower Prices

Our prices are 6% lower so that volume-based recovery being able to get operational leverage which lowers costs which then goes into price is what we've been driving, right. Since we took a basket that we had two years ago, we've kept that basket the same. I've showed you all the way through what it is we've done to actual prices that actual people, customers are paying and we're more than 6% cheaper than we were two years ago.

Increased Customer Footfall

It's interesting in the first half of this year, if I take the Kantar Worldpanel so you will have seen it, we're talking on that same period of 200,000 more shoppers coming to visit Tesco. So penetration, right, footfall, whichever you – people use that measure interchangeably. But actually more people, our penetration has grown over that two-year period in a way that quite frankly in the years before that actually we were declining.

Switching Gains

And very significantly for us and based on all the questions that you always ask me, the switching gains. So gone from a place of two years ago being a donator of share to the marketplace to a place where actually we see in the first half of this year some very strong switching from our competitors who are choosing now to shop in Tesco versus where they were shopping before.

So that volume leverage, lower prices, more people coming, seeing the switching data turn positive in the first half of this year.

Securing and Protecting the Balance Sheet

Property

The balance sheet is more secure. We've gone – we've talked a lot, I'm sure we'll talk again, about generating cash from our business. We've continued that trend. We've lowered the net debt by £4.4bn and we've also been very active in property. And again we'll talk about that when we talk about the future but what I've given you there is an update of where we are in terms of property. So over that period we've increased the Group ownership by five points and in the UK by seven points as we seek to buy back very profitable stores that we would want to own, you know. Yes, it costs us and there's capital involved in doing that but also we get the benefit of avoiding those upward-only rent reviews that were a cost pressure in our business.

Pensions

I'm sure we'll talk about pensions when we get to the – and I'll let Alan deal with some of the technicalities of it but obviously we've done something very significant in pensions in terms of moving from a DB to a DC scheme for a very large number of people and getting ourselves to a place where we agreed with the Trustees a format and a formula for how it is we would make long-term cash contributions to the pension deficit. We think that's the right model. We think that's the right vehicle by which we can deal with volatility in the marketplace. So we're confident in what we've done and we're confident in what we've got but obviously we'll address your questions around accounting definitions and what that means given some QE which is definitely completely outside of our control.

Rebuilding Trust and Transparency in the Business

YouGov Trust Monitor

Finally in terms of rebuilding the trust and the transparency in the business, I've kept this chart exactly the same. It's the YouGov Trust monitor. A number of you in the room use it and obviously October of 2014 was definitely our nadir. It was a very difficult time. I remember standing here and preparing for that meeting two years ago and I don't mind telling you it was a bit different preparing for this meeting than it was preparing for that meeting. But the thing that's really encouraging here is the feedback that we're getting and you'll see it when I talk later, from all of the stakeholders in our business, be it customers, colleagues, supply partners. Actually they appreciate all of the opinions that we're getting is recognising that the value and the quality of what it is we're offering is improving. And very importantly in our behaviour, actually they're seeing a different Tesco and that is translating into an appreciation of trust in what it is we're doing. More we can do. That's the best it's been in for four years but definitely not happy with that. There's a wealth of opportunity but against what we said we would do we've managed to achieve that.

Trust in Leadership

Big part of that, trust in leadership. So if I looked at the survey of our employees, we do it twice a year, it was at 61% in October of 2014. We just repeated the survey. It's now at 74%. The work that Jason and the whole of the Tesco team around supplier re-engagement is fantastic, nothing short of fantastic. Twice a year we do a supplier viewpoint. In full-year 2014 only 51% of our suppliers said they were happy with the engagement that they had with Tesco, right. Fast forward, in total that's risen to 78%. I'll talk a little bit more about it later but in certain categories that's above 90% in terms of reconfiguring and re-engaging with our suppliers.

Transparency in Reports

And we talked about transparency in our reports and we've had some very – there's always more we can do and I'm sure there's one fact that we should give that we don't give for somebody in the room. But we've had some really very strong feedback that the transparency that we brought into the report and accounts and the analytics around it has been very much appreciated by the market. So there's some great work by Chris and the team and Alan and the team for that.

Three Turnaround Priorities Achieved

So I suppose we're calling – you know, we're calling it in terms of those three priorities were important in terms of stabilising the business. I would argue with you I think quite convincingly that we have regained our competitiveness in the UK. It's not just one-off. Actually three quarters of like-for-like and Alan will show you more of the detail. We have protected and strengthened the balance sheet. A huge amount of work has gone on there. And we are indeed rebuilding the trust and the transparency in the business. And it's all of that that's going to allow Alan to talk about the half-year results.

Half-Year Results 2016/17

Alan Stewart

CFO, Tesco PLC

Thanks very much, Dave. Morning everybody. So, as Dave says, these are the half-year results to the end of August and you've seen them already this morning. Overall Group sales up 1.3% at constant currencies. We have had some currency impact in the half and that would continue through the whole year in terms of the reported numbers. But really for us, as I've always said, the constant currency is the important metric, because that gives us the market within each market how we are doing within the competitive environment there. Group operating profit up 56.7% to 596 million; these results of course excluding Turkey, which we've treated as a discontinued item, and is separated in the details pack you've got. We do have some exceptionals, which I'm going to come onto, and the mix of some credits and some debits comes back to 81 million overall, and gives us a statutory operating profit of 515 million, which again is up stronger year on year.

So going into those in a little bit more detail, the segmental performance UK, and as Dave said, growth for the third consecutive quarter, 0.6% is the margin growth – is the constant growth, margin up 105 basis points from this time last year, so a strong underlying improvement in our margin. Volumes up as well in that, and transactions up. International business of 3.2%; different markets in different conditions there, again I'll give you a little bit more detail behind it. And the Bank also saw growth in terms of both the sales and the operating profit. International operating profits down slightly in terms of the year-on-year, and overall the 56.7% improvement to 596 million in terms of the segments.

If we now look at the UK and ROI, this is a format you've seen before. Very, very similar, but very importantly, the third consecutive quarter. This is the first time in almost six years that we've had three consecutive quarters of like-for-like growth within this market. Irish market coming off a very low base in 15/16, continues to show growth. That market competition has been a bit stronger in the recent period, but we continue to deliver good growth in that market. And I would also point out that the deflation in the market continues as well. So in the first quarter, we had 2.7% deflation. It's slightly less than that in the second quarter. In the overall – in the half, it remains in the UK a deflationary market. And that's something which we continue to plan on. We expect to continue to remain competitive, and there is more that we need to do to stay competitive in the UK.

In terms of the segmental, and this is now aligned with the previous slide, so that all of these slides are now at ex-VAT, IFRIC compliant basis. Importantly, you can see continuing strong momentum across all formats. The Extras saw growth, Superstores good growth, the Express having – continue to show good momentum have actually picked up in the second quarter, and the Metros are pretty well at a breakeven position, so across all of our formats in the UK, our like-for-like, we are encouraged by.

In terms of online, small segment, you'll remember that grocery home shopping is about 7% of our overall business. We've pretty much changed the way that we address that market. We're looking at the sustainability of the offer. And our basket size in the online market is up 3.8%, which we do think is encouraging from that customer loyalty and what customers value is that they buy online with us.

In terms of GM and clothing, down just under – just over 13%. We did have lower marketing activity in this part of the market. We introduced a £2 Click & Collect charge for all orders under £30, and this has shown in the underlying metrics. The clothing market in the first half, we saw growth in the clothing market in some very challenging market conditions. So we are encouraged by that.

In terms of the operating profit, again, this is a bridge which you – which will now be familiar with. The lower prices, this includes the Farm Brand investment, which – which we spoke about back in April, it was a key part of our activity in the first half, but there's more there that we continue to invest in lower prices. Of that, we saw volume and mix benefits improving, and we also had quite significant cost savings. We very clearly sought to address the investment we're making in prices through cost savings, and we're now running at over 500 million of cost savings on an annualised basis.

The other is Dunnhumby and ongoing small movements, but overall, a very significant increase, as I've said, a 105 basis points, in terms of the margin and profitability rising from 164 million to 389 million.

If we look at the international, again, we see growth in all – in both parts of the market. The European market, Poland and Czechoslovakia have faced very strong competitive markets, again, this is up against very strong comps; in Poland last year we had more than 5% like-for-like, and so we're up against strong comps, and wearing courage that we're still seeing like-for-like improvement there. Asian market, Thailand remains very strong, we saw the highest ever market share in July. That's against what we previously spoke about as the highest ever market share in the run-up to Christmas last year. And across the formats internationally, we continue to see the same improvements. Hypermarkets: good growth; Superstores: very strong growth; and Convenience: pretty much the same growth as we see in the UK part of the market. So, overall encouragement despite different trading conditions in the different parts of our international business.

In terms of the operating profit bridge, investment in prices is – is an important part of it. The – there is, and this again is a constant exchange rates, what we are showing through, the volume and mix that with seeing in the international business has given us a strong benefit. We have made other investments in customer facing activities; range and availability are what I'd call out here. So, as we try to get that balance between what's right for the customer and what's right from an operating profit perspective, we're seeing some increased cost in that part of the market, and we are continuing to focus on costs and savings overall.

So, pretty much flat in terms of the international, and we continue to see real potential in our international markets.

If we look at the Bank, again, a core part of what we're talking about. We saw 2% growth in active customer accounts in – in the – in the half year. The underlying trading within the Bank offset what we previously have spoken about in terms of the increase – the decreased contribution from the interchange fees that the bank owns, and some of the key stats that I'd pull out is that our customer lending in the six months exceeded £1 billion for the first time. And we launched the mortgages through the intermediary channel, and that's been well received in the market. And we also launch the premium credit card, which for those of you who want to apply for it, speak to Benny afterwards. Clubcard points are additional to it, that you get – you earn more Clubcard points, you can get an enhanced exchange rate and travel money, and you can get family travel insurance. All of this has been well received, and it's part of our overall focus on Tesco customers through Tesco Bank.

The operating profit is up 3.5% before exceptionals, and most importantly from the Bank perspective, as you can see on the bottom right-hand chart, the core Tier 1 ratio and the liquidity position remains strong.

In terms of Tesco Mobile, and this has now been in existence for the 14th year. It's a very successful part of the market. It's the largest MVNO, mobile virtual network operator, and it's the fifth biggest mobile provider in the market. We have 4.8 million customers within the market and if you look at the right hand graph, you can see that the mix of pay-as-you-go, which is the dark blue, and pay monthly, which is the light blue, is growing in favour of the pay monthly, which are clearly more loyal, more – more valuable customers to Tesco Mobile.

A couple of other important points. For the sixth year running, it's the Which? recommended provider. And we have successfully building what customers like when they go on holiday, we had a very successful European roaming campaign during the summer. So overall, strong position, as we pointed out at the – at the interims and previously, this is a business which, being linked with O2 is clearly part of that – of what happens there, but very successful, and the part of the business where we see a lot of value for Tesco customers and therefore the Tesco overall of the brand.

If we now move on to finance, income and costs, interest payable pretty much flat year-on-year. Against some of the – the increase here that we are seeing is because of the debt that we took on as part of our property buybacks. We took on some bank debt which is now consolidated within the business. Those were 49 stores and two DCs. Capitalised interest continues to fall as we – as we – as we really build out the balance of the stores. Net pension finance cost is set at the beginning of the year and given where the – the interests were at that stage, it's fallen year-on-year. And then finance income is a mix of cash and non-cash. Within this number, the 40 million drop, overall about 203 million in the half is cash interest costs, so around 80% of the net finance costs are cash interest costs, which is important from a – from a modelling of what's happening with our cash.

In terms of tax, the tax rate in the half was 28%, we expect our full-year effective tax rate to be around 25%, and as we rebuild the profitability in the UK business, so we see some of that higher effective tax rate being reduced, as the profits come through. Overseas jurisdictions will continue to impact our overall tax rate and of course this year we also have the banking surcharge coming through tax. So, there's some moving carts, but a very significant reduction in the effective tax rate, with it dropping, and over time we would expect to see it dropping more towards a more normal tax rate for the whole of the group. We did have a small cash tax payment in the half of around £17 million, and that's really because we continue to focus on closing prior years and reclaiming tax and agreeing open years with the different revenue authorities.

Tax and interest are both continuing focuses within the business, as we look more towards the EPS part of our – of our overall income statement.

Exceptionals, just to remind you, we set out with the intention of not having exceptionals; we would want to run the business without exceptionals. However, if there are items which are sufficiently large, and significantly material, then we will bring them out and call them out separately. The restructuring and redundancy split's around 70 million in the UK and retail parts of the business, and just over 20 million in the bank, where there's been a significant restructuring activity as the Bank now sets itself up for the next three years as well. Within the bank as well, there have been the continued provision is made for the long-running PPI and Plevin[?] exposures, – and this now brings the bank in line with where it expects to – these to end. There is now an end date on the PPI from a – from a regulatory perspective.

The property credit is something which, given the size and scale, we have taken it out as an underlying offset against the charges we're taking, and this relates to the sale of properties, both in the UK and most particularly in our Czech business, where we sold a mall called Liberec, in the Czech Republic. This is against no exceptionals at this stage last year. So overall, a net 81 million exceptional charge.

If we look at the pension, and this is something which has had a lot of focus for reasons which are understandable, given the external environment and the way that this is measured. And I just remind you that what I said before is that the – what we're looking at here is something which we really don't look at when we're looking at the scheme, and when we're talking to the trustees. It's an accounting mechanism which measures the IAS 19 deficit, by reference to corporate yields. Those yields have dropped very significantly, because of the quantitative easing, but importantly, there has been no change in the underlying cash which we are going to be paying to our pension members. We've closed the scheme, as Dave has said. We've de-risked it significantly as we look at the potential variability in the scheme from year to year through our asset investment strategy, and that's processing well, in a market where the supply of the de-risking elements is relatively tight, we've done very well in de-risking. We have seen a 28% increase in the assets, and improvements in assets over the period, and that's offset some of what we're measuring here in the IAS 19.

The – most importantly, the funding framework which we set up, and I'm very happy to – to take questions on it afterwards, the funding framework that we set up with the trustees, which was designed to work through different market conditions, and to work through the triennial valuations, remains in place. We have a triennial valuation next year, off the March numbers. We'll see where we are when we get there. But, the framework we set up was one which was set up and designed to work through different market conditions, and designed to give a predictability to the cash flow, and we have that 270 million of deficit funding which remains in place.

If we then look to the movement in net debt, and again this is a format which we've seen before, we generated 850 million from continuing retail operations, we focused on the cash impact of exceptionals which we've booked, we've paid out 26 million, and we generated 131 million from underlying working capital. We continue to focus, having published our trading terms as to how we will pay suppliers depending on the category they're in and the size of the business we're doing with them, we're very clear on that and we are committed to that, but we continue to focus on – on improving the stock side of our working capital, and we've seen real improvements in stock days in our UK business and in our international business. That generated 131 million of working capital, 955 million of retail cash. We generated a small amount of cash from the Turkish business before in the half, through the cash flow, this isn't treated as discontinued but as you can see, it's only £9 million, which generated 964 million from operations. We paid 220 million of tax and interest costs in cash and we spent 540 million on X, giving us 203 million of free cash flow.

We also generated 290 million from the disposals of Dobbies and Harris + Hoole, and we generated 236 million from the sale of property assets, which I've already referred to. And then we have some other roundings, which bring the reduction in net debt to £758 million in the half. So, the movement in net debt and the on-balance sheet debt continues to be trending in the right direction, with just under 800 million reduction in the half.

And that takes us to the total indebtedness, and I think this is important that you understand how – how we think about the total indebtedness. Whilst it – we very clearly set this out as part of the way we look at the business two years ago, it is very clearly three different categories of that. There's the balance sheet net debt, which is the mix of our bank borrowings, the bonds that we've issued a net cash sitting on our balance sheet, and a very significant reduction in that over the two years from 15/16 and down to now. The second element, again a key element of what we spoke about are the lease commitments. We do seek to reduce these by buying back properties where they are available, where it makes sense, and where we want to trade from the properties for a long period of time. So we will continue to focus on that. And in the, in the period, it's pretty much flat from the full-year to where we are now. But again, very different characteristics in terms of these lease commitments, compared with the on balance sheet element of our net debt. And very different from the pension deficit, which is a very long-term commitment, will be met over the 80 or so years that the scheme is going to be around, and as I said, this is an accounting measure which – which doesn't really bear much resemblance to the cash flows that we're committing to with the trustees. So, three different elements, three different categories, and we are really focussed on managing the pension deficit through the long-term funding agreement, managing the lease commitments through the – the way we look at our properties and reducing exposures, improving the quality of the property, and then reducing the on balance sheet that through – through the ways you'd expect.

During the half, we did buy back seven stores, and then in the second half of the year, we – we expected this point to be buying back another two – two stores. Relatively small amounts involved, but as I've said before, it takes somebody who wants to be selling at a price which we are wanting to buy, and we continue to look for those.

So, from a liquidity perspective, we are in a strong position from liquidity – we've got £5.2 billion of available cash. Behind that, we have 5 billion of committed facilities. Since the period end, we've redeemed 1.2 billion of bonds which matured, and over the next 18 months we can see another 2.2 billion of maturities coming up. And we are focused on improving our debt metrics, and remain of the view that we would want to be an investment-grade issue.

So, coming to the end of the financials, it's been a strong half, and we've seen good performance and broad sales growth across all of our markets. We've rebuilt the profitability and we've seen further progress in that. We have a strong liquidity position and we have a more secure balance sheet. With that, I'll hand back to Dave.

The Four Key Stakeholders

Dave Lewis

CEO, Tesco

Thank you, sir. Great. Thanks. Okay. So, before I talk about the future, consistent with what we've done before, today, we will cascade to colleagues around the world what the performance of the group is in exactly the same way. We use the big six as the way of articulating it. If you were fortunate to go into a backroom of any store or be in any one of our facilities around the world, you would see this as appropriate to that particular operation. What it means at the group level; you know, last time I presented, it was all six green, actually we've got two reds now, right, at a group level. So let me say two things on that, not because the numbers particularly are important, as you'll see, but it gives you, hopefully, a little bit of an insight into how it is we, as the Tesco leadership team, are behaving.

Group sales

So you've heard the growth; we were more than 1% growth. We missed our target, our own internal target, of where we wanted to be by the half-year by £12 million. So it was – we had nearly £24 billion of sales and we missed it by £12 million. It translates to a few minutes of trading, but it's amiss, right, and I think it's one of the things that, as an indication, we did set ourselves a goal. We got there and exceeded it in the UK, we were ever so slightly shy of it in international, as Alan has said, and therefore what we'll communicate to our people is, against the staging post we set for ourselves, we were £12 million behind where we said we would be.

Colleague recommendation

The colleague recommendation is also interesting. We do it twice a year; we do it in January and we do it in the middle of the year. Year on year very significant improvements in both the UK and international, and across the group in total. But we did set ourselves ever so slightly more as the staging post for the middle of the year, and so we've cascaded to everybody the fact that we're not exactly where we would want to be; even though we've made great progress and against external benchmarks we actually, now, are in a very, very good place. But we said ourselves that we wanted to be a little bit better and we didn't get all the way there, so there's more that we need to do in the second half of the year in order to address that in January. But I say that to you just because it's the sort of conversation that I want to be having with colleagues around the world about how the business is doing. And I'll say – some of you asked me earlier – one of the reasons why we've articulated what we have about the future is I want to have complete consistency between how it is we talk externally and how it is we talk internally about our business.

Long-term value drivers

So with that, let's talk about the future then. Let's talk about these long-term value drivers for four key stakeholders. As I said at the start, we picked out three priorities that were germane to the crisis we found ourselves in two years ago, but honestly, as an exec team, we've looked at our business through these lenses since the very early days, right? So our – in setting ourselves some long-term goals for the business, this is the lens we look through. The plans and the aspirations we share with you today are plans and aspirations that we've had for ourselves as part of the turnaround, and now's the time for us to share with you. And this is the lens through which I hope the next stage of our communication together will be built.

Previous two years

So everything I'm going to say to you now is about over the last two years, right? And through the lens of that, I'll talk about, obviously, customers first, colleagues, our supply partners and then the new bit, which is how it is we think about our relationship with our shareholders.

Customers

From a customer point of view and one to – you know, we talked – if you remember, the very first thing we did, right, even though we were losing money and we clearly had some financial problems, was recruit 9,000 people in the UK and put them back into stores and serving customers. Over the two years that we've been responsible for this turnaround, we put 12,000 more customer-facing colleagues into our business. So the only thing I'd say to you is, as we do modify, and as we reshape and we change service models, and you see that in the UK now, please put it into context of 12,000 additional roles that we added as well. We have significantly reduced those colleague numbers in the areas of non-customer-facing, right? But we have not – you know, we've invested a huge amount of shoppers a little better every day.

A little fact for you, I always listen to every single bit of customer feedback I get, be it from customers, dare I say it; be it from the media; be it from some of you now and again, and you always share your views with me, I listen, but over the last two years we've had 2.9, just under 3 million customer feedback through our customer viewpoint in that time. It is – it's our own proprietary system, it's by far and away the most complete customer survey I've ever seen. We get it every week for every store, but I just – you know, as we talk about serving Britain's shoppers a little better every day, just thought we'd give you a context in terms of how much we are listening to; that level of feedback is gold dust, you know? Some of it is – thankfully some of it is now good, but also they're pretty good at telling us about the things that we can improve.

Colleagues

And the other thing I thought I'd share with you for the first time is what we call the 'front end' of the store, for those who are familiar in terms of that, so the cashiers and those customer service experience specialists; 57,000 colleagues here in the UK have had enhanced training about how it is we want to engage with customers in order to give that better service. So we talk about price, we talk about other things, but I just thought I'd give you a little bit more about what's driving the service agenda as we think about how it is we build value with customers.

Sales-based availability

We talked about sales-based availability. Our dotcom availability is off the chart, it's never been better; it really is running at a record level and that's why the customer feedback we're getting online is fantastic and why the subscriptions are so high. But our sales-based availability, i.e. that measure late at night, Thursday night, when you really want it, have we always got it? And I'll talk some more about that, but at 96% we're really getting to a place; much, much more, we start to have an issue in terms of waste, but that balance and that improvement has just been fantastic, especially when you look at it versus some of the stock things that I'm going to share with you in a second.

Customer spotlight

Now, this middle bar, we've never – I don't think we've ever really shared this with you before. We have another thing that we do, which is a, what we call, 'customer spotlight.' So the viewpoint is just our own shopping experience. The spotlight is one that we do competitively across the market. So every month we take 7,000, right? Those of you who are familiar with market research, 7,000 a month interviews about people that shop in Tesco and shop elsewhere within the UK. We then roll it up for three months, right, so 21,000 samples for what it is we're getting in terms of customer experience across all our competitors in the UK, right? Now, for reasons that you'll be clear, I've not named the competitors, but what you'll see as we go through here is, you know, we're not very proud about the fact that two years ago, when we asked about everything available, we were seventh, right, we were seventh. Where we are now, neck and neck leading in terms of availability, and I'll show you a little bit more data on that in a second.

But that's how we judge whether we are making progress. You saw in the announcement, when I said we're making clear gains against competitors on the things that matter most to customers, this is the data on which that is based. The interesting thing is that increase in service, increased availability and increase in customer satisfaction have come by reducing the stock in the business by more than 16%, right? All of the things we talked about in terms of range reset, all we talked about in terms of putting our business together and the way that we've worked with our suppliers, everywhere from demand forecasting all the way through, has allowed us to improve the quality of service, improve the price to customers and lower the operating costs and the stock, and the working capital tied up in the business.

Pricing stability

In terms of more stable pricing, you know, 6% lower; you know, we've kept that basket. You've – you know, I've always been keen on not talking about tens of or £100 millions of investment; it's not at all what customers see or appreciate. We've always looked at the basket and we've always looked at what it really costs people when they walk out of our store, and that's more than 6% down year on year. Our promotional count, over those two years, is down nearly 40%, right? We've stripped out that indirect pricing and we've put it into base pricing. For those who are eagle-eyed and have been around as it rolls out, you'll see also that as we moved and invested so much more in getting our prices competitive, that translates into a more confident, clearer articulation at shelf of what the price is through very simple things, like the shelf-edge labelling that we do. You know, for those who do watch this in detail would have seen some very complicated, overly confusing shelf-edge labels and we will progressively improve our price communication for customers as we change.

Range reset

Look, the – we talked about the range; we've talked about the fact that we've moved to a simpler, more relevant range. Over that two years' period, that's a 23% reduction in total. We have managed to invest in and increase the amount of space that we've put to a higher-quality own-label offering; that's also a very good value-enhancing experience for our customers. And for those who always ask me about range reset, does that mean that there's somehow a dearth on innovation and newness? Actually, you know, 3,194, to be precise, new innovations, new products have been introduced during that period, so there's no lack of innovation as we've made those ranges better for customers.

This chart you've never seen before, right? And I picked this chart in here because, in a way, if I were to pick one chart that articulates almost everything we've been trying to do for our customers, it would be this one. So same spotlight information, and for those of you who are looking at the competitors and trying to take a colour and equate it to who the competitor might be, don't. We've mixed them up, all right? So there's nothing to be done there, so I know the game you all try and play. But what this is, is again, from customers, period six, where we were a couple of years ago. Was everything you wanted available? All right, again, how customers judge it, or how – is everything you want available? We were here. All right, so the red line is Tesco. And what you see is, as we have – and Jason and the team and Tony and the team at Matt and the team – have changed the range, simplified the range, changed the service model. All of the things that we've been talking about, you see that actually our availability has gone from being the worst in the marketplace to the best in the marketplace, all right? And that's how we judge the progress that we're making, all right?

If I take that one step further, in terms of customer recommending, so people are having experience with us, who are then recommending to other people whether that is something they ought to enjoy for themselves. Net promoter score up 13 points. Huge leap in that time period. And on the same measure, betting shopping experience from the bottom of the pack to joint third. Not where we would want to be, so whenever I say there's much more we can do, this is what I'm talking about. It's progress but there's much more that we can do. Helpful colleagues: six out of seven, now third out of seven. And if I were allowed to – if I were to let my team just have one period rather than the rolling, they would point to the fact that over Christmas we were by far and away the most helpful retailer for UK customers. So we can be, we want to be – it's part of the brand, part of the proposition – but that's where we sit for the half year, all right? Those are the things that we're trying to drive as we build value for our customers.

And on top of that, we have some little helps – not so little sometimes. Brand guarantee: unique. Means that people have peace of mind that they never walk out of our store versus the big four with a branded shop that they've paid more for than wherever they might have bought it in the big four. You've seen free fruit for kids. We didn't think it should be just for kids, so there's some for you outside, so do me a favour – pick one up on the way out, because otherwise we'll donate it. But that's another example of how, you know, one of the things customers tell us, 'can I get my kids to eat more healthily? How do I keep them entertained as I take them around the store?' Actually giving them a piece of fruit – phenomenal experience, and great feedback. And interestingly an idea that came from a colleague in a store that was picked up, everybody liked it, and it's now available across the estate. And for those who are in more to the technology, we introduced PayQwiq in collaboration with the Bank, which is our own payment system that links to the loyalty card. It's now available in all of our large stores and rolling out.

So that's what we've been doing to build value for customers. To colleagues, you know, a great place to work. We want our collages – you know, we've faced into some very difficult things in terms of turning the business around. The interesting thing is through that period, the engagement of our colleagues is sharply up – the motivation to go the extra mile. And actually colleagues recommending us as a great place to shop – significantly up, all right? Really important to me. Our colleagues are some of the most knowledgeable customers we could have, and a number of initiatives that we've done we've launched to our colleagues first so they experience it before it is they give that experience to a customer, and have a guess what: as they see what it is we're doing for our business, actually they become much more, much more prevailing in terms of their willingness and their recommending Tesco as a place to shop, all right?

Investing in Colleagues

We've invested in colleagues as well as – back again – talking about the number of colleagues, there were some, you know, not proud to say it, there were some basics that we needed to invest in. That actually translated to things as simple – two years ago was investing in uniforms and in presentation and in all of those things. We've continued to do that. We listen a lot to what it is colleagues need in order to serve Britain's shoppers a little better every day.

We had a very difficult first year where we had no inflation in our payroll because of where the business was, so everybody inside the business took a hit in that sense, but did, because of the performance, benefit from the turnaround bonus, and as you know, we've agreed a two-year deal, which is a 3.1% increase in base. So actually now our colleagues are feeling some of the benefit of the business improvement, and that, I think, is an important and sustainable way for us to be thinking going forward.

And we've done some other things in terms of value rewards, so actually we've enhanced – historically, families could only have one privilege card. We've extended that so there are two privilege cards so husbands and wife can both use. So we've listened to how it is we can make the value of working for Tesco can go further and we continue to listen and invest in that.

In terms of closer to customer, you know, that purpose we talked about. Interestingly here, you know, a survey of 245,000 colleagues in the UK, you know, the three numbers there are, I understand the purpose of the organisation, I'm motivated by it, I get it and I can see what it is I can do to contribute, all right? I've been involved in some change programmes in my time. The scale of the change program in Tesco is – is enormous, but a number of you have fed back to me how much you've appreciated what a change you've felt in our stores over time and this is what's driving it, you know? All of our colleagues have training directly in that purpose of serving Britain shoppers a little better every day, and the feedback in our survey this time is 96% of them get it and are motivated by doing it.

We've been much more consistent in our management structures. Whilst we've put colleagues in it we've been much more challenging about what the right way to run stores is in the management group. And significant for us is a new scheduling system. And what that does is it gives colleagues much greater forewarning of what the plan is coming down the tracks so that they can get their store ready for it coming. Historically you might not find that out until right at the last minute, but now, in these three big test stores, they have a four-week window where they know what's going to be coming. And it allows them to prepare their stores just better. So small changes, little changes, but they're all designed for colleagues to be easier, simpler, and more effective in serving Britain's shoppers a little better every day.

You know, I'm often asked – and we've not talked about this before – about employment. I've talked about in total but over these two years we've granted and we've run 3,000 apprenticeships in Tesco. All right? We've taken on 450 graduates here in the UK. Tesco has always been a place – and not something started by me – but always been a place where people could get on, and it's interesting that what we're talking about here is nearly 4,000 colleagues who have been promoted as we've gone through this change programme. We support the Movement to Work. So for those who are not familiar, this is long-term unemployed, and – and we've granted 1,000 new starts as part of that programme as we redevelop and as we reopen stores, we're very active in that space. And that great place to work is something I'm personally very committed to.

You know that we've moved. Some of you actually have been out to visit us at Welwyn and – and see how it is that the team all comes together. Feedback from colleagues has been really very positive to that, and we have – for those that asked me the question – we have sold the old Cheshunt building. That's one of the property things that Alan was talking about. And this – this drive to build one Tesco team – we're not competing with each other. We're not. We're going to serve customers a little bit better by all coming together and how it is we link different parts of the business. For those of you who are very familiar with the inside of Tesco will appreciate how much of a change and difference that is.

And the other thing we've not talked about before, but we spent two days again last week talking about how it is we build a more inclusive culture, all right? It's a very broad church in that sense that, you know, we have 320,000 colleagues here but half a million colleagues around the world. And one of the things I thought I'd share with you is we have an organisation – an LGBT organisation in Tesco called Out at Tesco. And we have the largest LGBT network in Europe that work and are active inside the organisation. So how are we building value for colleagues? Either through simplicity or indeed in terms of development. That's what we've been working on over the last two years.

Supplier relationship

Now, apricots – no, suppliers. Under Jason's leadership, you know, obviously this was one of the things that was somewhat a bone of contention when we met two years ago. We've fundamentally, radically overhauled – completely changed – our approach to commercial practice with our suppliers. I can't put it more fundamentally than that. The approach says we're going to move from 24 forms of investment in our relationship to three. We've done that already with our own label supply. We're there already. With some other brand of manufacturers we've said we'd go from 24 to five on a step to three. Pretty much everybody is on that journey and we're happy. Without wanting to give anything that's competitively sensitive away, remember we talked way back about the amount that was back margin and front margin? Of the back margin that was there, we had a very clear target of where we wanted to be in order to move it. So we didn't want conditional money, we wanted unconditional money in base prices in order to be able to give it to customer and drive the volume. Over two years, we've moved 91% of that back margin into the front. Right? That's a – you used to ask me questions back then about how the hell are you going to manage to that, what will it mean for the relationship? Jason and the guys have been absolutely brilliant. By the way, so have our suppliers. So have the partners in terms of coming with us and seeing that the benefit of supporting Tesco rebuild volume is beneficial to everybody. But that is a hell of an achievement.

We are, we did, and we published our standard payment terms, all right? I think we're still the only large food retailer in the UK to do that. And you'll see in a second we're completely compliant with those trading terms. There's a lot here, all right? There's a supply – we set up and reinvigorated the supplier network, so we have a network with 5,000 supplier partners who are members. We set up a help line because they told us they found Tesco a complicated place to deal with two years ago. There has been a little bit more than 500 calls thus far and we always have a good metric in – in Tesco, so we're 99.95 resolved within seven days. So our commitment to any suppliers and any issue in terms of how it is we work is that they have a direct line in that they can solve the issue. We did set up a supplier protector line in the same way we have a colleague protector line. We have twenty issues raised with us, all of them have been solved, right? As we've gone through the change in the commercial practices that Jason has led. We've trained 1,238 people from – there have been courses run which educate our suppliers as to how it is Tesco runs and therefore they can engage with us better. And, you know, approximately 8,978 courses have been completed in terms of buyer training over that time against the new way of working under Jason's leadership. And I just thought I'd put in here – I checked again and I look at it every month. When we said small suppliers to Tesco, I – under 100% will be paid – i.e., actually receive their money – in 14 days. Third period: 100%. So if you talk to our smaller suppliers about what it is and how it is to deal with Tesco, that's what's driving some of the – the feedback we've had.

Supplier feedback

That feedback is here. Simple, transparent, and easy to deal with was 36% in 2014. Now it's 61%. More that we would want to do, but big progress. Communicates, 44%, now 72%. And treats me fairly, 55% to 73%. That's in total. If, you know, Jason happens to be here – who's in town – you can ask him the question later, but I'll spare his blushes. If I take the UK alone, the UK is stronger than that. If I take the UK and I break it down as to where we started, the first place we started – you'll remember – was in fresh and actually the relationship we have in fresh. And if I were to put that together for all of the suppliers who work with us in fresh, that number would be 93%. All right? So 93% of the people are engaged with us in the turnaround in the produce area – and I'm going to talk about produce in a minute – would say that Tesco treats me fairly and be very positive about that that relationship has been. And I – I pay tribute to the people that have changed that.

Some outside recognition. You will have seen just recently, but in the annual report the adjudicator made the following comment in terms of the feedback they were getting. So not from - not via us, but some suppliers about the improvement that they were feeling, and Tesco, by far and away, the most improved. And indeed, in terms of following up on the adjudicator, I think there's a press release recently about the follow up. You know, we did our own inquiry, they certainly did their own. There was series of recommendations, we report on them, and following that there was a report from Christine Tacon about actually the level of satisfaction of what it is we're doing, right?

Right, I thought – spurred by Chris – and some of your feedback is, 'Give me an example. How does that all actually play out?' So, here's produce. And with their permission, AMT and one of our partners – it's the Munoz Group? It's a partnership at Tesco. Predates me. It's a very good illustration of where it is we would want to be in terms of end-to-end partnering. We were – there are basically – I'll keep it simple, if you'll allow me. They are our citrus supplier, all right? They're our citrus supplier. We work with them on varietal development. In fact, Jason and I had the pleasure of going and opening one of their R&D centres in terms of how it is we work on them on new variety development. We work with them on global supply, so they are not just in Spain, they have other facilities around the world. They work with us in terms of crop optimisation. We've done a lot of work on packing and consolidating at source. We joint risk manage. We have an open book arrangement in terms of what the input cost, conversion costs, transportation costs are so that we can optimise the business together. It's completely open. AMT is, you know, Munoz and Tesco. And we do category leadership with them together. That relation is what drove two days. By changing the model end to end, we gave to our customers two days more freshness on shelf. All right, massive, great for customers, great for operations, great for our suppliers. The supply chain savings that came from that change about £5 million shared between, and the sales growth – 11%. So by changing the way you work with us, the volume growth and the way of working means that you can lower prices for customers and enhance the profitability of both businesses.

We've done it across – I kept it all to produce. Reducing the surplus production – key and important element of reducing waste, but also maximising the return from a crop. John's in the room, but we had the Board recently standing in a lettuce field in Peterborough as we walked them through the supply chain to show how it is. We're working and sharing demand forecasting literally down to when it is we decide to harvest that field, versus that field, versus that field in order that we do not drive waste into the supply chain system, and that's what's lowering the system waste that you see here, and ultimately improving the quality.

And an example – a couple of examples that I love. I don't know how familiar you are with crop flushes. We did it once in the first year. We've done it six times or so – in fact slightly more – and this is – what this is, for those of you who are familiar – and all new to me over the last two years is, you know, hitting a demand forecast as a farmer is difficult, right? It's really difficult. You don't know when the sun's going to shine, you don't know when it's ripe and what the crop will be. So we have a demand forecast and – and everybody doesn't want to short that, so they always produce a bit more. If you only take what the demand was, then you've got some waste. What we do is we work with our partners to say – and these are examples of when, just after that period – in fact, actually it was that period that the Board were there – there was a huge amount of iceberg lettuce coming out of the fields early. We worked with them very short order – these things happen in days. This might be a Monday conversation or a Tuesday conversation. We open up our network, we buy all of the crop. There's a marginal cost to the crop. The farmer gets to sell everything – no waste. We manage to keep a small amount of margin as we go through. The customer gets a hell of a bargain, but nothing's wasted. So these are six examples of crop flushes that we have managed by working with our partners together in a completely different way. Bottom right-hand corner – avocados. Anybody been in South Africa will know there's been a drought. A lot of avocados come from South Africa. There's a size specification that everybody would want for an avocado. Because of the drought, avocados are smaller this year. All of them will be outside of the quality spec. Never forget, sitting with Jason and the rest, having boxes of avocados on the – on the Exec tables – I kid you not – as we went through looking at – quality was fantastic. Absolutely fantastic. So we did a deal. We bought all of the small avocados, because otherwise they would have gone to waste. At the time – correct me if I'm wrong, Jason – avocados in the stores were £0.75. We sold all the small avocados for £0.49. Farmer got to sell the crop that otherwise would have been outside of the spec that we had set. We had a benefit. Customer had a benefit. Just to try and illustrate how it is we're working together with them.

Farm Brands

Farm Brands – Alan talked about it. Really happy with the success. They've actually been more successful than we thought. It was a very big investment for us. In the end it wasn't as much of that because actually the volume was better, the prices were better, and actually the mix was better. And so actually that's one of the reasons why we did well in the first half. More than 80% repeat rate. So we test them every week versus a competitor benchmark to make sure that the quality is good. And in terms of a – meat and produce, those are the amounts that category price went down. And the thing that might be interesting to you, and you know, I've – I've always hesitated in terms of the competitor commentary, but if I take, over the six months that we've launched them, an unweighted look at those Farm Brands in those categories, and I look at the same offer in our, you know, five other competitors – we've been the cheapest. Right? So by working in the way that we did, plus the investment we did, we were able, through the Farm Brands, to be the most competitive offer in the marketplace over six months.

That's what's driven the outperformance in meat and produce. We were further ahead in produce. We had more to correct in meat, so they run at slightly different levels. But the volume outperformance has been really very impressive.

Shareholders

Right, shareholders. The new bit. The new bit. Look, no surprise to you, we talked about it every two years: business model. Volume-led recovery, positive volume growth into that operational leverage, and hopefully we've given you enough examples of how that works. First call, invest back into the customer to be competitive and serve them better. And then allow, you know, some margin recovery which is what we've seen in our numbers. But in that sequence and in that order.

Now the strategy exercise that we did two years ago and again every year, we identified six strategic drivers for our business that we've been working on. And what I'm going to do now is you saw in the releases I'm going to give you some headlines for each of those so you know what we're thinking and later today, from Chris, you'll receive an invitation to an Investment Day Welwyn Garden City on 16th November, where what we're going to do is with not just myself, but with the team is take you through some more detail on each of these six.

So what I'm going to do now is I'm going to give you a flavour to set up for that because actually to understand them in detail will take some time, but it's also a chance for you to come to Welwyn, engage with the team and get some real sort of substance around what these six are, but I'll give you the headlines now. A differentiator brand, like if you want to do this academically, brands long term add value for shareholders, all right. It's as simple as that. There's an opportunity, I'm absolutely convinced for us to add more value through the brand. How are we doing that? The purpose is huge for us. This is huge for us. Every little helps serve Britain shoppers a little better every day. Everything we do has to ladder up to that. Every little help serves Thailand shoppers a little better every day. Everything that happens in Thailand has to ladder up to that. That is important. That element of helpfulness is a key differentiator in the Tesco brand and I've given you some feedback on the UK in terms of how well that's started to be embedded in the business.

The proposition you've seen this from me before, the brand guarantee anything, brands that are the same, competitive always. And then we look to invest in those things which are unique and different. Tesco on label being one, lots of other elements to that. Brand guarantee is unique to us. The range that I talked about and I showed you in the chart, you know market leading on range, getting to a place to being market leading on service and helpfulness and much more competitive on price. We have Clubcard. We have Exclusive F&F. We have the bank. We have mobile. That's the elements of differentiation that we can bring to the relationship with our customers. And a lot of investment in on own label and here to take one example, but going back to that entry level, the core, the finest, you know good better best for those who are historians of the business.

We think that's a very important part of the unique offer of the Tesco brand and it is one that we will continue to invest in and those who were eagle-eyed would see as we go through category resets. How it is the own-label brand is being relaunched and invested, invested in. So that's number one. Number two is how we're going to reduce the operating cost by a third to one and a half billion over three years. There are three buckets. And again I'll give you some insights to them in terms of store operating model, logistics and distribution goods not for resale. That one of the reasons I want you to have this is every time one of the things I have experienced is every time I talk about cost, not so much in the analyst community, but certainly in the media everybody goes to restructure and staff, and actually a huge amount of the cost that we have to take out is not headcount, right.

It's just about reshaping how it is we run our business and the efficiencies you know, you'll see that as we walk through here. In terms of operating model, you've seen some of it. So there is some becoming more agile. We have on the base let's keep it around numbers of just over 400 we've taken the 24 hours off of around 150 because actually it's not economic to keep the store open overnight. So we changed the model. We brought the filling on today's. We changed the shift pattern. That's the consultation that you read about now. We still have 250 stores that are open 24 hours where there's a demand and a need for it. So we've looked at consolidating – you know customers hate the fact that if they have an issue they go to this desk for that, this desk for another, that desk for another. By consolidating you give a better experience and actually it saves you money. So it's not a bad thing for us to do.

Scan as You Shop, a very good way of changing the model and those you will have seen if you watch in the advertising that for the first time ever we advertised the benefit to customers as Scan as you Shop just recently. In terms of logistics and distribution, a number of things in this space. The things, I talked about if we manage to take 16% stock out as we worked with our supply chain differently, then that has potential ongoing efficiencies that allow us to think about logistics and distribution differently. So the partnerships and sales forecasting and forecast accuracy for me, hugely important. Our fulfilment costs need to continue to come down and we can see ways of doing that as we integrate the supply and the logistics. We have an opportunity to leverage a little bit more internationally than we've done in the past and that will lower costs for everybody.

And there's – you know I'll give you an interesting insight is this there are some packaging solutions which we've not yet adopted. One of the things I learned supplying Tesco years ago was the concept of direct product cost and direct product profitability and the cubic space of what it is the product had. As I look at what's happened both in the supplier base and indeed our own retail operation, actually there's a waste of space and we need to deal with the waste of space and that's what all drives some of the improvement that you'll see in there.

And here we call it goods not for resale and our different competitors call it different things. But basically this is purchases we make in order to run our business, be it toilet rolls or be it a service provision that we do obviously don't sell on. And we've never bought that as effectively as we might. A big piece of work has been done on that around a single procurement policy. There's some transformation in finance and IT systems that are going to help this and there's a functional roadmap to get to a place where we get the leverage of our scale into this area and it's not a small amount of money. This is not a small amount of money that we spend running our business in this space and we're clear that there's a 500 million opportunity. So that's where the cost opportunity sits. You picked up the 9 billion cash from what it is we put into the targets. It's obviously the things that drive the margin improvement. You know quite an important part again to the cash.

The stock reduction that Alan has touched on and the working capital and what you see is the capital discipline we were very tight. We've given you some – we will continue to be 1.25 for this year. But as we walk through the change programme there's some additional money that we will invest in order to make the changes I've just talked about so our three-year average on capex will be 1.4 billion through the life of this plan. Difficult chart, one of the other ways of generating cash from the operation is to stop investing capital in loss making businesses. This is the history from 2009 and as you can see from 2014–2015 we've taken a slightly different approach to that. And you have my guarantee it will continue because there were any loss making businesses and we still don't want any capital associated with them.

Now what we call Maxing the Mix, right, and what I'm going to do is share with you an insight in terms of how it is our think emerges in Tesco which is we look at it through lens, geographic lens. Actually, the profitability of one country is better than another so that should play into how we make investment decisions all other things being equal. Profitability of channels is different all right, and the profitability of different products and category groups is different. So how do we think about that as we look at how it is we can figure ourselves what we sell where? We call it Maxing the Mix and this is the illustration of principle.

So if you take and for this sake, let's take this is a – you know a UK example large store, small stores and online, which is how we run the business now inside and we have four sort of key categories. The absolute margin for our business is the bottom green. You'd not be at all surprised I haven't put specific numbers on for each of those boxes. I hope. No surprise by that, are you? Good. What I'm trying to illustrate is the average is the X and there are certain boxes which are above or below X. So the challenge for us is how is it we think about the overall large store operating model in a way that lowers the cost for all categories. So there are certain initiatives that make large stores more efficient, more effective. I've talked to you about some of those already and there are certain things which are very specific to a category in a particular channel.

And we look at our initiatives in terms of their ability to influence the mix all right. So that's what we talk about in terms of Maxing the Mix deciding how it is we invest and how it is we think about what it is we sell where. We touched on property. Alan talked about what we bought back our total retail installation over the last couple of years is 120 million. All right, so it's not an insignificant amount of money as we've avoided those rent increases. We have looked at property asset optimisation. You've seen in terms of some of the sites that we've sold in the UK. I apologise for the fact that there is a cartoon of a store. There are two reasons for that. One is every time I put up a store in the context of this it gets to that and somebody says well that's so and so. Does that mean then that store? No, we're not, we're not there. I don't want that sort of speculation around that's not what it is. And where we do have property asset optimisation with partners actually there's some confidentiality about showing that particular development before it's been revealed elsewhere. So that's why you have the toy time graphic so just to explain that.

And Alan's already touched on it we have looked at how it is we can realise value from non-core assets and Steve has done an absolutely stunning job on exactly that.

And the final one from us is innovation. Right, there's a whole stream on innovation and this is the one that you like the most because I talked to you about brand guarantee, talked to you about Farm Brands. I haven't talked to you there about food waste. Definitely market leading in terms of food waste and what it is we're doing there, something we're extremely passionate about. We are committed that no food that's safe for human consumption will be wasted in Tesco's retail operation by the end of next year and we've done a phenomenal amount on that. All large stores by the end of this year, brilliant achievement and what you've seen in terms of technology, but there's more to come.

There's more to come and I suppose this is the bit that when – if you were to come and see us on 16th November you might go away ever so slightly disappointed because I'll give you some indications of what we're going to do, but you'll appreciate this is the one that we're not going to lay out what we're going to do over the next three years because that's where we get to the competitively sensitive stuff. Six drivers, importantly I suppose what you know people ask me Dave, why are you doing this now? Why are you giving some clarity as to what it is you aspire for the business now? I'll give you two or three bits of feedback on that which is that we've now got ourselves to a place which is we think the crisis is over. We've stabilised the business. We have made progress on the three priorities that we set.

Now we feel is the right time to set for all of the stakeholders, but particularly for our shareholder, some of the aspiration that we have always held for our business, but we sit in a place where we have more confidence. You know we don't have all of the answers and we don't know for sure everything that happened, but you know on a very balanced view we have a good perspective of what it is we're going to try and achieve over the next three years and we wanted to share it. The third thing is I want to share consistently inside and outside the business because as I share this with you and I share it with colleagues inside, it engages around what it is we're trying to do to the total business. This is part of the culture we're trying to build and the ownership and the way that we reshape our business to deliver what it is key stakeholders need from us in terms of their commercial return.

So now it seems the right time for us to do that for all of the stakeholders that are in the business and that leads me to the last chart which is think we'd say to you over two years is a broad-based improvement across the group. We made the progress on the three priorities. We did invest in the fresh food brands and it's succeeding for us and indeed for customers. We have six drivers that we'll talk to you about over the three years as we progress, and we believe that they're delivering value for those four key stakeholders in the way I have hopefully given you an indication for. And so you know market is tough. Yeah, it's not getting any easier. You know all of that, but we have a confidence that whatever that market condition is we as Tesco can indeed fair well within it. So with that I'll stop and take any questions or like Alan and I'll take any questions that we might have right.

Tell you what, why don't we start down here and we'll move across the front and then go backwards. How is that? Yeah gentleman here?

Q&A

Edouard Aubin (Morgan Stanley): Yeah good morning Edouard Aubin from Morgan Stanley. So in April, you told us that your UK margin would fall sequentially in H1 and it expanded by around 20 basis points. As you said so I guess what happened is it just related to Farm Brands? And more importantly I guess your full-year guidance implies for the UK and EBIT margin in the second half of around 1.6, 1.7% so why the more cautious you know trajectory regarding the margin that UK is just lowering the bar so you can beat it?

Dave Lewis: No it's not. It's about reflecting – in all seriousness, it's about reflecting into the marketplace the forecast that we have inside the business. Right, it’s as simple and straightforward as that. Look when we – so I'll give you some details that we've not given before about the first half year. When we sat and made the decision on the Farm Brands in totality with the assumptions that we had there it was a £420 million investment. Not a small investment given where we were and we didn't know what the outcome would going to be, and that was the big uncertainty for ourselves. There were uncertainties elsewhere, but uncertainty for us in that first six months because of performance because of mix because of a number of other things. It didn't cost us that they've succeeded and they didn't cost us all of that. And as a result the step down that we thought we might have from that investment in the first half year didn't come great and therefore you see the performance that we have.

In giving you some guidance about where we go for the balance of the year is just a pure reflection of the investment plans we have for our business right. So that was what happened there and it relates directly to that one thing. But I think I've always said I see lots and lots and lots of opportunities to keep investing in the business in order to drive the wheel that I talked about before. And we're going to continue to invest in the business as we go forward and that investment yields profitability you know balanced as we sit now of 1.2 billion and that's what we've shared. So it's about our willingness to keep investing and we'll get ourselves back to you know a 50-50 split in terms of profitability this year. It's what Tesco historically did.

We thought we would have a curve that would be uneven and actually because the Farm Brands have worked, it's been better in the first half, but we're going to continue to invest in the second half year. It's not, it's not over all right. And as you saw from that volume first, yeah invest in the customer and then margin recover. And that you know if we get 1.2, we're nearly 30% profit year-on-year improvement and that's probably a sensible level in terms of how it is we – how we step forward to make it sustainable. Okay. Why don't we just – I'll keep it practical and move that way so that we have a problem with the mike, how is that?

James Tracey (Redburn): Good morning. James Tracey here from Redburn, two questions from me. The first one is on the 3.5 to 4% margin target. What sort of like-for-like sales growth assumptions are embedded within that?

Dave Lewis: Okay.

James Tracey: I can see you answered already.

Dave Lewis: Yeah.

James Tracey: And why not reinvest the excess margin back into the customer proposition or have you already you know, have you done enough in terms of customer proposition that you wouldn't want to drive the like-for-likes more.

Dave Lewis: I think look we – so let's answer the first one as candidly as I can. I'm not going to give guidance in terms of what I think the like-for-like is in there. We have a number of scenarios as to what might happen in terms of market pricing, but it's extremely subject to the assumptions that we make. So we're not into a place. We obviously have an assumption, but we're not going to – we're not going to put that because that's definitely the one thing that is outside of our remit in that sense. In terms of you know we've invested a lot in the customer proposition so the opportunities now are very much more specific. It is possible to have an initiative that you know it doesn't yield. So the big challenge for the UK team, but all the teams is picking where it is we make the investments and on what time and what place with what support, and that's just the planning of when is we lay down particular activities. So you know we shared the forecast based on the operating plan that we're going to run and a bit like last year if we see other opportunities and if we were to get ahead then there are things that we can invest in, but that's just the balance. That's the way that we operationally choose to make the calls inside the business.

Question: Yeah thank you. As we've been told by a lot of retailers, margins are an output. In that respect two points, firstly, what do you think would deflect you from hitting your targets over the next two, three years and where does supply relationships sit with or supply chain sit within your aspirations because you talked about Opex, store Opex and logistics. Is there much more to come from the supply chain?

Dave Lewis: Yeah two, so let me take the second one first. When I talk about supply chain and logistics it's actually is the end-to-end. So if I have given you the wrong impression that's not. So this – in of you know margins are an outcome, but as I told before one of the things that I'm very keen for the whole of Tesco to have is a view of the aspiration of the business both inside and out all right. It frame some of the way that we go around some of the decision-making that we make. It actually forces into our thinking different ways of how it is we run the business model and probably makes us and encourage us to face into some changes that we need to make otherwise we wouldn't. Suppose the one thing just be absolutely categoric, just by setting some margin aspiration the idea that we go back and change our approach on commercial income – not at all. Absolutely not at all. We're going to do that in a structural way, but by being clear about it, Clive, it actually engages everybody in what it is we're trying to do in terms of restructuring and reshaping the business.

You know what could we – you know what could knock us off: look it's never been more uncertain in terms of what the future would be. I know people laughed at us in April when we said you know who knows what's going to happen over the next six months and you know it wasn't actually about prediction. There were quite a lot of things that people didn't think could happen. Look like – consistent deflation of a very protected period of time will put a lot of pressure through the model. You know it will. If there were to be you know an irrational customer competitor activity we'd have to deal with it. So you know it's not a promise. It's not a guarantee. It's an aspiration and if there were something material that happened out there that forced us to respond, I'd come and explain it to you in the way that I've explained everything over the last two years.

But everything we can see you know everything I look at exchange rate or other, actually our relative position versus other retailers in the UK is actually quite strong. We have an international hedge against exchange rate that others don't have. So actually we've got to get confident that whatever the weather is we can actually be you know one of the best performing businesses in the UK market, and we have some confidence that we can do that.

Do you want to pass it down this gentleman here? Thanks.

Stewart McGuire (Credit Suisse): Good morning. Stewart McGuire, Credit Suisse. Two questions for me. Number one, the uptick in CapEx –

Dave Lewis: Uh-huh.

Stewart McGuire: – is that going to translate into space growth at all or is that into purely the operational aspects? Second question, online in your colour matrix, online is red, red, red, red, red. What are you going to do to make that like –

Dave Lewis: You have to come on 16th November for that.

Stewart McGuire: Okay.

Dave Lewis: And that’s the tantalising bit, right? So, look, the – Alan can add on the CapEx. There is some space expansion modest in the UK. It’s modest in the UK but it is so in the – in the UK. A couple of large stores, 26 or so express stores. It’s more in places like Thailand, so we still have space expansion aspirations in – in that fast – sort of fast-growing market.

But quite a lot of it is in some of that infrastructure and the productivity improvements that we – that we want to drive that actually contribute to the – to the cost savings that we've announced. So the delta is more to – relating to that change programme and the cost savings, whereas the other is relating to the 1.25 we had before.

And, look, the fact is, if I look at online and I look at it particularly in – in general merchandise and what have you, it is – by the way, it doesn't say loss-making, right? It says it's a margin that's below the average of total. So the question for us is how do we step it forward. So everything can make a contribution by being better tomorrow than it is today even if it's below the average, alright?

So we'll tell you a little bit about what it is we're going to do. And if you're familiar with what we've done in Fenny Lock, you'll see some of the things that we've done on – in General Merchandise and GM Online as a precursor to where we're going.

Bruno?

Bruno Monteyne (Sanford Bernstein): Bruno Monteyne from Bernstein. Three for me. So you say in terms of the –

Dave Lewis: Oh, no. We should have one each. I didn't say that, so go on, Bruno, quick. I'm sure they'll be short and very easy to answer.

Bruno Monteyne: You talk about the extra footfall in the business. Is that the increased frequency you were looking for for customers that only did a few shops with you? So do you see that change in shopping behaviour, bringing an Aldi basket back?

The second one, international profitability level was too seasonal and it's clearly a big step down in H1 from H2 last year. Are you saying there's seasonality in international profitability or has it been a big step back? And if so, why?

And last but not least, dividend reinstatement given your margin guidance, how much cash you're generating, how much further out is that?

Dave Lewis: I'll take the first two. Why don't you answer the third, Alan, is that alright?

Alan Stewart: Yeah.

Dave Lewis: So, look, the – what we're seeing in terms of metric is more people and there's some indication of coming more frequently, to your points about frequency. But actually, the biggest – and the reason I pulled it out is actually it's the delta in terms of more people coming back, which is what's driving the switch in behaviour that you see, alright? So there is some more frequency, but actually, the most important thing is actually more people coming back in to – into store.

Actually, I've – I've looked for ten years because I was looking at this myself. Actually, international has always been more second half than first half. It's only in the very recent past that we changed. And I think part of that was about adjusting and trying to help elsewhere in the group. So actually, it's always been, if you look over ten years, more seasonal in the UK. The UK has been the one that's actually historically been 49-51 type thing.

So actually, there's nothing fundamentally different apart from getting back. I think in – in fairness to the international team, they're confident about their phasing first half, second half.

If it hadn't been for the changes in Poland around legislation and all the things that came with that, I think we would have been – we would have still managed the tough market, as Alan says, in line with our plans. But that was a – something that came outside of our control. So I'm not – I'm not concerned about the international profit delivery.

Alan Stewart: Yeah. The only – you remember actually international last year, there was some threat of potential taxes in one of the European markets which didn't actually come to roost. So there was an element of credit in the second half of last year, which we were still accruing for in the first half.

Dave Lewis: Yeah.

Alan Stewart: So – so there's an element of – of that. Now, there are still potential challenges in some of those markets today.

As regards to the dividend, today is too early to talk about the dividend. Nothing has changed in terms of our – what we've said before, which is just to remind you the – we don't necessarily put investment grade rating in dividend in – in any particular order. Clearly, there's a linkage between the intention to pay dividends which are sustainable whenever we return the dividend. And equally, we won't – we would want to be doing that in a way which didn't damage wherever we were in terms of that investment grade, whether we were there or not yet there.

So nothing changes, but it's too early today to talk about dividend. Clearly, we've – we've – we're focussed on cash. We're focussed on the – the net debt and the balance sheet and our cash commitments. And improving business performance drives all of those and creates better conditions.

Dave Lewis: Indeed. Now, as you pass the microphone, I can see now why Chris is now scowling at me. I was supposed to say, the feedback last time, there was – by asking people to stick to one particular question and that was appreciated. So at the risk of incurring Mr McCarthy's wrath, if you pass it over there, Dave, you've got one question for me.

Dave McCarthy (HSBC): Yes. My question is how many questions I have?

Dave Lewis: I deserve that, yeah.

Dave McCarthy: Yeah. Just a simple question really. You've talked about the margin being 3.5% to 4% in group level. Looking at the weightings of your business and we know, yeah, you know all the question now, so is it fair to say that the UK will be, at the minimum, at the top of that range and possibly above with Asia, higher than that range, and Europe which is bigger than Asia being below that range? Or how's that makeup going to be different?

Dave Lewis: Look, I think we – we won't – you – you know the answer that I won't give segmental guidance on margin, but nice try. I think the – the fact is, our international business as we see it today as a margin which is ahead of the UK and Ireland, alright, and that's a function of many things that we can go into. And – and based on the plan that we see, we actually see an opportunity to improve the international margin as well. So actually, we're looking for both to make a very positive contribution to the 3.5%, 4%, but I'm not going to give you the breakdown.

Dave McCarthy: But do you think Asia can move its margin forward as well then?

Dave Lewis: I do.

Dave McCarthy: Okay, thanks.

Dave Lewis: Mm-hmm. Let's go – I'm going to work backwards. So there we go. If we could – just one question, please? Please, yeah.

Xavier Le Mené (Bank of America Merrill Lynch): Xavier Le Mené from Bank of America Merrill Lynch. One quick one for me.

Dave Lewis: Thank you.

Xavier Le Mené: Just looking at your 2020 guidance then, for the three years plan, what kind of assumption do you have in terms at least of inflation? What do you – how do you see that, you know, going forward? Because it's quite important actually.

Dave Lewis: It's – it's very important, I get it. But I'll – I'll – I'll borrow what Alan said. You know, we've had deflation and we assume that deflation carries on through the course of the plan. Now, what changes in the marketplace, we don't know, but the way that we built our thinking is that there's a need for us to enhance the competitiveness of the business. So we stay in a place which is looking to sharpen our competitiveness; and therefore, we assume a level of deflation. We won't give a number but you should know that we think that actually there's still more to be done.

Okay. Just pass it one row back. I'll just keep moving backyards if that's okay. Seems like an equitable way of going ahead. There we go. Sorry, stand out the light. I can't see.

Rob Joyce (Goldman Sachs): Thanks very much. Rob Joyce, Goldman Sachs. Just on the cash flow. So the – I just want to work out what the retail cash guidance means in terms of free cash flow. So my number is 9 billion, is roughly 3 billion a year, it's pretty easy. Then you've got 1 billion of interest, pension and tax on a normalised basis. 1.4 of – of capex. Are we getting to a sort of free cash flow of around 600 million? Is that the way to think about that 9 billion?

Alan Stewart: I think a couple of – a couple of comments. The – the weighting isn't necessarily equal each year. As the business recovers, you'd expect there – the cash flow generation to be – to be higher towards the back end than the front end. The – in terms of the underlying metrics, we certainly could see a position where we're continuing to generate strong free cash flow through the plan. So I'm not going to answer the specifics, but yes that we – we continue to think about that.

Equally, we need to recognise that we've always said that this business, when performing well, is strongly cash-generative. So we do need to think about the overall balance sheet and capital structure in the light of that as we evolve and as we build increasing confidence about that – that recovery story. But I think the way you're thinking about it is absolutely one that I'd agree with.

Rob Joyce: Thank you.

Dave Lewis: Okay. Pass down to the end of the – thank you. Oh, sorry. I thought –

Question: Yeah. [Inaudible], Goldman Sachs. So how much did UK lease expense fall in the first half versus last year?

Alan Stewart: They're two – they're two moving parts in terms of the – the lease expense. Are you talking about the – the commitment or the actual balance, the – the – the – what's going through the P&L?

Question: The P&L. P&L, sir.

Alan Stewart: In terms of the year-on-year, it's – it's – it's some offsetting that, there's also underlying rental increases which are inflation-linked, and so we see that. It's not a significant part of the cost-saving drivers that we've seen this year.

Dave Lewis: No.

Alan Stewart: But overall, when you look forward, the 121 million which Dave had on his slide was the annualised basis on which we've reduced the rent. It will increasingly become important as we go forward.

Question: Thank you.

Dave Lewis: Okay. You want to pass?

Andrew Gwynn (Exane): Hi, good morning, all. So it's Andrew Gwynn from Exane. I'll be the pension ball. I'll now go for an A and a B, a little bit cheeky.

Dave Lewis: Oh.

Andrew Gwynn: Yeah, sorry. What do you think is a fair measurement of the pension deficit? So putting the IAS deficit to one side, what do you think the fair measurement of the deficit is? You know, do a pre-deferred tax if you can.

And then, why are you so happy on the 270 million? I mean you said that that's obviously agreed with the trustees, but are you pretty confident that that will be the amount that stays for next, say, five years?

Alan Stewart: Mm-hmm. I think maybe it will be helpful if I – if I – if I give a little bit of background and – and thinking into the way that – that I and we and the trustees have thought about the commitment we've made to the pension fund.

So we have a liability, a commitment which has been entered into and which will last over many, many years, many decades in fact. As we look to meet that liability – the liability actually evolves in annualised cash payments – annual cash payments which are made to the members as and when they're for due. The intention is to have assets which will meet those liabilities and those assets deliver cash on an – on an annual basis as well in order to meet them as they're for due.

The potential for variability between the asset performance and the liability on an annual basis can be very high depending on your asset mix. So we've set out a framework whereby a period of time we want to get to an expected return on the assets which is not too risky in terms of your asset investment strategy and which we think about in terms of a gilts plus return compared with a market gilt.

That period is many, many years from now. Let's say 20 to 25 years from now is where we would like to get there. So I think about four different valves we have in that journey towards assets being invested at a relatively safe, if you like, from the variability perspective of gilts plus and how we get to that.

The four valves are firstly the time period by which we're getting. And it's not a specific point in time, it's a period of years, 20 to 25 years say for example. So that's valves one, the period by which we're going to get there.

Valve two is actually what is the gilts plus that we're choosing. And that will be linked to the – the way that we – we expect the assets perform. But equally, that's an assumption which is some way out. So that's valve two.

The second – the third valve is the period from now to when – to when we're going to get to that position. And we can change that, so the time period over that. Above which we're making deficit contributions is valve three.

And valve four is the quantum of deficit that we're making.

So if we look about all of those, the framework that we have today even taking today's gilt yield which I'll come back to what's not as relevant, taking all of those, the only valve that I need to change potentially as we look at the next valuation is the length of time that we are making deficit payments, nothing else has changed.

So we haven't changed any of the other valves that we're still in the position when we talk to trustees about that 270 million being paid maybe for a long period of time, nothing else has changed.

So the reason why the IAS 19 is irrelevant is because it's measuring a liability by reference to something which isn't what's going to be paid out. Our actually cash payments to be made to pensioners haven't changed at all.

They've actually dropped from February to where they are now because of pension members transferring out, different elements of some – the assumptions around mortality. Those things change. But actually, we have less cash to pay today than we have in the future than we thought we had to pay back in February. And yet, the deficit has changed. So it's a very imprecise measure. Perfectly understandable from IAS perspective as to why it was relevant at the time it was entered into because it was a proxy for the asset – for the return from the assets. But it's no longer the relevant proxy.

And I'd – there's an article which you – makes this very interesting really by Anthony Hilton a couple of weeks ago which really just points to the measurement being the imprecise calculation of what the actual liability is.

So to come back to – we will discuss with the trustees and it's their decision and we would discuss in the basis of the March numbers. But we very clearly set out a level of deficit contribution which was designed to last through changing market conditions and was designed to be predictable and stable as we went through that.

I don't know what we'll agree. But that's where we are today and I recognise that conditions have been pushed to a level that's measured, looks very stressed. But from an actual liability perspective, no real change.

Andrew Gwynn: So just to summarise that, you essentially think that your trustees will give you longer to pay down the deficit? Is that –

Alan Stewart: Well, I don't want to put words in the trustees mouths because the trustees have responsibilities which are theirs, but we will talk to them. And one of the things which I would certainly think – and I've always been clear that the period over which we pay this – this deficit isn't fixed.

One of the key valves that I would be wanting to talk about is that period over which we're paying the 270 million.

Andrew Gwynn: And then just on the – the question I think which was how big is the fair measurement of the deficit? Is IAS is a wrong number, what is the right number to the extent you could have a say?

Alan Stewart: The way that I look at it is on an annual basis the cash flows that actually will be likely to be paid. You can then choose how you discount those back and how you will seek to measure them. But it actually is – the only answer I can give you is that in 2052, I'm going to have to pay X million, in 2053 X plus or minus. And then how you measure those today, very, very difficult. But that's the way that the liability will be delivered.

We have within the fund more than 15 years of cash if we look at what the – without selling any assets today, that we can meet these. So these are annual commitments which we're choosing to measure at a point of time.

Andrew Gwynn: Okay.

Dave Lewis: Give me a favour and pass the mic. And we have about half a dozen more questions.

Niamh McSherry (Deutsche Bank): It's a –

Dave Lewis: Another pensions question.

Niamh McSherry: No, it's not. There we go. It's Niamh McSherry of Deutsche Bank. However, I do have a clarification question, I'm afraid.

David Lewis: Go for it.

Niamh McSherry: You said on deflation that you basically are assuming a level of deflation through the course of the plan. Can I just make sure that you're talking about deflation until year 2020?

David Lewis: That's right. So I think what we're trying to – what I'm trying to be clear about is no element of recovery of the – the 3.5 to 4 is based on a return to inflation in the marketplace, which I think was implied in the question.

Niamh McSherry: Oh, that wasn't my question.

David Lewis: Okay.

Niamh McSherry: I meant actual deflation. So you're not assuming actual year-on-year deflation for the next four years?

Alan Stewart: Niamh, if you're talking about absolute sales, we're not going to go to what we're thinking about in terms of our total sales. But we do think that we should be more competitive and there's more that we can do in terms of our competitive position.

Niamh McSherry: Okay. So you're on relative price position, not deflation. Thank you.

And then the question that I had was actually on the portfolio. So is it – well, is it right to assume that the group margin aspiration that you've given is based on the current portfolio and also the current store, ie, no further store closures in the UK or abroad for that matter?

David Lewis: Do you want to answer that?

Alan Stewart: Yeah. What we have as the group is the group today. And that's what we plan going forward. We don't have any specifics toward closures that we've got in mind. But clearly one of the ways – as what we've always said is that we come to a lease expiry and the economics of the store don't – and we can't agree at a rental with the landlord at that lease expiry which makes it the right decision for us to extend the lease then we will make a decision which is the right economic decision.

So – but we don't have any of those planned at the moment. And in that sense, the answer is there's nothing planned within that that we've given.

Niamh McSherry: Great. Thank you.

David Lewis: We go back one more row and right over to the gentleman over there. Oh, in fact, there's one behind you. Exchange the microphone. There we go.

Sreedhar Mahamkali (Macquarie): Sreedhar Mahamkali from Macquarie. Just hopefully a simple question. You've talked a lot about Fresh. Rightly so, it's very visible in the stores. In that sort of end to end supply chain work, where are you in grocery? How far down the line are your core grocery? If Fresh, if you say you're 80%, 90% of the way there. That's the work you want to do. Just give us a scale where you are in terms of core grocery.

David Lewis: Numerically, I mean you look at Jason as I say this. On the simplest scale, sort of – I would say about half of the way that we would want to be. And that's just much because when we did a lot of the category resets in our large stores, we're only now doing those category resets through the – through the express format, so we're introducing there.

And the category resets that go with that are to the – to January and to February. So actually, we'll not be able to say that we've made all the progress on core grocery in the way you're saying until we've done the express elements of it. So notice our own as we are in Fresh. And we –

Speaker: It's about in or about there.

David Lewis: Okay.

Sreedhar Mahamkali: And that's – to get to where want is another year, 18 months, two years?

David Lewis: I think from a category point of view, we'll get there by the end of February. In terms of what it is we want, I think then there are different opportunities with different supply base in terms of how it is we can do some of the real end to end stuff. There are some that are really well advanced and there are some for whom it's a bit challenging because they were in a business in a way which is not thinking just about how it is they engage with Tesco so that takes – it tends to take a little longer if you want a big multinational branded player to change the way they work with us in order to simplify this part, it's actually more of a – of a change for them sometimes than it is for some of our own label suppliers. So it does take a little longer in the grocery space.

So [inaudible] over there. Okay.

Sreedhar Mahamkali: Okay. Thank you.

Dave Lewis: Thank you. Turn to the rest at the back, three more. So one, two and –

James Grzinic (Jefferies): Thank you. Good morning, it's James Grzinic from Jefferies. I'm afraid I have two, one for Alan and one for Dave.

Dave Lewis: Okay.

James Grzinic: Alan, the – going back on the makeup of the margin guidance, that does not include future benefits from freehold repurchases. Clearly, there will be in the future, given how you – you run your balance sheet and the way I'm seeing it. Is that the case, that you – that that is not included in the – in the margin guidance?

Alan Stewart: Within our – again, we're getting into, really, specifics. But within our overall plans, we do have some targeted further properties. We don't know what they are, but we would be looking to buy back some properties. So as you saw, the UK is now running at 48%, and we expect to get some. Whether they get there, whether they turn up or not, we will see. But there is an element. It's not a significant part of that improvement that we're – we're looking for, but there is some element that we're targeting. And if I said no to that, then Steve would be let off something of what his – his objectives are.

James Grzinic: And that's not included within the 1.4 billion CapEx guide? Those potential opportunities?

Alan Stewart: No, it's not. No, no. And I think that's an important point. So – but – but when we look at it from a – from an overall perspective, the CapEx that we're talking to is about the CapEx for running the business and in terms of running it today. So turning things around to the way you asked the question, there's not a significant element contained within it which you should think about in terms of the CapEx guidance.

James Grzinic: And just to close a specific circle, can you perhaps talk about the way you think about lease adjusted measures and what is the appropriate capital structure, particularly given that there might be issues in terms how IFRS 16 changes, how that is accounted for otherwise?

Alan Stewart: I think about it and we're spending a lot of time trying, really, to work through the intricacies of IFRS 16. For the moment, we think about it in the way that we – we always have. We capitalise in the way that we set out in our – in our notes. IFRS 16 has got a lot of complexity, not only in terms of the – the going forward implication, but the actual point of implication. And it will change very significantly, the way that all of us look at the balance sheet that – and the – and the P&L as a result.

No change to cash, clearly, because it's a – it's a no-economic change. But it's too early for us to talk in detail about what that is. We're spending a lot of time thinking through it, and we are going to have to work with yourselves and with the agencies to help our thinking and their thinking get to a point that we each are looking at it from the same perspective.

James Grzinic: Thank you.

Alan Stewart: Okay.

James Grzinic: And Dave, my question was really, can you be more clear about what was better in half one relative to what you expected? Presumably, Farm Brands being very successful would be a margin depressor. So what – what has worked that has meant that you got 30, 40 bps more margin than you thought?

Dave Lewis: Well, a number of things have worked. So I think the fact that it wasn't as it is – as much of a depressor as we thought it was when we made the decision to invest has been a positive. The work around maxing the mix has been a positive. The benefits that we've seen in changing some of the store operating models has been a positive. The way that we've worked with our suppliers in terms of how it is we've driven some efficiencies in the operating model has been a positive.

So the positives, as Alan showed, are significantly greater than that, but we've chosen to keep investing back in the offer, in the outcome as the bps improvement that you've seen. But it's a balance of all of those things, alright?

James Grzinic: Okay. Thank you.

Dave Lewis: Do you want to pass the gentlemen in the middle, and then I'll finish just here, if I may? How's that? And then we've done them all.

Borja Olcese (JP Morgan): Hi, it's Borja Olcese from JP Morgan. One for Alan. Sorry for the specific question, but I think it's – it's important.

Seemingly, you saw year-on-year, lower UK depreciation in combination with year-on-year lower operating lease in the UK as well. Can you please confirm this was the case and why this would be a trend we should be extrapolating going forward?

Alan Stewart: Sorry, just to make sure I've understood the question. Year-on-year drop in depreciation?

Borja Olcese: In the UK and in – in the rental bill or operating leases in the UK as well.

Alan Stewart: The – well, some of it will be because of the – what we've brought back. And the other is that we did have the impairments which we took, and there you see the full year impact of that, then we get a benefit from that. We have some asset impairments, which you'll recall we took. Sorry, does that answer the question? So in terms of a trend, well, we'll come – we'll talk to the – next year, when we get to the April, in terms of it from the first half into the second half, that's the trend you would expect to continue.

Borja Olcese: Okay. Thank you.

Dave Lewis: Okay. With that, the final question, sir, is all yours.

Nick Coulter (Citi): Hi, it's Nick Coulter from – from Citi. I'm setting down – one down from – from Jason, but – but could you – or perhaps Jason talked more about seeing your – sorry. The – specifically about Farm Brands, and why the shape of the investment was perhaps different to what you had anticipated and what that told you about your offer? Just as an observation, when you kind of go into a store, you can see quite, seemingly, different penetrations by products for Farm Brands.

Dave Lewis: Yeah. I'll say one thing, and Jason then fill out. I think it's – when we made the investment decision, we have a number of variables which was around what elements of trading down there might be in terms of price point. So what the mix would be across those three different tiers. And we made an assumption, at the time, going in.

And as Jason told you, the reality was somewhat different. But mate, why don't you talk about why?

Jason: Yeah, I think – what you saw at the same time as a launch to the Farm Brands is a relaunch of other ranges within those subcategories because what we wanted to do was to be able to give a distinct and segmented offer to customers so they understood how Farm Brands set in, so it's a redesigning and relaunching of Tesco brand and Finest.

And our assumptions around mix met – where we felt more of the business would go into the Farm Brands didn't come out the way that we expected it to. So Farm Brands are very positive, but actually, as you saw from the value and volume outperformances that Dave shared, you know, overall, the – those categories perform well.

David Lewis: Yeah. That's right. And I think the important thing to build on that is that's about how it is we uniquely can play three tiers in the – in the Tesco brand.

Nick Coulter: To just follow, like say, for example, carrots. You had a really high penetration – that's – sorry, it's being a geek. But just think of the –

David Lewis: Carrots is your thing. Let's go to carrots.

Nick Coulter: No, but – it can be carrots versus potatoes or whatever. You know, a lot of the – he's nodding.

Speaker: [Inaudible] it was absolutely variable, somewhat – somewhere ahead, somewhere behind. Overall, it was – it was – that trade down wasn't as high as we expected overall. Yeah. Yeah.

David Lewis: Yeah. Yeah. And look, the important thing is, for me, if I take the aggregate – sorry, is the fact that the outperformance versus the market on volume and value is the ultimate test of what we did for the whole portfolio, was that right or not? Yes. Did it make us more competitive? Yes. And that's why I took an unweighted basket of where the pricing was to give you an idea of how competitive we were.

Right. Thank you very much for your attention and your questions. It's been a bit longer than before, but we've obviously shared a lot with you. I suppose my closing remarks would be, it's two years. We started in a place where, you know, let's be honest, there were some pretty big challenges sitting on the group. We have faced into those challenges. I think – I believe that we've done what we said we would do in terms of addressing the three priorities we set for ourselves. It's time for us to shift gears on things about how it is we build on that.

And whilst the market stays uncertain and indeed difficult, we have some confidence about what it is we can do as Tesco in those market conditions to make the business more competitive and indeed more valuable for shareholders.

The last thing I want to do, and – but probably is the most important thing is, you know, I'm standing up here. I'm standing up here. We're sharing with – the results. If you want to know, it's 500,000 people that faced into that reality two years ago and it's a whole bunch of suppliers who faced into that reality and came with us, and it would be completely, completely wrong if we were talking about the results here and I didn't let you know that the biggest thanks that I could give to anybody are those 5,000 colleagues who have done and made the results possible of what we've done and give us the confidence to talk about what it is we might try and do over the next three years. And so to those colleagues and to partners who have come with us on that, I'd just like to register publicly my thanks to them because they've been absolutely awesome.

So with that, thank you very much indeed.

[END OF TRANSCRIPT]