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Tesco Full Year Results 2016/17

Wednesday, 12th April 2017

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Full Year Results 2016-17

Dave Lewis

Chief Executive Officer, Tesco

Introduction

Good morning everybody, nice to see you all. There's a bit of a refurbishment gone on in here since last time we were here. It's quite difficult to see faces, so apologies for that. It's great that you're here. You have, as always – I brought the majority of the Tesco executive to be here today; it's the one time I ask them to make sure they're available for your scrutiny, your questions and your probing, so please make use of that if you haven't already. I'll introduce some of the new members, actually, in the middle of the presentation, not to embarrass them too much at the start. But I have two apologies, which is Tony Hoggett is on the Advanced Management Program at Harvard, so he sends his apologies, and Matt Davies is celebrating Passover, so Matt's not with us this morning either, but both of them send their regards. So, look, what Alan and I are going to do is take you through, in tried and trusted fashion, how it is we see the results that we've announced this morning and then give you a chance to ask us some questions, okay?

Agenda

So, without further ado, I'll start by talking a little bit about what we consider to be a year of strong performance. I'll bring you up to date with where we are on the six drivers that we shared in detail in October. Alan will then take you through the detailed results, and I'll come back and I'll talk about the four stakeholders that we think through in terms of how it is we're adding value for each of them as we turn our business around.

A Year of Strong Performance

Positive sales growth, strong profit growth, strong cash generation

So, look, you've seen the numbers. It's a very full pack because you've got all the notes and all the risk – approach to risk from auditors as well. But look, in essence you will have seen that sales growth is up 4.3%. Profit – operating profit before exceptionals is up 30%, and the UK and Ireland is up 60%. So the operating margin improvement, which is around, sort of, 46-48 bps in – at a Group level, is around 64 bps within the UK and Ireland. And you see that we've continued where we started in terms of strong cash generation year-on-year.

Customers recommend, colleague engagement, supplier viewpoint

In terms of the customer recommends, the net promoter score continues to strengthen. Our colleague engagement, despite all of the changes that we're taking into the business, it continues to step up and is at a really high level compared to any benchmarks in the UK. And the supplier viewpoint that we've shared through these last three years continues, under Jason's leadership, to go from strength to strength.

A Strong Year of Performance – UK

Volume-based recovery, transaction growth, increasing footfall

In the UK, 1.6% volume growth. So we're into our full second year complete of volume growth, and actually second half-year stronger than the first half-year. Transaction growth at 1.7%, and we have about 140,000 more customers year-on-year.

UK like-for-like Volume

Now, when we talk about volume performance, you've seen this chart from me before and you see what's happened, you know, going all the way back to 2011/2012, and you see the performance over the last two and a half years. So year-on-year, but year-on-two-years we continue to perform well. Now, I know you have a question about the fourth quarter, so let me give you a context of that. If you look on the right-hand side, what I've done here is I've taken the IRI data and I've looked at our performance versus the market. So what you see on the top is the full year. So what you can see is our outperformance on volume versus the marketplace Total Store is approaching 3%, and in Fresh is actually approaching 4%, and across the board, that's where we were. In the fourth quarter, though, you see that Total Store volume ahead of the market. But it's fair to say, as you would know, market volumes fourth quarter, based on macroeconomics, were more challenged than the previous three quarters. But we did well in Food; did particularly well in Fresh and in Packaged.

Couple of things that affected our fourth quarter growth. General Merchandising, we talked about it. End of Q3 into Q4 we changed our trading approach around boost, and I'll show you later, we made some other decisions that affected our volume in terms of what promotions we were prepared to chase and which promotions we weren't prepared to chase because of their impact on mix. But actually, our relative volume performance continues to be strong, particularly in the key areas for our business, which are food, right?

A Year of Consolidation – International

Volume growth, sales growth, portfolio simplification

Now, international, more challenges in international. But when I say that, it's really crystallised around Poland. Eighteen months of strong performance in Poland; the last six months of last year significantly more challenging from a competitive lens, and we felt that in the performance of Central Europe because of the size of Poland to that group. Matt and I, with the new management team, were there last week. Plans are afoot – I'm encouraged by what I'm seeing in the short term, but we have to go on and we have to deliver those plans. Overall, we still had volume growth in international, but the other thing that we did have with Poland, I should mention, is actually Thailand.

Now, some of you will know about the Thai market from other investments that you make, but the Thai market is depressed versus expectations. There's definitely been a reaction, in terms of market momentum, to the death of the king; everybody, ourselves included, being hugely respectful of that. So our like-for-like is up in Thailand, our market share is up in Thailand, but the market size in Thailand is not what anybody predicted it'd be because of that sad fact. Sales growth still 4% in Asia and slightly up in Europe, and you know that we've simplified and completed the Kipa transaction.

Our Six Strategic Drivers – a Progress Update

A differentiated brand

If I move, then, to the six drivers, and if I were to summarise this in one slide, I'd say, look, we are differentiating the brand; it's a long journey. I'll introduce you to Alessandra later, who will lead the charge on that for us going forward. But actually, there's some really strong progress through the course of this year. The YouGov survey that everybody uses, we've kept that as a consistent theme and I'll show you some of the performance there, so I'm happy with the way that the brand is developing.

Reduce operating costs by £1.5 billion

We set out, last October, that we would reduce the operating cost by £1.5 billion, right? Now, we said that by 2019/20, so if you like, from October that's three and a half years to get us to that £1.5 billion. In the first six months of that period, we've delivered £226 million of those cost savings already, and that's part of a full year – i.e. including what we did before October – a total cost reduction last year of £455 million. So our cost reduction programme actually in really good shape and actually accelerating versus where we were in October. We brought forward – were able to bring forward some of the plans that we had, and I'll share those with you in a second.

Generate £96bn cash from operations, max the mix to achieve a 3.5-4% Group margin, maximise value from property, innovation

Cash, I've talked about. In terms of maxing the mix, you've seen where we are. We've taken the Group margin from 1.8% to 2.3%; the improvement in the UK has been stronger than that Group average, so really good progress there. And we've released about £0.5 billion from our property portfolio, again consistent with how we talked about it in October. And I'll talk a little bit more about innovation in a second. So when we talk about being ahead of our own expectations, it's the expectations we set in these drivers, and let me share with you a bit more.

A Differentiated Brand

BrandIndex score – an overall measure of brand health

So in terms of brand, you've seen this chart. Over the last two and a half years we continue to improve, which is important, but also to narrow the gap to the three other big UK supermarkets. And what it is we need to do is obviously to get those lines to cross. But on that measure, you can see that we're still moving in a positive direction.

Exclusive fresh food brands, unique proposition, great quality

The things that are driving that: farm brands, we invested £300 million last year, little bit more than £300 million in the launch of the farm brands in the end; significant investment for us. So the performance of the business is with that investment included, obviously. Interestingly, 64% – so nearly two thirds of all baskets in a Tesco shop – now have a farm brand in it, right? Really strong feedback from customers to the value equation, the quality that they're getting from the farm brands versus other offers in the marketplace. We know that when people fully understand the brand guarantee, it increases their propensity to shop with us by about 15%; that's something unique and differentiating in the marketplace. And the good and very important thing is, customers are now starting to appreciate the great quality that's in the Tesco product. We've got more to do, but actually that's starting to come through strongly and I'll share with you some of – some more of that in a second.

BrandIndex score – quality

Because the YouGov survey – I've kept the same survey – we have lots of different ways of looking at the brand, but if you take that YouGov survey and you talk about quality and perceptions of quality, actually between January 2016 and 2017 YouGov, Tesco most improved brand in terms of quality, right? So already that progress we talked about last year coming through.

Interestingly, we, earlier this year, moved on to another phase in terms of advertising and communication. We brought out the Food Love Stories idea based on a very important insight about the role of food in all of our lives, but also sharing some interesting recipes and solutions, which you will have seen, if you've been in our stores, are brought alive – and, indeed, you'll see some outside – for our customers who walk into our stores desperate to think about what it is they want to cook this evening, desperate for a recipe, this is really helpful, but also an emotionally engaging way. And I thought I'd break with tradition and show you the two ads that are going to be used at Easter time, which are consistent with this, but appropriate to the time of year. One of them focuses on our relationship with our suppliers and one with our customers. So can we run the two films, please?

[BREAK IN AUDIO]

So just an illustration of how we take the campaign on, make it more seasonally relevant, but the feedback that we're getting is fantastic. And just to carry that trend, you can see what's happened to the quality perception around food in Tesco as we feature it and share the Food Love Stories. So really pleased with the way that that campaign is differentiating the brand.

Most improved brand, brand story of the year, ad memorability

So YouGov, if you're interested in these things, campaign talked about it as the 'brand story of the year' and we're actually in a place where we're getting real memorability. And the important thing about ad memorability is it builds brand, but it also builds marketing efficiency, right? So this is not something warm and cuddly; the more that we can make our advertising memorable and mean something, then the less quantum you have to invest to get the same marketing result. It's as simple as that.

Reduce Operating Costs by £1.5 billion

Service model improvements, simplifying our distribution network, streamlining Central European transport

So that's where we were in terms of the brand. Operating costs of £1.5 billion. So, since October – so if you've been tracking it, we've talked about, already, changing the store operating model in 1,500 stores. We've already announced a simplification to the distribution network, taking out two distribution centres at Welham Green and Chesterfield, and we've streamlined, already, our European transport in part of the goods not for resale that we talked about before.

Store operating model, logistics and distribution, goods not for resale

So we gave you the buckets, when we were together in October, and we took the opportunity of advancing the plans from three years into the last six months. And, therefore, you know, where we are – giving you the breakdown in the buckets – we've saved around £130 million in our store operating model costs, about £32 million against the targets we set in logistics and distribution, and £63 million in that bucket of goods not for resale. So £1.5 billion for, basically, a three and a half-year plan; first six months, £226 million delivered in this configuration is where we are. But, as I say, total cost reduction for Tesco, last year £455 million.

Generate £9bn of Cash from Operations

New terms, lower stockholding, improved availability

In terms of cash, we've put out new terms. I think we're still the only retailer that publishes all of the terms for all of the categories and all of the partner sizes. Small suppliers, 99% – 99.4% of all small suppliers are on those terms and were fully compliant. 93% in terms of the larger ones. If you remember, we set the end of this year in order for everybody to change, to move on to it, of the larger ones, and we think we'll done by August, Jason. So ahead of the plans, so that working really well.

Stockholding has been a phenomenal performance. If we talk about where we are in terms of cash, working capital improvement efficiency really impressive. We've taken about £300 – a bit more than £300 million of stock out of the business over the last two years, which is a little over a third. The interesting thing, as you'll see in a second, is we've done that and improved our service and improved our availability. So all that work that we've been putting into the operating model of the business is allowing us to lower cost, lower stock, but improve availability and improve service levels. And one measure of that is, again, we've improved the availability late at night, so this is sales-based availability, 6.00 in the evening of the thousand most important lines, this year, again, gone from 93% to 96%.

Maximise the Mix to Achieve a 3.5-4% Margin

Now, this chart, right? This is the chart we shared with you around how it is we think about mix, and to remind you, the colours are indicative of where a particular category or channel sits relative to the Group average. So bottom right-hand corner, which is the Group operating margin, as I've said it's gone from 1.8% to 2.3% this year. The mix, in terms of how categories have contributed to that, has stayed pretty much the same. So everything has risen, but the relativities have stayed pretty much the same. I'm going to give you some illustrations in a second.

Channels

So if you – if you think about what's driven that, we've done a number of things. Remember we talked about the different lenses of mix. So first of those was channel. So if I take the example of the UK, you'll remember – I certainly do, two-and-a half-years ago talking about unprofitable stores within Tesco – we set ourselves a challenge. We closed some, and set ourselves a challenge to improve. 107 stores that weren't profitable a year ago are now profitable. That's about two thirds of the ones that we had set ourselves to improve. You would have picked up that we've changed the convenience model in our Express stores, so that's about 1,700 stores that are changing. And you've seen what it is we've done in terms of online to make that a more customer-centric, but much more commercially sustainable business model. So in terms of channels, this is where we basically improve the operating efficiency of the channel almost regardless of the category. We're lowering the cost and the margin therefore benefits as a result of doing that.

Category

When it comes to category we have some choices, and this is where it gets interesting. I picked an example here of – obviously I've kept the competitors anonymous. You can guess which – who's who later. The thing that's interesting here – because it illustrates something – is so Tesco on here total growth getting towards 2%, good balance between food, good balance between drink. Because this is period up to January, so it's December. It's four weeks in December, and I was really interested in the balance between food and drink, because what you can see is what happened in December – happens in a number of Decembers – is there was a beer price battle. Now anybody who, you know, looks at the beer market and looks at the slabs of beer, the cans of beer – there's no profit there. None at all. But they are a significant volume driver. And we were competitive, quite happy with where we got to in terms of Beers, Wines & Spirits through the period. But as the prices got closer to Christmas and people chased it for volume, we didn't. We didn't. It was – it was the equivalent of blowing your brains out. We didn't – we didn't do that. We didn't feel we had to do that. So we became more choiceful. And that's a concept that I need to be able to share with you in a better way, which is, as we start to build mix and we move from getting volume momentum just to move the business forward, we now start thinking more choicefully about which are the right categories to be putting discretionary effort into in order to drive a sustainable volume improvement that enhances mix? And that's where – this is an example at a category level where what Jason did was play the category differently.

Product

And part of that is what we did in product part of that category. So to see it all the way through. If you've not seen it, there's a range reset in our Beers, Wines & Spirits fixture. We changed the range and the space for spirits, for sparkling – including some British sparkling offers – and also enhanced the space for low-alcohol, all of which enhance margin mix for that category. Own brand performance – and little tip for those in the room, there's a range of Finest wines with – that have that little silver shield on the top. We've mentioned this to some of you before. There's a whole new range. My little tip to you is: try them, yeah? You'll be – the price range is between £8 and £20, but spectacular wines for really good value. Our own brand performance is up 8% in this category. And interestingly craft beer. Now, a subject and a category very close to the Chief Product Development – Chief Product Officer's heart. But actually interestingly we changed our approach in Express on craft beer, and you see it also in our large stores, it doubled the like-for-like of craft beer in our Express offer. So just trying to give you a sense for how it is our Category Directors need to think about a category and the product mix in order for volume to contribute to that margin expansion.

Maximise Value From Property

Increased freehold ownership, further buybacks, April 2017 transaction

Now, in terms of property, you will have seen through the year we bought back 16 stores. We've announced this morning that we've bought back seven more stores from the last joint venture we have with British Land. So that takes us to 23 stores. The impact on our rent is – is what you see on the chart there. But I think the number I was going to call your attention to here is actually the UK & Ireland percentage of our estate which is now freehold. Two years ago, only 41% of our business in the UK was freehold owned by Tesco. Through the actions we've taken over the last two years, that's back to 51%. So either you say ten points higher or the other way of looking at it is 25% more than it was two years ago. So again, back to that point about how do we improve the future potential of our business to sustain the margin improvement when it's commercially right and advantageous for us to buy back? We're interesting in buying back stores that we really would want to own, and we've continued to do that in terms of maximising the value from property.

Repurposing space, retail partners, refurbishing stores

The other things that have been going on by Steve and his team – we've repurposed over a million square feet of our space across the business. That's either in terms of taking space and subletting it – and you saw some of that in October that Trevor shared from Asia – or indeed some of the subletting that we've done with Arcadia and other partners.

These are the partners that we've worked with around the Group. I have to say, if we take the UK the partnerships that we're having with Holland & Barrett and with Arcadia and indeed with a couple of others, working very well for us, working very well for them. And that gives us an opportunity to continue that, and Alan will talk to you about the performance of large stores in his presentation.

And because people ask me, I'll put it up there. So last year we refurbished 202 Tesco stores as part of our refurbishment programme.

Value release, air rights, optimising land

We did release value – about £0.5bn of value. You know, we put Letňany on here as a – a very specific – so where we've been able to raise value from the portfolio. Steve's done a fantastic job. We talked to you about air rights in October, and for those who are very eagle-eyed – but I don't think you'll get it from the computer, that's – that's Hackney, right. So we just – we just announced – I don't think it's – it's not particularly in the public domain. We sold the Hackney store for £55 million to the borough. We'll get back a – a store at an advantageous rent for ourselves, and they will build affordable housing above that store. So that's the first of the air rights that we talked about of what it is we were doing when we saw you in October.

And – and in terms of optimising land, I don't think you'll be able to tell which this one is, I hope, from where it is. But this is part of the car park development that we shared with you. So there's about 17 of these in advance negotiation at the minute, which is how we can use excess car parking space to actually sublet and use. So given that you can't tell where it is, there'll be a MacDonald's drive through in one of those car parks – in that car park in the very near future. So just examples of what we talked about in October of what we're doing to realise value from our property portfolio.

Innovation

PayQwiq, new products, Free From retailer of the year

And in terms of innovation, PayQwiq is rolled out – you know, PayQwiq is rolled out and I'm pleased to say one's used every five seconds. You know, more than a million a day is paid for on PayQwiq and growing really very quickly. Last year, just under 2,500 new products; so whilst we continued in our range optimisation we've not stopped innovation. So last two years 4,500 new products. And you see I put Prepared Meals in here, but Free From – we continue to be the country's leading Free From retailer, and pleased to see that we got that award for the third year running. So lots of innovation going on, and obviously Booker, which I will talk about at the end.

So that's in summary where I see the year, how we've done against the six drivers we shared with you in October. And now I'll pass on to Alan to take you through the detailed results. Thanks.

Full Year Results 2016/17

Alan Stewart

Chief Financial Officer, Tesco

Introduction

Great. Morning everybody. So in terms of the results for the year, obviously during the year we had the impact of the change in the inflation rate with the sterling depreciating, and that's – that has mixed our results. We began to see that in our half-year results but – but fully coming through in the – in the second half of the year.

Group Performance

Overall sales up 1.1% at constant rates and 4.3% at the actual currency at the year-end. Operating profit £1.28bn, a 30% increase year-on-year and – in actual rates, and 25% at constant – at constant rates. So a significant step-up in our operating performance, which I'll go into more detail. The exceptional items, the primary – there will be more detail, but the primary element here is the £235m charge, which we took and announced a couple of weeks ago, with the SFO and FCA settlements which – which are now concluded with the court order on Monday this week. So that's the key element of our exceptional profits. And then a significant increase in the Group profit before tax and before exceptional items and net pension costs, up 72%. This is – this is a key element of our EPS, and again, I'll talk back to that later.

Segmental Performance

In terms of the segmental performance, we've said, as Dave said, a strong step-up in the UK business and – and some mixed performance in the – in the international businesses.

UK & ROI, I think the key element is, as Dave said, the increase in margin. Margin recovery is 68 bps in the UK, and we're at 1.84% margin in – in the UK & ROI segment as at the moment, with profit improvement from £500m up to £800m in the – in the year.

The international margin was down 42 bps to 2.81%, as you can see, still ahead of our overall Group margin, but a bit of a drag in – in the current year. And the – and the markets were – were, particularly in Poland, challenging. Profits in that segment were £320m year-on-year which was flat at the actual recorded currency.

Bank margin much less relevant to the Bank because of the way that the Bank business runs, but down 145 bps at 15.5%. The Bank results, again, I'll talk on later.

Overall Group margin up strongly to 2.3%, which is along the ambition towards 3.5% to 4% margin by the 2019/20 financial year.

UK volume-based recovery

We've spoken before about volume and how important volume to us is in the UK. We've also told you on a number of occasions that the way that historically we'd measured volume wasn't really where we would start, but in order to create a clear trend we continued with that.

Well, today we're shifting to what we believe is a clearer indication of volume, which is the scanned singles going through the till. This is the way that the product people look at it, it's the way our colleagues look at it and it's the way our suppliers look at it. So it really aligns with the way we're looking at the business. And as you can see from this, the trend line is pretty much the same as you go across the different one – different elements. The green line is the – is the previous measure. The major difference is down to mix. And going forward, if mix is an important part of what we're – we're looking at in terms of that scanned singles transactioned volume base, we will highlight it. But – but from now on we're going back to that. Importantly, volume remains critical to our business recovery, but as Dave's said, we will be choiceful and mindful about it as we look forward, as well.

UK transaction growth

Transaction growth, another key part of this and as Dave also said, 140,000 new customers. This is the number of customers going through the checkout, and we've seen strong transaction growth year-on-year. Continued and pleasing trend in that line.

UK and ROI Like-for-like Sales Performance

Looking between the two elements of the UK & ROI segment, as you can see, the UK continued growth. We've spoken about Q4, we've spoken about some of the choices we make, and this is the first reported full-year growth since 2009/10 year. So a year which is important in terms of that turnaround of the overall business. The Ireland business – really pleased with the results. It's not what the chart shows, but we are really pleased with that, because the volume growth in the Irish business is significantly above the market and in Q4 there was a strong impact from the – the inflation – the deflation that we were putting into the market in order to maintain that competitive position. There's a small element in Q4 in Ireland relating to the industrial action which we've got there and it's about 1%, but we were pleased with the Irish business performance, which is lagging slightly behind where we are in the UK. So very encouraged by – by the way that market's developing as well.

UK Like-for-like Sales Performance

So as Dave said, we – again, as usual, we look at the – within the UK, the like-for-like sales performance. And you can see that across all formats we maintained the encouraging trend. I'm going to talk on the next slide about Extra so I won't say any more. But Superstores, Metros and Express continued to see good growth. Dave's spoken about the Grocery Home Shopping and the growth in the – in the online business. We're encouraged by that. Basket size is up, loyalty is up and we're – we're continuing to see a very strong customer loyalty through the Saver delivery. General Merchandise & Clothing, as we saw at the half-year, some impact from moving to the new – the new website. F&F moved onto the same site as the General Merchandise business. And again, some impact as we shift and look at improving the profitability within the General Merchandise part of the business. But overall a year where across all of the formats and the ways that we are engaging with customers continued to make good progress.

The like-for-like – and this goes right back to the 2014/15 year – you can see that around June 2014/15 we were really at more than 7.5% negative growth in terms of that business, and since then a strong and continuing improvement in that business. Remember that a lot of our General Merchandise performance also comes through these large Extra stores, so there's – there's an element in that, as well. But encouraged by the continued performance, and again, you can see that in the store profitability, which – which Dave referred to.

UK & ROI Operating Profit

In terms of profits this is the – this is the key build within the UK & ROI segment. Starting at the £503m we delivered last year, you can see that we invested more than that in lower prices in the year. £300 million of that, or so is the farm brands, which we launched early in the year, but across all of the categories, we continue to invest in price in order to maintain that competitive position.

We get a volume and mix benefits and you can see that we made some other custom investment. This is some of the range reset and the recent food love stories, in particular we would highlight and then underpinning all of the margin recovery as we set out our ambition is the net cost savings. This includes the store operating model, distribution savings and the marketing savings in which we have spoken about before. Finally, the other category takes us to that 803 million of overall profit delivery, up very strongly year-on-year.

International Like-for-like Sales Performance

The international like for like sales performance, Dave has referenced the competitive position in Poland and we saw that during the year and in Asia as we have seen the fourth quarter and the third quarter were impacted by the events, particularly in Thailand. However, market share is strong enough in that market and the business which is viewed very strongly from a customer perspective.

International Operating Profit

Again, the chart of how we have – the operating profit, as I have said, flat from £320 million to £320 million. Some investment in low prices more than offset by volume and mix and benefits. Other customer investment is in availability which was one of the key areas within the European market. We spent on availability and some increased marketing spend and we made some cost savings in that market. Store operating model is again an area of focus. In a number of stores, we have closed on profitable counters. Dave has referenced to distribution savings we made in Poland. Not only have we moved to different distributors, we have closed a move to a new centre in Poznan for distribution, with a significant saving in terms of our distribution cost. Overall, a business performance which is one which is mixed, but one where we have clear plans for the future.

Tesco Bank

In terms of the bank, the bank performance is one which again we are pleased with. Different metrics obviously from a bank perspective. We have seen 3.5% growth in our active customer accounts. This is now very clearly the bank for Tesco customers and that is the purpose of Tesco Bank and we are encouraged by the growth in current accounts. We recently relaunched the offer having had a very, very strong reaction and positive reaction to the offer which we launched pre-Christmas and we have recently relaunched that with a take up in line with our expectations.

The other thing I would highlight about the bank results is that, of course, this is the year that the bank brought the full impacts of the change in the interchange fees and on an underlying basis, the performance is strong at 29%. Now, clearly banking markets change, conditions change, but it was a year where the bank delivered a good set of results.

Strong lending growth in line with the bank's aspirations and that is being funded as the bank expects through customer deposits. Good growth in lending and in deposits and underpinned by an ongoing cost saving program. The capital in lending in ratio remains strong. Net interest margin, slightly down in with the desire to become more competitive and the cost income ratio at an underlying basis, 62% compared to 66% if you take out the impact of the one-off customer redresses which I am now with the PPI claims, with the finites and endpoint, we can begin to see when that will end.

Then the bad debt asset ratio – slight shift but one which is acceptable from the bank's perspective. Overall, a bank with strong capital ratios and a business performance with which we are pleased.

Tesco Mobile

Tesco Mobile continues to be a really outstanding part of our portfolio from customer perspective. It is, again, focussed on Tesco customers. It is the fifth largest mobile network in the UK and the largest virtual network voted for the number of years as the best recommended provider. It has picked up the lowest customer complaints. In fact, in December, there was zero customer complaints for Tesco Mobile and it has got a very high customer satisfaction, so a strong business delivering continued growth in a market which is competitive where Tesco Mobile has a very strong and established position.

Exceptional Items

I said I will give you a little bit more colour on the exceptional items and this really breaks them out. Net impairments is a mix of a number of things. Obviously, we, having taken a significant impairment charge in the 2014-2015 financial year, we need to recalculate that every year across the whole of our business. There will always be movements in this provision, net in the year when you take into account lease provisions, impairments, et cetera, a very small movement, but there are quite a lot of work goes into that from an accounting perspective and I would not be at all surprised if annually we have a movement in that net impairment.

The restructuring and redundancy, we have spoken about the changes in the distribution network, we have spoken about the changes in the store colleague structures and we have also spoken about the cost saving measures in the bank and those are the key elements of that £199 million restructuring and redundancy charge.

The bank, as I have mentioned, took a £45 million charge for PPI customer redress. That scheme is now one which is visible towards the end, this date, in 2019, by when all claims have to be in and as I say, we can now begin to see the end of that.

Offsetting that, we had £57 million from an interchange settlement which was pleasing to have resolved a long running dispute. We generated £165 million net from our property transactions. Dave mentioned 500. We also buyback properties, so this is the net number and then we have made the provision for the SFO and FCA. That leaves the total to £263 million. We continue to call out in the exceptionals issues which are significant and material to the results, but we also seek to run the business with as few exceptional items as possible.

Finance Income and Costs

If we move now below the operating profits, to the finance, income and costs. The first line here of interest received is as near as we can get to a cash element. We had more cash. We managed that cash as well as we could in a very low interest environment across the course of the year and we generated £48 million from it.

IAS 32 and 39 movements are mark-to-market movements, non-cash, generated by the market changes in respect of risks across some of our hedging instruments and that year-on-year gave us a 61 million credit compared with £19 million, but I would stress that they are non-cash.

Then interest payable went up here, principally because as part of our property buybacks, we do very often take debt on with that and during the year in February last year, we acquired a number of stores, 49 stores and two DCs and that came with some debt. We repaid a lot of that, but that was a lot later in the year, so year-on-year, we carried more debt within our balance sheet. We do really continue to focus on the cost of whatever in debt we are carrying and seeing how we can minimise that.

Then finally, IAS 19, pension costs reduced year-on-year. This is set, as you know, at the start of the year in relation to the pension deficit at the start of the year. It is a very mechanical non-cash element and unwind came down because our pension deficit was down and as of February last year, this February with a higher pension deficit, we expect this charge non-cash in the current year to be around £165 million. Overall, that gave us the net finance cost of £521 million compared with £629 million. Happy to go into more detail separately because I know that there is a big mixture here between cash and non-cash and cash is one of the things which we focus on strongly.

Tax

The tax rates. Tax rates is 25.4%, up significantly from last year. This is higher than the UK strategy rate. The banking supplementary tax surcharge of 8% runs with the whole of the year. Then we also continue to have some assets which do not qualify for tax relief. Looking forward to the year that we are just starting, we expect this to be around 25% in the full year as well and we will continue to update that as we go through the year.

Earnings Per Share

Earnings per share, I mentioned before the £842 million of profit before tax and exceptional items and finance costs, up 71%. The diluted earnings per share is at £0.079, it is up 40% mainly because of the change in the tax between profit and tax, that is why the 71% does not come through. However, it is a strong increase in terms of this important EPS measure. Again, going forward, we will come back and talk more about EPS because it is the way in which we will increasingly want to be judging our performance. Very happy to go into some of the movements between that as well. Principal movements between operating profit and PBT is the finance costs which we have spoken about and then the losses and costs of our JVs and associates, which were around £30 million. However, an important improvement in that EPS underlying measure.

Movement in Net Debt

We have spoken a lot over the last two-and-a-half years of the importance of getting our movement in net debt to a degree that we can manage, generate cash, then spend that cash and end the year with an improvement in our overall cash position and this bridge really takes it through. These two lines are the cash from retail operations. £200 million is adding back the way that we account for the FCA and SFO settlement, so you could really add these together. There is a very small impact from Turkey, so around £1.9 billion of cash from our trading operations and then £387 million of underlying working capital improvement in the year. We focussed on working capital, Dave referenced the stock improvements and that continues to be a focus in the underlying working capital.

We did call out in the announcement that there was a fuel payment in that number. It is contained within that. It is somewhat north of £150 million. It will be a benefit for us for at least the next three years. It is linked to the timing of the calendar month payment of this fuel supply compared with our year-end and when it pays. It will be a timing benefit which will continue to feed through into working capital for three years and then we would expect it to reverse.

Capital Expenditure

That gave us significant retail cash from operations. Interest in tax charges of 582 million in tax terms; CAPEX in terms of the normal business CAPEX, £950 million. The CAPEX through the accounts in the year was £1.2 billion which was slightly less than we had targeted at £1.25 billion and indicated, giving us free cash flow of £744 million. We then generated some cash from the disposals of the business, principally Harris + Hoole, Dobbies, the Giraffe business we sold in the year and then right at the end of the year, we sold the Turkey business. Then through property disposals, Dave mentioned £500 million we generated from property disposals. Against that in this chart, we offset the cost of properties we have bought back, so net-net, we are still generating more than £130 million of cash from our property portfolio having bought back those number of stores. Then finally, other movements take us to a total reduction in net debt of just under 1.4 billion in the year.

To give you a little bit more shape behind our CAPEX, as I said, we spent around £1.2 billion in the year on CAPEX. In the UK, by far the majority of this is on our existing space. There is some element of new space and new business CAPEX of the total of £731 million. Europe, all on our existing business, £141 million and In Asia, about 40% of our CAPEX is on new stores and business expansion, and that is 40% of the 262 million. Again, focussing our spend on CAPEX where we can see returns where we can be sure and clear that we will get the necessary returns and get them in a way that generates value for the business and our shareholders.

Total Indebtedness

We are pleased with the reduction in our indebtedness and again, just really want to look at this in the three ways that I think about this because they are very different characteristics. Net debt, significant reduction over the last two years, from £8.5 billion to £3.7 billion of net debt as of the end of this year. This is what is on our balance sheets. It is the bank and bond financings we have and we will talk a little bit about that in the next slide.

We then also have lease commitments. As we go through leases, as we buy back properties, obviously these reduce. However, equally, with a portfolio as big as ours, every year we come to decisions we have to make about lease renewals and if we renew a lease, then obviously we take on new lease commitments. We see that coming through the numbers as well. However, again, a significant reduction in our lease commitments over the last two years, from £9.4 billion to £7.4 billion.

Pension Scheme

Finally, the pension deficit which I will talk about again. As you know, the primary driver for the way that the IAS 19 measurement of the pension scheme, which is a £5.5 billion at the year-end, pretty much the same as it was at the half year. The primary driver is the drop in corporate yield, and despite that significant increase year-on-year, there has been no change in the underlying cash commitments which we are required to make to our pensioners and future pensioners.

During the year, we've focused on de-risking the investment side of that portfolio and we have made good progress on that, and that has now come to an end in terms of the asset de-risking strategy. We have seen good performance from the scheme assets, which is why year on year, from the half year to now, we have not seen significant change, and we continue to have the long-term deficit funding plan of £270 million. We set that up two years ago with the trustees, which was designed to work through changes in market conditions and importantly through changes and triangle valuations. So that has just started. We are very closely involved with the trustees on that, and they have told us that they want to get the pension trial valuation resolved as soon as possible, before the March year-end. Equally importantly, they have confirmed that they are working within the framework we set out two years ago. We will come back and give an update on that as we progress further. But it is very much starting from the perspective that we set up a predictable cash flow to fund the deficit of £270 million per annum. We will come back to that.

Property

Dave mentioned the property portfolio in terms of how that has shifted. These are numbers as of the end of February, so the 1% in Dave's numbers is not in here, that is the British Land transactions. We are really pleased, both when you look at it from a space perspective and a value perspective in terms of how we have shifted it. And we are really shifting back properties that we want to own back into the ownership of the business, to be able to run them without being concerned about the rentals that might otherwise be a drag on the business.

Liquidity Position

Liquidity is strong, we have £3 billion in available cash. On top of that, we have the cash which we have set aside - £760 million – for fulfilment of the booker, cash consideration, so the £3 billion excludes that just under £800 million. We have £4.4 billion in facilities which mature over the next three or four years, and we repaid £1.9 billion in the year with a relatively low level of maturities. This year and in each of the next two years.

Improving Debt Metrics

From a profile point of view, we feel that we are well set up with a significant reduction in an overall indebtedness, strong cash position and facilities which back it. Our metrics have improved. The key metric of net debt to EBITDA has dropped from last year 2.7x to 1.6x, fixed charge cover has increased from 1.9x to 2.2x and our total indebtedness ratio is slightly improved, from 5.1x to 5x. If you hold the pension deficit flat year on year, the indebtedness ratio has dropped from 5.1x to 4.2x. So, there is strong underlying improvement if you hold the pension deficit. I accept that the pension deficit measured is as it is, but that is very separate in terms of the way we think about it. So, there is an improvement in our metrics.

Financial Summary

Before I hand back to Dave, Group sales are up 4.3%, a profit recovery which continues with profits up 30% in terms of our core operating profit metric. Our EPS is up 41%, our cash generation is strong, we have paid the £1.9 billion of maturities and we have a strong liquidity position.

Thank you very much.

Big Six Full Year Performance

Dave Lewis

Chief Executive Officer, Tesco

Consistent with what we have been doing for the last two years is to make sure that every bit of communication about the performance of the business, both inside and outside the business is aligned. At 7.00 this morning, as we released to the market, one minute later, everything goes to all colleagues, so that everybody gets to hear first from us what is happening. In the same way, we share with you how it is, we feed performance back to the colleagues in the business.

The Big Six

This is what we call the Big Six; you have seen it at each results presentation. One of the reasons that we say we are ahead of the expectations we set for ourselves is that you can see that both in the Group and against the UK and Ireland, we have exceeded the target we set for ourselves on the three financial measures, and on the customer, colleague, and partnership measures. That is another good performance by all parts of the business.

The one thing I want to draw your attention to is that we made one change over the course of the year that you should be aware of. When we set out our cash flow, we had an assumption that the UK turnaround bonus would be paid in shares, and actually the election of colleagues was to pay it in cash. So, that cash flow is after we have made that adjustment. It is something that we decided to do after we had set the targets. But in the spirit of transparency, we made that change. It is beneficial for all parties that we made that change, so we were happy to do it.

We talked in October about the way we think about how we build the value for the four key stakeholders in the business. So, what I thought I would do to conclude is to take you back to that and talk to the lens of customer, colleague, our supply partners, and our shareholders.

Customers

Better service

When I look at it through a customer lens, we have seen a continued step up in our service. As you know, in addition to our own testing and surveying of ourselves, we do that among our competitors, we call it the Spotlight. The speed of service: we continue to lead the market and have advanced that. Interestingly, as we develop the brand and Every Little Helps, helpfulness of colleagues is a key part of what it is we want to build in our business; helpfulness in a way that our customers appreciate. We see that 80% of our customers are recognising that, and at the end of our year, we were leading the market on colleague helpfulness for the first time in our history. That is a very strong performance.

Record availability

Interestingly, people talk to me about the shift from nights to twilights in the way that we change and some of the changes that we have put into the Express format. It has made quite a lot of change in our estate; it has changed our operating model. But it has put nearly 130,000 more colleague hours on the shop floor, facing customers, serving customers, as we change the operating model. The interesting thing about that is, when I look at how I asses the whole thing, one of the questions that say, when I come to Tesco, was everything I wanted available? What you see here is the progress of Tesco versus the big four on that measure over the last two years. When we put service and availability at the core of that very first presentation, we have continued to drive that. We will continue to drive that. That is what we mean when we say we are putting the customer at the heart of everything we do. I am really, really pleased on that.

I have given you the details of the availability of food stock, but in the core element of food, we were carrying something like £935 million of stock, full year 2014/2015. That is down now to £755 million of stock. So, better service, better availability but from a lower working capital. Interestingly, if you look on the right-hand side, look at the availability always, and you see a very strong improvement from our colleagues, but also a significant difference between our competitive set as we make sure that everything that people want is available at the time that they most want to shop.

Clearer, lower, more stable prices

This is what has been happening in the way that we change our model. People appreciate the prices. For those who remember all the detail we present, last time we were here, we talked about prices being nearly 7% lower. They are 6% lower now and we kept the start point the same. That relates to the 0.6% of inflation that we have seen. We are still talking about our basket size being 6% lower than it was in September 2014. We continue to reduce the number of promotions. Participation continued to decline, therefore, as did the depth of the promotion. We might talk about that when you ask me questions about inflation later.

We have seen in the market place that as there has been some cost inflation, there has also been an increase in promotions happening as part of that negotiating way that cost increases can sometimes happen. We continue to prefer lower, stable, more consistent pricing for our customers, and therefore, while the market has become more promotionally active recently, our trend is still for us to be lower. It will be interesting to see how the market goes in the next three or four months, but that is the trend that we set and that is how we delivered against it for customers. Trust in our pricing is growing because we are doing that.

Right range

The range continues to reduce and optimise, we are talking about a further 7% versus 2015/2016. We have been able to increase the space that we have given to own label; that has helped our participation, it is also helping the margin position. And, for those who were in October, we talked about our move on one-touch replenishment; so 7% of all cases, which when you move as many cases as we do, is an awful lot of cases, are only touched once from the back of the store to serving a customer, and that helps us run the business more efficiently.

Right range: Express

We started with big stores two and a half years ago for reasons that Alan touched on, the performance of, and this year we have been taking all of that thinking to our Express estate. It is fair to say, our assortment in Express has ballooned, even more than it had in the rest of the estate. We have taken the assortment down by 46%. In terms of range in stores, we are talking about adding new range. So there has been quite a lot of change of category for the particular missions in the Express outlet, and we have changed and cleared 1,200 of free-standing displays and other things that have been pushed into a convenience outlet that really are part of a convenience shop, and we have seen that work very well for us.

So across all of our business: customer at the heart – very strong feedback. Every single customer-service measure improved last year versus a year ago.

Colleagues

A great place to work

Lots of changes for colleagues; a huge amount of change for colleagues over this last two and a half years. I cannot begin to tell you how much engagement there is with colleagues on that change agenda. It is easy for me to stand here and say we changed the store operating model from nights to days. The amount of change that that involves for individuals and for the operation is enormous – absolutely enormous. I can share with you some of the details of that outside, as indeed can my colleagues, but do not underestimate the amount of change.

The interesting this is colleagues stay highly engaged. Again, two and a half years ago, we talked about actually having lost a little bit of that colleague engagement. Even with all the change that we are bringing in, we have managed to hold a very high level versus any competitives[?] that you pick in terms of engagement. It is pleasing to see that 65% in our survey this year said, you have made the job simpler. It goes back to what we talked about before: how do we simplify everything so that they can serve customers a little better? It still means that 35% did not think we did, so we have still got some way to go, but it is not a bad start. The important thing, and the bit that was, let us be honest, a little bit difficult for us is, two and a half years ago, not many colleagues were recommending Tesco as place to shop.

That has changed dramatically over the last 18 months and I am pleased to see that starting to come through.

Investing in colleagues

We continue to invest in colleagues. You will read in our annual report, we have been very clear, our stated intention at every level in our business. So the one thing that you will see from how we engage and reward is the principle applies to every colleague; myself, to a colleague serving customers in-store and everyone in between. We want the best people to perform the best within Tesco, and we want to be able to offer them a reward which is in the top 25% of a competitive set within the marketplace. And you will see us report against that for all of us. We are committed to that. That is where we are for our colleagues. If you take the base pay of colleagues and the fact that we still do pay some premiums – not everybody does now – but we still pay some premiums, if you monetise all of that, at the moment, our colleagues get about £9.04 an hour versus the minimum wage that you would refer to. But we also have the pay review which is in the middle of this year.

We have a very strong and very demanded, if you like, from our colleagues, the benefit programme that we put together. And we have done an awful lot this year on health and wellbeing. One of the things that we talk about inside Tesco is nobody should get hurt working or shopping in Tesco, but also, we think that there are things that we can do to help and invest in the health, the wellbeing and the vitality of our colleagues. And so January inside our business was our own turned[?] health month and we engaged in a whole series of things with our colleagues for their own personal health and wellbeing, which was phenomenally received. One example that we have put on here is, the free fruit that we give to children in-store, we gave to colleagues through that month, in terms of encouraging them to engage with their five a day. So we gave 1.8 million pieces of free fruit to colleagues in that month of January.

Opportunities to get on

The other very important thing, and not so often talked about in Tesco, is it definitely is a place where people can get on. I shall talk about a couple of those examples in a minute. There'll 4,000 promotions since we last spoke to you about this. 2,500 apprenticeships this year, all right? And, you know, we are – we talk very openly about wanting to be a diverse and inclusive employer, right? I know that we can talk about the diverse bit in terms of gender, but for me, that's a very small part of this whole point. The point in Tesco, is everybody is welcome. Everybody is welcome. And we can talk about that, if you like, later.

Strengthening the team

Now, talking about colleagues and talking about strength in the team, this is where I get to embarrass a few people in the room by showing their picture. But these are the changes that have happened in the senior team since we last spoke. So, Jane, you have got to know by now, who leads the Communication function, joined us from Coke, but leading Communications. Alessandra Bellini, who you may have known because she's only been with us six weeks. So, very much new, in that sense. So, Alessandra, who joins us as Chief Customer Officer, was previously with Unilever. Matt Simister, who most of you will know. Matt is sitting down here. Matt's one of those people that's been in Tesco quite a long while. And I'm pleased to say he joins the Executive to run Central Europe. Tony Hoggett, who was the Chief Operating Officer in the UK until a few days ago, is in Harvard. But Tony joined Tesco I think 25, 26 years ago, in fact, the same time as Mr Tarry at the back there. And he will take over as the CEO in Asia. And you may not know the gentleman on the right. That's Guillaume, who is taking over as the CEO of Dunnhumby. He's with Google at the moment, a place where opportunity to invest and grow Dunnhumby significantly as a standalone business inside the Tesco Group. You'll see some changes in how it is we go to market with Dunnhumby, a whole different offer based Guillaume and his team and his expertise. So, just wanted to say hello and welcome to that. Please, if you haven't, I'll get them to answer questions you've got for me later. But get a chance to say hello to the team.

Suppliers

Simpler ways of working

So, moving on to suppliers, one of our young farmers there. But in terms of simpler ways of working, we – 94% of our suppliers are now engaged in the supplier network and telling them it's a very helpful way in which they can understand how it is they should, could do business with us. We run a huge amount of supplier training programmes in order, again, they can understand them, we can understand them better. And we've run over 1,000 inductions where we allow people to come in, invite them in and understand how it is Tesco works so they can customise and, indeed, make their business proposition an easier fit in terms of how it can work through Tesco. It's all part of getting that joint understanding of how our businesses work so that we can create new opportunities together.

True partnerships – meat

Giving an example, try and always give you at least one example, you know about farm brands. But here's an example for meat. An example for meat. We introduced Boswell Farms, as you know. In the last year, the volume of steak sold by Matt and the Tesco team is up 22%. Okay? More affordable because we changed the envelope in terms of pricing, different cuts, different offer. But 22% up. The interesting thing is the impact of that volume on the savings and the efficiency of the supplier, right? So, that volume allowed this supplier to invest £1 million in a piece of packaging equipment that increased their speed by more than 25% and the cost benefit from it. So, if you want an example of how more volume can lead to benefits all the way through, customer got a better deal on steak, we actually grew our volume, enhanced our margin through the operational leverage of that volume. And they were able to enhance their profitability by changing the way they serve that volume. Interestingly, this particular supplier – interestingly, this supplier, in their results announcement this year, put down to their improved performance the change in the relationship with Tesco and the opportunity that Tesco afforded as one of the reasons why their performance had exceeded their expectations in the marketplace.

Building trust

So, just one example of how we can work with suppliers in really quite a different way. I'm really, really pleased with the progress that we're making there. You see that in trust – you know, simple, transparent and easy to deal with, communicates well and treats me fairly. All right? So, it's difficult, right? There's inflation there. There is some difficult conversations that are happening and have been happening over the last six or eight months. So, this is not the easiest of environments in which – but the way that Jason and his team have engaged with our supply partners around that. You know, our view is we don't want inflation. We want to work together to mitigate it. So, let's sit down and say everything – and I mean everything before we think about having to increase prices to customers, all right, and still be building these sorts of relationships I think is a testament to the team and the way they've gone about what has been a very important but not easy transformation in the way that we dealt with suppliers over the last two and a half years.

Shareholders

Sharing our plans

Finally, shareholders. Well, we set out a plan. We set out a plan in October last year. We were running to the plan beforehand. We shared with you the six things that were driving our activity and what it has meant in terms of delivering our margin aspiration of 3.5-4%. We are in a good place against that. We're ahead of the milestones we set for ourselves and we're confident about the plan that we've got against the ability to deliver even in the environment that we're in. All right?

Dividend policy

We've announced the dividend policy, and Alan touched on it a little. So, that is, again, a reflection of where we are and where the Board is in terms of the turnaround of the business. Now, we'll recommence in 2017–2018 and we'll grow progressively. The idea in the medium term is that we get to two times earnings per share. But that is a measure of the confidence that we have in the turnaround of the business and sharing what that means for our shareholders, right?

So, that's the business. That's where we are. That's what we've done in terms of performance, where we are on the strategic drivers and that's what it means for key stakeholders in our business. And what I'll conclude with now is that which is on top of that, right? So, on top of the plans that we shared with you, nothing of what we've talked about now is dependent on unlocking the growth that comes from the merger with Booker. And it's a very important distinction, right? It's a very important distinction.

Tesco and Booker

So, in January, we announced a merger with Booker and we talked that – about that very clearly in terms of unlocking growth potential for both businesses. Now, we completely believe in that growth opportunity. The work that we continue to do about the market, the evolution tells us that opportunity is there and together, we can be a very competitive and compelling force in that marketplace.

Now, I won't repeat everything we've said about that. We're at the very start of the journey. This is a conversation that will go on. We will engage completely in the competition with you. And after that is done, obviously we'll take it to shareholders for a vote. But what I thought I would do is just try and illustrate in a slightly different way what it is we've been talking about. You've seen from me – if you went out in October, you saw this chart before. We see three ways of creating value in the Tesco business. Product – everything that Jason is responsible in terms of the range that we buy, the category plans that we build for our channels. The operating models in each of the channels. So, you go back to our [inaudible] which is there are four categories in these three channels in the Tesco business. And obviously, we then have the customer. All right? All three of those pillars can create value to the Tesco business. Two and a half years ago, we changed the organisation of the top of our business through our Chief Product Officer to somebody chief running the channels and Chief Customer Officer. So, we've been designing this for two-and-half years, all right? That's what we've been building in our business for that time. What Booker does is it adds a channel. It adds the channel of wholesale. And it adds one more category, which is that element of professional, all right, particularly for professional cooking and cleaning, which is a speciality which exists very well within the Booker business.

The UK's leading food business

So, what we're doing is we're adding channel expertise, number one UK wholesaler and we're adding some products expertise in terms of that professional offering for food service and, indeed, for sort of household cleaning into our business. And we think that that matrix is perfect in terms of dealing with customers, be they consumers who come to our stores, buy food for in-home or actually those people that are involved in the out-of-home consumption in food. And remember, for those who are not familiar, in-home consumption, i.e., grocery shopping are £110 billion a year in the UK and flat – and flat last two years inflation. So, flat. Out-of-home, £85 billion opportunity, growing at 4% with a margin which is higher than the retail offer. All right? So, it's the addition from a Tesco point of view of an £80 billion market which is growing and had a profit pool which is greater than retail, okay?

Now, the way that we see it is that growth – in the document, you would have seen we put – you know, £25 million of growth we've put there. We think there's many more. There's much more growth here. We have to prove it and we have to be able to quantify it. So, there are hurdles for us to do that. And that's what we'll do, the time between now and then. We can look at how it is. We can share with you more of those growth opportunities in the way that we can quantify and then declare.

We said there are at least £175 million of synergies and that's after very good due diligence and third party review. And the way that we look at it – and I really will let you do all the reading the different ways of looking at this deal. We're very confident about the synergies. We really are very confident about the synergies. And so what – the way that we look at is post synergies, the multiple here is a little over nine times. All right? So, in terms of the value of the proposition, we think it's very compelling. And we intend to sort of build that proposition up to past competition review and ultimately into a shareholder vote.

So finally, in order for you to think of the way we think about it, right, because people ask me how do you think about it. I look at it this way, which is geographically, it's our core. It's the UK. From a product point of view, it's core because it's food. The channel is new, right? What we're doing here is we're putting our hand up and saying actually, there is expertise in running a wholesale food service channel. And actually, Booker have it, Tesco don't. We need to get that. That's the uniqueness that comes. We think the expertise is leading. It's the leading retail and wholesale. We return our WAAC after two years. There are not many mergers and acquisitions, to use that phrase, that gets you to that level. And as I say, there's an £85 billion market growing at 3.8%. And we think there's an opportunity to grow a very compelling proposition there together that couldn't be done by either alone. So, that's where we are on Booker. But we're at the start of that particular journey.

Summary

So, we're ahead of our own expectations, we're being candid with you about that. Profit increased at the Group level was 30% – was 60% in the UK and Irish business. We do believe we are creating long-term value for all of our stakeholders. And we'll continue to drive those six drivers. We think we're well-positioned. We're not at all naive about the challenging environment we've faced. Our supplier relationships have never been stronger. Our control of our costs is very good at getting better all the time. And therefore, actually how we keep the customer in the centre of us and make ourselves more competitive, we think we are well-placed to be able to do that. And we believe that the proposed merger with Booker unlocked new growth which comes on top of the plans that we've already shared in detail with our – you know, with the market back in October.

So with that, I'll stop and invite you to ask us any questions you may have.

Q&A

Dave Lewis: Was that Eoin[?] or Mr McCarthy first up? I didn't know if you were stretching or putting your arm up there.

Speaker: A bit of both.

Dave McCarthy (HSBC): Hi, it's Dave McCarthy, HSBC. I wanted to ask you about how you're managing cost inflation. Historically, you know, the industry has always done the cost plus margin approach. But if you've got, let's just say, 5% cost inflation coming through, including cost of goods sold, do you think you would pass on 5% or less than that?

Dave Lewis: So, I'll give the general answer and Jason, I'm going to ask you add on to that a little. So, we start from a place which is – first of all, we do reserve the right to challenge whether the 5% is justified.

Dave McCarthy (HSBC): And if – okay.

Dave Lewis: Right? It's actually quite important, because otherwise I think you get some slippage which is just opportunistic and we don't think that's right. So, that's something which is – should be resisted. But then is a question of, if that's real, how do we together mitigate it? And so, actually, that end-to-end review of how can we lower the way we work together in order to make sure that that cost inflation is not passed on in its entirety, in a way.

And then, there's the question which is, if it can't be completely mitigated, there's a question obviously for our supplier partner in terms of the price they choose to charge. And then we have to decide whether it is something that we have to absorb and offset from our other cost-saving programme, because actually, we don't want to have that position in the marketplace. So, everything is about reducing it. But Jason, do you want to be more specific than me?

Jason Tarry: I think you've given a very good summary, actually, Dave. And that's exactly the approach that we are taking. So, anything unjustified gets pushed back. Anything else that where we see real cost-price inflation, what can we do together – looking at it together – in order to be able to mitigate against it. And that might be looking at the range that we have together, looking at the processing costs, looking at the input costs. And we do take positions and take a view on where the – when we should buy and for how long we should buy for. So, there is a lot that we can do together and we are because we're very – we don't think it's a good thing, and we're trying to keep it under control as much as we possibly can.

Dave Lewis: So Dave, to your point, give you a data point to help you. So if you take – I've seen two different market views about inflation in March and up to March. One at 2.3, and actually one at just over 3. I've not had the chance to look at both of the bases of those, but let's say somewhere in that range. Against that we're at 0.6, and if you look at – you know, we track the inflation in the basket, take out the promotion in the basket, we think we are the lowest of the big four in a measurable way as a result of not wanting to pass on everything.

Dave McCarthy (HSBC): So you have – you believe you've got a competitive advantage in dealing with cost inflation and this period of inflation you can use as a competitive weapon to improve your position?

Dave Lewis: I completely agree with what you just said. And it's consistent – it's completely consistent with what we've been saying. We've taken our prices down by 6%. The way we can enhance our competitiveness this is the marketplace is not to let prices rise as much as everybody else does. And we think we're well placed to do that, okay?

Go ahead, why don't you just pass it? We'll start the front and work backwards this time. It's been the other way.

Dan Ekstein (UBS): Thank you it's Dan Ekstein from UBS. I've got two questions. Firstly on Project Reset, I think this time last year you said you were down 18% in terms of SKU count. You said a further 7% today, I think. How much further is there to go there? I guess both in sum and across the different categories within the business.

And then secondly on CAPEX – CAPEX guidance for this year is sort of 15% to 20% below where you said you thought it would be, and you called out cloud technology. I thought that was interesting. Is there an opportunity for the business to become sort of structurally less capital intensive than in the past through application of that? Thank you.

Dave Lewis: Okay. Jason, do you want to talk about range and Alan you can pick up on CAPEX? Is that okay? You're the experts.

Jason Tarry: Yeah, so quite rightly, over the last two years, sort of cumulative 24%. The good news is actually our share range perception has improved over that period of time, and that is also linked to availability improvements and get what I want. But actually there also – the feedback is our perception has – it's easier to shop, the choice is clear to see. We think there's more to do, so it's a bit like you keep opening the curtains and seeing something new. So we still believe there's a bit more to go. I mean, the big step was in year one where we were sort of 18%. You saw what we've done in the last year. And it will be single digit again, I think, in terms of the opportunity going forward, but still a bit more to do, and even so retain our perception leadership.

Alan Stewart: That's right. It's like gardening, isn't it? You're constantly pruning and rotating – and yeah. In terms of the CAPEX, yes, we guided and in fact continue to guide to an average of £1.4 billion of CAPEX over the three years. But in the year ahead and important that we've always said we will give more specific guidance in terms of the year we're just entering, and that's the £1.25 billion.

And from a structural perspective, we definitely are wanting to shift what historically would have been capitalised technology spending into expense technology spend, and that's consistent with the way the technology market is going. We are moving more to cloud-based services. I think from a business perspective it gives us a greater flexibility as well, because you're not carrying the drag of that inflation. You're able to respond more quickly in terms of where you wanted to spend money.

I think we will always be a business in which there's quite a lot of CAPEX development. Opening a store, keeping a store has quite a lot of CAPEX. But wherever possible, having less CAPEX invested in the business is somewhere we would go. But structurally, depreciation this year is at £1.18 billion so it's 1.2 billion. We're pretty much aligned with depreciation and CAPEX now. And – but that's really where it is and we – all of our CAPEX needs to hit the returns. Cash payback continues to be a – one of the key if not the key metric that we look at in CAPEX. Yeah.

Dave Lewis: Just pass it. Should we go by row just to keep the logistics easy? Go for it.

Speaker (Exane): Hi. Good morning, it's Andrew Gwynn from Exane. Just on the – I forget the [inaudible] it was, but obviously the volume momentum in the UK business is a bit softer. Are you still of the view that now is the right time to recover the margin – the 3.5-4% margin? I suppose the sort of connected question to that is what are the circumstances where you sort of take a step back and put the ambition maybe a little bit further?

Dave Lewis: So that it's very clear. We are very straightforward. Market momentum in terms of volume was more challenged in Q4 than the rest of the year. Our performance versus the market was still outperforming, and that plays into the importance with which volume is a key part of our business model.

I think – so will – does volume stay focused? Absolutely it does. I think the only nuance we would give you is not all volume is equal. We used to have a measure of volume that sought to aggregate large screen televisions with cans of baked beans. We think there's a more sophisticated way of doing that and we'll go to the scan singles way, so that we actually drive volume in a way which does unlock the leverage that we're talking about. We think that's just the next level of finesse and specificity.

But to your point about margins, you know, the way that I look at it is if we declare £1.28 billion of profit this year and we think that we've got a £1.5 billion of profit opportunity of which there's still £1.3 left to go, we can get to our margin aspirations through cost and keep Jason and the others focused on making sure we're competitive to drive the volume. So volume is an important part, but we think we've got enough opportunity in our cost base and the plans that we've got in that £1.5 billion to be able to continue to say that 3.5-4% can be delivered from the business even when the market is a little bit more challenging. Okay.

Speaker (Exane): But if volumes go negative, is there a point at some point where you say, look, that maybe we'll kick out that margin ambition a bit further?

Dave Lewis: Well we'll continue. So again, a bit like – so Dave's question is how do we think about cost increases is if we think – and the reason that we don't – you know, remember that we don't target our category guys on percentage margin, we – and so if people believe that actually a lower price or lower percentage margin drives volume and the equation is better, they're perfectly at liberty to do that. So that will be how Jason and the others have to think about how it is we play in the market, depending how it unfolds through the inflationary cycle. I suppose the bit to take is there is a very open, very transparent conversation in decision now where the percentage margin is not the key driver of the decisions that the buyers are making, right? Go for it.

Stewart McGuire (Credit Suisse): Good morning. Stewart McGuire from Credit Suisse. Two questions for me. On Extra stores, do you think that they need to be improving at a faster clip in order to actually get the volume recovery that you're hoping for, given that they're still quite flat with the exception of Q3?

And then a question for Alan – on the pension you've increased the discount rate by 40 basis points in the last six months, which I think should have about a £2 billion improvement in the deficit, but it only improved by about £350 million. Can you give us some colour on that, please? Thank you.

Dave Lewis: So large stores – actually I'm – I think started at 7.5 negative to get to flat and growing we think is progress. We think we can enhance the offer in large stores so they will improve. I think if you take out general merchandising from large stores and you look at the food element that you see the growth that we're talking about. But that comes through also how it is we augment the mix. That's how we think about the partnerships, and how[?] it is we do. Without drawing attention to it, we put a couple of different trial propositions in the marketplace recently that will look at how it is we play large stores ever so slightly differently.

So Duncan Hoy who works in for Matt in the UK runs the large stores. He's completely focused on how it is he builds that proposition to improve the performance. So – but to be honest, the critical thing at the moment is that people don't appreciate there was a myth that these were drag on our performance. They're not a drag on our performance, all right? And the way that we see them in Cole[?] food, not at all. Do you want to talk about pension?

Alan Stewart: Yeah, so couple of points in pension. And this is a market measure and so in that sense it increases as the market increases and as yields in the market shift. So it's something which we just reflect the market measure. I've said and a number of times and I'll say it again, I think the IAS 19 measure is the least relevant measure of any of our pension – ways of looking at pensions. But it is there, and therefore right that we talk about it. And the other – but it's very much outside our control because it's market bonds and then the other side of it, of course, is the asset performance. And the asset performance is one which is there for the long term and for there for the long-term delivery of the pension obligations which are there. They will move out of line at times, and is very much – totally outside our control. We will continue to try to get the most accurate measure of what is the right discount to use for that liability, but it's something which may well move by the sort of quantum that you've seen this month, maybe this period, maybe even more. Really important for us is the predictability of those pension deficit payments.

Speaker: Edouard Aubin from Morgan Stanley. Sorry, don't sit down. So you did not show us a table comparing and contrasting your cash flow generation in 2017 versus 2016. I think very back of the inflow calculation, if you strip out exceptional items, cash and discontinued operations, I think your free cash was down around £300 million to £400 million. So could you just come back on the different moving parts? You mentioned the cash bonus, for example, being one of them and petrol[?] and so on, so if you could just elaborate on that.

Alan Stewart: Yes. Really, the exceptionals this year – really it's an accounting noise, it's a technical noise because in truth, the cash was generated in the business, but the way it comes through the results is that left-hand column is reduced by it because we have taken the charge, which is why I added those two together. The £2.3 billion of cash generation includes the £387 million of working capital. We are focussed on that very strongly and the cash generation is up 9% year-on-year. There will be some shifts. Sometimes we are dealing with quite large outflows in payments, so this year, cash flow, in the year we've just ended, we will have the payment of the elements in relation to the SFO and FCA settlement. Those will come through this year.

But in a principal basis, we're looking to generate from the cash we make what we then spend in terms of the CAPEX and the interest in tax, plus any other activities which we have, such as property buybacks. We want to end the year with a positive cash flow and continue to – to be able to reduce our debt.

There will come a point at which the £3.7 billion of net debt is one which we are look at and say, 'Well, actually, within our capital structure, that is the right level of debt.' We are not there yet, but as the business performance increases and as we got – meet our aspirations, that point is certainly one that we can begin to think about.

That is the way we think about it. It generates cash, year-on-year. I get what you are saying in terms of it. Last year, I did talk about – you will remember at the prelims last year, we spoke about that we had done very well in terms of the working capital generation, because some of our activities had yielded results earlier than we had planned. So in a sense, we captured it last year. That does not mean we are any less focussed on capturing it in the year we have just closed, and indeed in the year we've just started.

Speaker: For this year, I know you are constrained in terms of your guidance, but do you expect the free cash to be –underlying free cash to be up or down versus 2017?

Alan Stewart: You are going to have to run it through your own model in terms of what it is. We are focussed on generating the cash, we are focussed on increasing the – building the margin in line with the aspiration that we have set out and we have been very clear in terms of where – we think the CAPEX this year is about 1.2 billion.

Dave Lewis: So that commitment to the £9 billion doesn't change. Yeah.

Alan Stewart: Just to be clear, £1.25 billion for the year that we have just set out is what we said.

Rob Joyce (Goldman Sachs): Rob Joyce, Goldman Sachs. I am sorry, I am still standing.

Speaker: Dave is always happy [inaudible].

Rob Joyce (Goldman Sachs): I mean, just two questions leading on from Edouard's is on an average basis over those £9 billion, three years of retail cash, what do you – what does that free cash flow number average out on an annual basis? Running it through my model, I am getting kind of £800 million a year. It's [inaudible] number. Is that ballpark?

Alan Stewart: Look, it is a difficult question to answer, but your model, if you look at where you are and you look at how you face[?] then, we are focussed on doing what you do. You have got the redemption schedule of our bonds. You know what we are expecting to spend. I have said that the CAPEX average will be £1.4 billion, so providing nothing changes, I would expect a bit of step up in CAPEX next year – the 2018/10 year. But any more than that, I cannot really help you, I am afraid. But generating free cash – really important to the ability to run the business.

Rob Joyce (Goldman Sachs): Could you give us any details on the working cap you expect over the next three years, average tax and the restructuring charges?

Speaker: Just send the spread sheet and we will –

Alan Stewart: send it to Chris. He will fill it in later.

Rob Joyce (Goldman Sachs): Fair enough.

Sreedhar Mahamkali (Macquarie): Hi, good morning. It is Sreedhar, I am coming from Macquarie.

Speaker: Hi, Sreedhar.

Sreedhar Mahamkali (Macquarie): A couple of questions, please. Can you talk a little bit – we talked about volume and you have given a couple of examples of how and why volume is very important, and clearly, volume isn't quite there. In that context, can you talk about relative volume versus absolute volume and the value growth – physical pound sterling value growth – and how that helps the margin in question? We talked about cost, I get the point, but what P&L leverage in terms of relative volume and in terms of value. That is the first question.

Dave Lewis: Okay. No, go on.

Sreedhar Mahamkali (Macquarie): Second one is just in terms of rent savings, you talked about, I do not know, £152 million rent savings in the year? I remember from the investor day, you told £176 million back then, am I missing something here or is it now, this year –

Dave Lewis: Time period.

Sreedhar Mahamkali (Macquarie): – is it getting it into £176 million?

Alan Stewart: One was a target, one was what we have delivered.

Dave Lewis: Time period.

Sreedhar Mahamkali (Macquarie): Okay. And this year, what kind of number should we be thinking about?

Alan Stewart: Well, look, the, the, what we've done in terms of the British land transaction is sub-£20 million in terms of the improvement in rent. But for most of last year, we actually had it for most of the year, because we brought the majority at the start of the year, so there's very little animalisation impact in terms of what we've done. But we will continue to look at it. And finally, I will come back to just the one other thing which we shouldn't ignore in terms of that free cash generation, or the cash generation, is the property side of it. Because, as you've seen, we generated significant value from our properties. Some of that we chose to invest back in the property buybacks. But that's a key part of our cash generation to generate value as well and in terms of debt reduction.

Sreedhar Mahamkali (Macquarie): Could you – just the last one, then, probably [inaudible] –

Dave Lewis: I'm waiting, don't worry.

Sreedhar Mahamkali (Macquarie): Well, with Alan. Going back to Edouard's point, Can you quantify the cash bonus? Is that possible or is that…?

Alan Stewart: In terms of the – what Dave referenced?

Sreedhar Mahamkali (Macquarie): Exactly.

Alan Stewart: It's… Yeah, I think it was about £77 million. About. Is that right, Kate? Where's Kate? Right at the back. A bit more, isn't it?

Kate Koch: Yeah, last year was at least more than that.

Alan Stewart: More than that, but going forward will be about that.

Dave Lewis: So we should give the number. But because we're talking about the turnaround bonus for last year, which was higher than the ongoing level, the number I had in my mind was around £130 – £135 million, I think, was that twist of equity cash.

Sreedhar Mahamkali (Macquarie): Thanks.

Dave Lewis: Indeed. Okay. Going forward.

Speaker: Sorry, and looking into the year ahead? Yeah. You asked about –

Dave Lewis: And what we can do on rent is we'll take the – what is delivered in this year and we add them together and you'll be quite happy against the £170 million, I think.

So back to relative volume and I'm going to look at Jason and probably Matt, because they can help me with some examples. So the way that we look at it is this. We're pretty – you know, people have modelled this, right? We're pretty confident, to the extent of our ability, that our absolute size allows for an advantage in buying relative to others, right? Particularly in food, okay? Now we have a view as to what that advantage is. We've never said it. It's competitively sensitive and you wouldn't expect me to reveal that. It is fair to say that by where we were three years ago, we'd lost that advantage and position in the way that we were dealing with our suppliers and we've, under Jason's leadership, got that back in the way that we've changed the engagement throughout. So I do believe that we have a relative benefit in volume that comes in a lower cost price that gives us greater optionality in terms of how we price in the marketplace.

In terms of cash, the thing that's really interesting in terms of how this works, and the example that I'm going to use – but I'm going to look at Jason and Matt, because they can give you more flavour if you need – is I've seen it work out in agriculture very starkly. Which is, we had a situation before which is, if you were our farmer, we'd agreed with you what the specification was. And during a point in time, we gave you a volume demand which had some tolerances in it, of a certain specification that you were, you know, invited to hit. So we might take 60% of your crop, because it fell within that specification at the time when we were demanding the volume. As a farmer, your problem is what do I do with the rest of the volume that came at that time, right? Or indeed, those that are outside of the specifications that you've agreed with Tesco.

What we've done over this period is work with them to say, 'Actually, how do we increase…' with our select partners, 'How do we increase the volume we take?' So increasing the crop utilisation is the way we talk about it. But also, through our proposition in terms of Perfectly Imperfect and others, take a greater range of specification. And the things that have really struck me is that when there are crop flushes – so we did, I think we said, nine last year? We've done three or four already this year. So cauliflowers and carrots are the last couple. There have been some on English strawberries just recently. An opportunity where a farmer will come and say, 'Actually, sun's earlier, crop's earlier, there's more volume.' For the farmer, that's a nightmare. Because the opportunity is either I give you the 60% you wanted and the rest is wasted. Terrible – so profitability, but also environmentally wasted. Or discount to the marketplace in order to sell that volume.

So what we've been doing is saying, 'Actually, we'll take the volume.' So we get the benefit of a lower actual price because we take the greater volume, the farmer gets certainty because he sells all the crop, and we then open our stores to give the customer a better deal in terms of strawberries or cauliflower or carrots. So that's when we see absolute – so with the last crop flushes we see, I get a piece of paper that says benefit for the farmer, benefit for Tesco in terms of pounds and also what the benefit is for the customer. So that's where we start to see the relative volume opportunity that we are for our suppliers translate into real money in terms of a benefit that we can enhance the margin with. I'm looking at the experts in the room in terms of Matt and Jason to either correct me or build on me if I've got it wrong.

Jason Tarry: No, you've been listening very well, Dave.

Dave Lewis: Fair enough. All right.

Clive Black (Shore Capital): Clive Black from Shore Capital. You can have a rest here, Alan, as I don't have a spread sheet. Following on from Dave McCarthy's question, in terms of inflation and managing inflation, it was interesting you said you were inflating more than the big four, but you didn't mention the discounters. I just wondered, in that respect, how you expect customers or shoppers in the UK to face into inflation? And in that respect, what do you see in your range from a proposition perspective? More private label, fewer international brands, more British brands?

Dave Lewis: So I think what I said is that we were inflating less than the big four. Not – just to correct. So it is less than the big four. But, Clive, you're spot on. We can see what's happening in terms of customer buying behaviour against the discount offer as people feel the pinch in terms of inflation. The opportunity for us is what do we do about that? We did it with farm brands, and that's using an exclusively owned brand to access a price point in order to offer customers, and we've been very successful with that. And we've got some thoughts and ideas about what we need to do to be competitive. Because whilst we make the reference here – just to be really clear – we see all of that as the competitive set. And so we, like I suspect others, need to think about how it is we – you know, at the end of last year, we could see switching in favour of Tesco from all our competitive set. In the first part of this year, we've seen that be different across the marketplace across some of the discount offers.

So we need to sit down and we need to be clear about how we respond. But you know that I'm not going to tell you exactly what I'm going to do about it, so I'll stop just there.

Go for it.

James Tracey (Redburn): Hi, Dave. Hi, Alan. James Tracey from Redburn. Two questions for me. The first question is on the UK profit bridge. And it looks like most the cost savings were reinvested back into price, so the improvement in margin could be put down to improving volumes and mix. So, given that's the case and volumes have slowed a bit, is it fair to assume that you need to have positive volume growth to get to the long-term target or are there other levers you can pull?

And then the second question is on the Tesco Bank. Lending growth was 17% over the full year. Have you seen a slowdown in the exit rate of lending growth? And I'm basically asking are you becoming a bit more cautious when it comes to lending money, given that the bad debt ratio is starting to tick up and the economy seems to be getting a bit more difficult?

Alan Stewart: I'm going to ask Benny to answer the second question if that's okay, because Benny is – I know he's here. But let me answer the first one in terms of the – it's interesting. Most people, James, talk about it and say the only way we're achieving it is through cost savings, whereas you have gone the other way. I think there is – there is definitely some and some and that's something that we definitely have to look at.

So we've spoken about the volume, we've spoken about the importance of it and we've also spoken about within max the mix, how increasingly we will be selective and choiceful as to how we improve the overall business performance by looking at those different channels and categories. So I expect to see there will be elements of both as we go through, but the core underpin – and this is really important – the way we look at it, the core underpin to everything we're doing is those cost savings and we've made the £226 million towards the £1.5 billion and we'll continue to look at those and to try to achieve them as quickly as we can and effectively as we can.

Benny?

Benny Higgins: Yeah, sure. On lending appetite, we've had a very conservative risk appetite on lending, both unsecured and secured lending. And so we're able, actually, to continue to grow the lending and the number of customers we serve without in any way breaching that risk appetite, which remains really very prudent. So it doesn't, we wouldn't say a slowdown for us, even if there's a market slowdown.

Dave Lewis: Okay, do you want to – I'm going to keep moving back. I'll come back to you at the – Could you do me a favour and pass back? Sorry, Bruno, I set a trend, so I'll – it might mean you get the last word.

Niamh McSherry (Deutsche Bank): Niamh McSherry, Deutsche Bank. I have three questions, and actually I did look at the chart and see it a little differently to James. My question was on the volume and mix benefit of about £500 million in that chart. It looks pretty good for a 0.9% like-for-like in the UK and worldwide. And so is that the type of volume and mix benefit that you might be looking for going forward, or was this your exceptional? So that was the first question.

Dave Lewis: Okay, carry on.

Niamh McSherry (Deutsche Bank): The second one was actually about expensing IT spend versus capitalizing it. Is there any – give us any indication of the magnitude and millions of pounds of, you know, that kind of shift in approach.

And then the third one is on your max versus the mix chart. Can't help noticing that online as a channel is still all red. You've made a lot of changes in the last 18 months. Are there more changes that you can make to move some of those boxes out of red?

Dave Lewis: So why don't I take one and three, and you take two? How's that?

So you're right about the volume and the mix against the like-for-like. The way that we see it now, but the market may change given Clive's question, is we set ourselves a point, which is how do we rebuild the volume in total and now more selectively and more appropriate by product category, because that's where the real leverage is? So we need to get more deliberate and choiceful about how we do that. And I'm pleased with the progress that we're making there. But the way that the plan worked, you know, the way that we'd set the work was actually we were 8% – 7-8% more expensive than where we wanted to be for customers, so every bit we saved and every volume that we grew went into funding that 6% price reduction that we've seen over those two years, right? And the idea was that as we then carried on making those savings and keeping that volume, that actually more of that saving could go to being able to recover the margin, because our price position was again competitive.

Now, everything's dynamic in retail in that sense, so we were really happy with where we got to and in our plans that's exactly how it plays out, and we have the wherewithal to be able to change that cost saving into more competitiveness to get the mix right against the 3.5-4%. Now, if the market's move, we'll have to adjust and we'll have to think about how it is we drive volume differently in order to get that element and the contribution from that, or indeed how we save more money in terms of cost in order to be able to give us the optionality. But that's how we think about it. But it's fair to say that the market is moving, particularly in the last couple of months, and we'll need to think about whether we have to adjust it. But based on last year, we were happy with the balance that we got.

What was the third one so that I can do them both at the same time?

Niamh McSherry (Deutsche Bank): The third one was online –

Dave Lewis: Mix. Online. Look, online – remember red is less profitable than the average, not loss making. I suppose the way that I would look at it is very happy with what we've done on grocery home shopping. Really very happy with what we've done on grocery home shopping. The particular challenge in online for us is still in general merchandise, and so we've made some changes – [inaudible] and other things, we've made some changes. We've also made some changes in terms of the impact of, you know, indiscriminate promotional activity. So a boost in that sense and whether that – what the impact of that is. So do we make – do we lose less than we did a year ago? Yes, we do. Do we get to a place where we would want it to be? No, it's not, so there's quite a big programme of work going on to address it. But within it, I'm really quite comfortable with where we are on food. More challenged in the general merchandising space.

Niamh McSherry (Deutsche Bank): Okay.

Alan Stewart: In respect of the technology and the spend, we originally expected CAPEX to be £1.25 billion. It came in at £1.2 billion, so it's tens of millions, but much more conceptually is within the technology area we're trying to expense rather than to capitalise because of the flexibility it gives us. But over time, there clearly are elements of CAPEX – and technology CAPEX which you are required to capitalise, so it will be some and some. But in the year, it was probably tens, rather than anything more.

Niamh McSherry (Deutsche Bank): Tens, but probably going up.

Alan Stewart: Directionally, going up. Always consistent within everything we've said in terms of our ambition as well. So we give the best possible view.

Dave Lewis: Do me a favour and pass back that way? Sorry, I'll come...

Speaker (Jefferies): Thanks. Morning, it's James Grzinic from Jefferies. I had a couple. I guess firstly for Alan, given that Dave is distracted. Cash exceptionals. The year ahead, are they going up or down relative to the year just passed?

Alan Stewart: Let me talk about, rather, the year passed had some definitely. The cash exceptionals this year, we know that we've got the 235 million which will come in the current year. The others will flow through to a certain degree. Some of those are bank, which we spoke… We called out the two bank exceptionals. That was in aggregate about £80 million of the exceptionals. So by far the majority of those are either bank-related and therefore, if you like, separated from the retail cash flow, but I can clearly see the £235 million coming through. Little of the other restructuring will be carried over into the year that we've just entered. There will be some, but a lot of it has been spent in the year.

Speaker (Jefferies): And for Dave, first question is have you recovered any of the scale advantage on sourcing at all since you have been at Tesco? And is the 3.5-4% ambition underpinned by going back to the historic advantage Tesco had from a sourcing perspective? And lastly, it's very evident that consumers are changing, switching over the past three or four months, are you seeing a change in behaviour in your stores as well?

Dave Lewis: Okay. So look and again I'll look to Jason just I think we what we've done if you remember is we went through a difficult process of streamlining the number of supply partners in terms of setting out how we want. So actually, for those supply partners who are now able to rely on the growth opportunity of Tesco, we think we're restoring some of that benefit in terms of supply cost. We think that there's more that can be done there, but it's much more in terms of how it is we run the business together. So the examples we tell, shared with you all the way through the last year about how it is we took stock holding points out between ourselves and our fresh food supply partners so that actually we could flow straight from Spain into store, take out two days, take out stock, benefit to everybody.

Those are the things that we think we yet now need to focus on in order to rebuild an advantage which is unique and exclusive to ourselves. And by taking more of the crop into the Tesco offer, we do reduce the opportunity for the market to benefit from the marginal volume that Tesco doesn't take. So but that's a very deliberate and very important programme of work we've got, but it's not just – the reason I say that it's not just about a scale buying advantage. It has to be an advantage which is from how we run the business together so that you've got that meat example where like it's interesting our supply partners are saying my business is now more profitable because of the way Tesco runs its relationship with me. That's as important to me as rebuilding our profitability in meat as well.

So there's a lot of programmes there and that's what Jason and the team are focused on. In terms of changing behaviour we've definitely seen some. We've seen some basket composition changes. I think what we've seen as well as the things that are evident is as is being cost inflation, we've seen different activity. So we've seen an increase in promotional activity across the piece and that normally comes in the form of a supplier saying we need this cost increase, but here's an increase in the promotion investment to try and you get really big sort of swings in terms of promotional activity after that sort of cost increase.

We've not done that. We haven't done that. We've said actually we don't want because to be honest all you're doing is increasing the cost increase to pay for the promotional activity. We want to be lower for more consistent so we don't want that base inflation. And we've seen therefore activity around promotions, which is driving some behaviour and we can see that in our buying guarantee response as people get the equalisation from us. And that's the bit that we're watching. So that's the bit that we're watching because history suggests that that's the three months phenomena and then the supply partner pulls the promotion investment and the price has to settle. And we've committed ourselves to try and be long term. If it doesn't, if it carries, on then we'll have to think about whether we change. But that's where we are. That's the dynamic.

Speaker (Jefferies): Thank you for that. And are customer starting to trade down within your offer? Are you picking up on that?

Dave Lewis: The last data I've seen I can't say to you that there's been a trade down. But what I can tell you is the increase in own label participation has increased, but that's on the three tier. So it's not a trade down I think in the way that your question means, but there is a movement in the mix towards own label as we improve that offer. Jason that – yeah?

Jason Tarry: Yeah, I mean Easter moving obviously makes –

Dave Lewis: Yeah, a big difference. Yeah.

Jason Tarry: [Inaudible].

Dave Lewis: Yeah.

Jason Tarry: Customers are more open to do big Easter shopping to shifting us in [inaudible] through, rather than in the discounters. So you – because that’s moved after a period, you will see [inaudible] – let’s put it this way. It would be very interesting mix [inaudible].

Dave Lewis: Yeah.

Speaker (Jefferies): Thank you.

Dave Lewis: Okay? Miss, down here – my apologies – please.

Mike Dennis (Lazarus): Mike Dennis from Lazarus. I fail to see where the operational leverage is in the second half of Tesco UK, and I was wondering if you could help me. You state your slides that rents have gone down. You've increased subletting. You've got more ATM income. You've got less CAPEX going into the UK. You've got lower amortisation. I can't quite seek in the second half where any of the operational leverage, given you've talked about higher volumes, is. So going forward into 2017, without any volume growth out there in the market – that's the whole market – I'm failing to see where the operational leverage is on the business? That's the first question.

And the second question is, given that and what you gave on the Capital Markets Day, is it a fact that the cost to sales ratio in the UK is just significantly too high, like a 31% cost to sales? And what you really need to do is go back to looking at the stores and FTEs[?] again and saying, 'I've got to take this whole business down whole level in order to make it operationally viable in a market where Aldi operates on a vastly lower level of operational costs.' I was just wondering on those two questions if you have any thoughts?

Dave Lewis: Well, there are two bits of it. The way that we look at leverage in the UK in the second half – the bit that you didn't talk about – is what it is we've been doing in terms of enhancing the offer. So actually that the gains that we've made – you know, we've invested £300 million inside the UK in terms of farm brands. We save £455 million in cost in total and you've seen the profit enhancement. So there is – we can see the leverage and how it is we run the business.

If you go to your second question – I don't disagree with your cost to serve idea. That's where the £1.5 billion thought came from in terms of benchmarking the marketplace. And you've seen, we announced after October changes to the store operating model. We've given you what the detail of that is. We've just announced a change in a further rollout of that to more stores in the UK, so that plays into this year. And we've now started to do the same thing in our Express offer. So we're quite confident about the things that we have that can either lower our cost or improve our relative leverage in the UK.

Mike Dennis (Lazarus): But it isn't, because the 31% has stayed the same. The annualised £500 million is really a cover for the increase in the underlying costs.

Dave Lewis: Do you want to?

Mike Dennis (Lazarus): I don't see where the– I'm just trying to work out exactly where the progress is.

Alan Stewart: Well the progress is clearly, Mike, from £500 million of profitability to £803 million of profitability. That's the progress. So we can we can talk about different elements of it, but fundamentally what we're doing is with we are reducing the cost of our business by making it simpler, and there will be some elements where costs go up, there will be some where costs go down. But we're overall aimed at reducing the costs of our business. We recognise that some of our competitive position needs to be – become better, and then that will reduce the overall margin that we make from what we sell, but we recognise that by becoming more competitive we sell more, so we get some of the uptick. And but that's where we are. We've increased it by 60% year-on-year, we've rebuilt from a base of zero and we're confident about the year ahead.

Mike Dennis (Lazarus): Yeah, if I'm wrong then in the cash flow, the retail cash flow wouldn't go from £1.3 billion down to £500 million X[?] the bank. So the cash flow turnaround is massive in the UK retail business, according to your figures. Just – so if you're right, the cash flow should be going up or sideways or...?

Alan Stewart: Sorry I'm genuinely not getting what you're saying because we've set out – we've shown you shown the –

Mike Dennis (Lazarus): One of them isn't right. Either you're not making the cash from the retail operations in the way, or the one-off costs going through your business – the cost benefits are the cost benefits to the retail operating profit and the operating leverage is quite small, which would be either in – going forward, if the retail sales don't pick up then you don't have much operating leverage going forward. Therefore retail margins should go down.

Dave Lewis: Yeah. Well, we're confident they're going to –

Alan Stewart: Yeah, we'll see and we'll come back and talk about it next year.

Dave Lewis: I'm getting the five minute thing. So can I just check how many more questions there are in the room? I know Bruno's got one. How many more burning questions because we're – is that okay? Might – what I suggest we do is we follow up you in detail with Chris to try and triangulate the question you've got. So should we – is that it are we now just Bruno? Perfect. Oh, two more. So yes please, and then pass the microphone down here to Steve, yeah.

Speaker (Bank of America Merrill Lynch): Thank you for taking my question. So Xavier Le Mene from Bank of America Merrill Lynch. One question about the international, actually, because we focused mainly on the UK. So can you elaborate a bit more, we think[?] that UK being the focus, so it has been that international is less important to you? And then if you were to potentially look at the different countries, so can we get a bit of insight of where you think you're committed on where you're less committed?

Dave Lewis: Okay. So after the business review we have a retail operation, which is UK and Ireland, Central Europe, Asia, right? We're committed to all. Right, we changed the management team so that he's responsible now completely for Central Europe, Tony for Asia, and Matt for the UK and Ireland, right? We've got a plan as a business that creates value in all three of those businesses, right, going forward. First time we've had that in Tesco for quite a long while, right? The levers we need to pull – different in different places. If I talk about Central Europe, what we've got is we've got three markets in terms of Hungary, Czech and Slovak which are growing, growing share, doing really very nicely. And we had a competitive reaction in Poland because we had 18 months where we did really well and now we seen the market reaction, and we need to think about how best we do that. That's what Matt's going to do. The fact – I was there this week – last week thinking through those plans, so this is how we're going to respond in Poland and we have a plan that we have to deliver.

In Asia, we see lots of growth opportunity, and that's where Tony is. Thailand's our second largest business, and indeed almost accretive to margin. So there's a return to be had there. We're growing share there. The market is a little bit softer than we thought because of what's happened there. It's definitely a one-off. And we've made a – really quite a big turnaround in terms of the financial performance of the Malaysian business.

So actually there isn't any more focused here than there. I'm really quite happy with the portfolio we've got, with the management we've applied, and the plans that we've got. We just got to get on and deliver them, all right? Yeah, absolutely no issue in terms of something becoming less in focus as a result of what we just talked about in the UK.

Okay. Bruno – last, but not least?

Bruno Monteyne (Bernstein): Good morning. Bruno Monteyne from Bernstein. Two for me. Would you comment a bit about how the market is changing? I mean, for at least three or four years there was always somebody losing very, very badly in the market – one or two. Now all the big four are growing, at least one – no, only one just very close to that so. And the discounts are still growing. So what's changing in the way customers are shopping or the way that retailers are competing that suddenly means everybody is relatively doing relatively well?

And the second one is to have your margin target of 3.5% to 4% of there. If I can check, that's two years away from now. Should we expect relatively equal pacing between today between then and getting there?

Dave Lewis: So look, I think we're all still seeing a change in the dynamic of the marketplace. I think there are still sources of volume that are out there in terms of sources of business for both the big four and indeed the discounters. But it's dynamic, right? And I'm a bit where Jason is. I'm going to wait until Easter is gone and have a look at the whole basket, because at the minute we're reading periods which are not like-for-like. And so what we should do is take a look, post-Easter, and actually then have enough to say, has there's been a shift that requires a change in approach from us?

But at the minute, if I look at our business in terms of customers, if I look at the penetration, if I look at the frequency and if I look at the basket, the dynamics have not changed massively from where we've been. I think the challenge for all is in the penetration as choice gets fuller. But we'll see. And that's why we need to build a more differentiated brand, i.e. reason why they're in Tesco and not somewhere else. But I think – to your question, I think we should probably follow that up. Probably in four, six, eight weeks' time, because I think we'd be able to give you a better answer, I think, to your question. And do you want to?

Alan Stewart: Yeah, look we've set out ambition. As you say, there is less time remaining between now and then than when we announced it six months ago, and we are aiming to improve our business year-on-year, and how that follows exactly we can't give – we can't give colour to it. But it will be very surprising if we're from 2.3% to 3.5% or 4% all happened in the final year – really surprising.

Dave Lewis: I think, look – to Alan's point, I think what we can and what we should say is, are we confident about the 3.5% or 4% even with the challenged environment? Yes, we are. Yes, we are. The first step, another good step in the right direction ahead of where we said we would be, and therefore all other things being equal, we should be more confident about getting there than less – and we are. We're not in the game of sort of giving detail month-by-month, year-by-year, quarter-by-quarter progression, because I want to have the flexibility to deal with the market that you just talked about. But point-to-point, are we clear that by 2019/20 we get ourselves to that place? Yes, we're clear.

Alan Stewart: And we're confident about this year.

Dave Lewis: Right, ladies and gents, thank you very much, indeed. My parting thought for you is this: two and a half years ago when we first spoke to you, we had a business that was clearly challenged in lots and lots and lots of ways. It was struggling. We went through a process of stabilisation, and then we went through a process of saying what is the medium-term aspiration for this business that could create value. We shared that with you in

October and we articulated it into six strategic drivers in order that you could understand what it was we were trying to do as management. Importantly, that plan, when we deliver it, creates a huge amount of value, all right? A huge amount of value. And let me tell you, we are completely and utterly focused on delivering that value. The first step of that since we talked in October, we think, is ahead of where we set for ourselves, and that just makes us more confident about this year and the year ahead against the aspirations we set for our business.

On top of that, and thinking about the medium and the long term, we're opening up the opportunity of greater growth, and what we think will be a margin accretive space with the merger with Booker, all right? We're at the start of that journey. We will continue to have a small – a very small group of people that are working on developing those opportunities in the same way we've managed other issues through the course of the last two and a half years, and then we'll bring that to our shareholders at the right time, post the competition review, for them to vote on. But the management team – and I'm not just talking about myself – as a management team, we're completely – completely – energised and excited by the opportunity that affords us, and actually very confident that when the deal is done, actually that opens up a real big opportunity for Tesco into the medium term. And my aspiration is not just the improvement in the next two years, it's about how we set this business up to be a long-term, growing, sustainable business in the UK. And Booker for me is a really very important and key part of doing just that.

So thank you very much for your time, your effort, your questions and your support. I appreciate it.

[END OF TRANSCRIPT]