Tesco PLC
Q3 & Christmas Trading Statement 2023/24

Analyst Call

Thursday 11th January 2024

Transcript

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Ken Murphy: Good morning, everyone, and a happy New Year to you all. Imran is here with me, in Welwyn as usual. First of all, I'll give a little colour on our performance and then we'll hand over to questions and answers.

I'm hoping you've had a chance to read the release, and so you'll have seen that customers responded really positively to our Christmas offer. In fact, the work we have done to invest in value, create high-quality products, deliver market-leading availability and customer service, has resulted in our best ever Christmas offer. We're delighted that so many customers voted with their feet and chose Tesco this Christmas, leading to a really strong performance.

We've been relentless on value because we know just how important it is for everyone. And for over 14 months now we've been the cheapest full-line grocer in the UK due to our investment in value. This Christmas we were proud to offer a full festive dinner for just over two pounds per head, including a fresh turkey. Those key festive lines are really important for customers, but so too is great value across the rest of the basket, and that's why we've lowered the price of nearly 2,700 products, on average by about 10%, during the 19-week period.

This week we've been helping customers manage their budgets for the new year too, with another round of price cuts on more than 150 products and a double Clubcard points event, it's the first time we've run a double points event like this for more than a decade, and we expect to give out around 10 billion Clubcard points over the next seven weeks.

Quality is also particularly key at Christmas as customers look to trade up and treat themselves. We spend a lot of time on innovation and product development, and our new Finest range really stood out from the crowd as a result. We invested in over 550 new and improved products, almost a third of which were Finest, including the launch of our Finance Chefs collection: restaurant-quality products designed by our expert chefs. It was a record Christmas for Tesco Finest, with sales up 17% and with more than 18 million customers buying from our Finest range over the period. We continue to win customers from premium retailers, and we've done this now for 17 consecutive periods.

In a return to tradition this year, it was all about the big Christmas shop for customers and they really came out in force for our busiest day on the 22nd of December. We invested more in colleague hours and our colleagues really stepped up to serve a record number of customers on Christmas Eve and we did nearly 820,000 transactions in just one hour.

So I'm really proud of the products and the range we had this Christmas, but what really makes the biggest difference to our customers' experience is the service from our brilliant team of Tesco colleagues. It's been a proper team effort, and we've had some real heroes behind the scenes working right across our business to make sure everything comes together. From the technology and online teams, to product supply chain, and a particular highlight for us was our

Whoosh rapid delivery service, which delivered nearly half a million orders in the run-up to Christmas, which is pretty good going when you consider this is really quite a new business for us.

All of this great work has culminated in us delivering market share gains and continuing to win customers from our competitors. Booker has also had a really great Christmas, driven by our exceptional service and availability. In Ireland we reached our highest levels of market share in almost a decade with strong growth right across Food, and we also opened our first store in Kilkenny, which now means there is a Tesco in every county in the Republic of Ireland. Our Central European business has delivered a really resilient performance against what continues to be a challenging backdrop.

In summary, we've got the right strategic priorities and we're making really great progress on them, and we go into the new calendar year with great momentum. You'll have seen that we've upgraded our guidance for adjusted operating profit and cash for the current year as customers recognise the progress we are making. So we've got the right plans and a great team delivering them. And with that, we'd like to move on to your questions. Thank you.

Moderator: Thank you. Ladies and gentlemen, if you would like to ask a question or make a contribution on today's call, please signal by pressing star one on your telephone keypad. That is star one for your question.

And our first question today comes from Andrew Gwynn from BNB Paribas. Please go ahead.

Andrew Gwynn: Hi. Morning, team. Happy New Year. Two questions if I can. I mean, obviously a very good Christmas, well done to yourselves and the team, but what's the setup feel like for the next financial year? Appreciate just a trading statement but your thoughts on that would be very welcome.

And the second, just into the detail actually, and looking at the Best Food Logistics, obviously quite a soft sales performance... some unprofitable sales. To help us understand that a bit better, is it something we should be aware of in the coming year? Thank you very much.

Ken Murphy: Morning, Andrew. Thank you very much. I think the key thing to take away from this trading update is that we have really great momentum in the Business across every aspect of the business model. So we lead as the cheapest full-line grocer in the market. We've had a great uptick in our product innovation with over 550 new products, one of the highest number of new products in the market, and a very strong growth, particularly in our trade up categories in Finest.

We've invested very strongly in the store experience and the shopping trip. We continue to invest in our technology capability, and so we feel really good about our readiness for whatever 2024 brings. We think the consumer is in a cautiously optimistic mood. That said, it's a battle for every basket. We're in a highly competitive market with 11 strong national players, and so we continue to expect it to be a really competitive and tough environment, but we think we're really well-placed.

In terms of Best Food, I'll hand over to Imran just to talk you through the factors there.

Imran Nawaz: Look, I mean, Best Foods, we called it out. As you know, originally we acquired that Business to basically give us core infrastructure for the catering side of the Business. The Business gave us, at the time when we took it, a billion of sales, it was in a loss-making position. Glad to say today it's in a profitable place, which is great.

And also, what we decided to do is, as you know, it's important to have contracts that make money. So we took the opportunity to prune out basically loss-making contracts, which will cycle through maybe another quarter or two, but then should be out of that. But feeling very good. I think as you can tell, the growth in Booker Catering has been phenomenal, especially over Christmas, and the Best Food Logistics was a bit of an offset there, but was actually not a big profit contributor.

Andrew Gwynn: Okay, all very clear. I suppose the key question will be, markets as far as you can see is remaining very rational? Competitive, but very rational.

Imran Nawaz: Yeah, I mean, look, I think when you look at the market dynamics over the last ... Since the half year we spoke about how does it feel, and what you've seen is a very rational backdrop. And I think as we look into next year, clearly commodities will do what they will do, but all the industry players and frankly the supply base will deal with the national wages increases as well. So I expect a continued rational market to persist.

Andrew Gwynn: Great. Thanks very much. Catch up soon.

Imran Nawaz: Thank you, Andrew.

Moderator: Thank you. And up next we have Izabel Dobreva from Morgan Stanley. Please go ahead.

Izabel Dobreva: Hello, good morning. I had two questions, please. Firstly, a question on your guidance which you have upgraded. It still sounds like you are building an element of conservatism in there, so I just wanted to talk through your assumptions for the back half, and specifically how you are thinking about price investments in the context of the recent price cuts and price match schemes we have seen announced. Is that just a normal post-Christmas belt-tightening in your view, and how are you thinking about the competitive environment when giving us that guidance?

And my second question was on promotions and supplier incomes, what are you seeing here and do you see further room for supplier funders promotions to continue to grow over the next 12 months? And at what stage would you be concerned that this becomes disruptive to the overall price image?

Imran Nawaz: Look, I mean, let me take the guidance question. I mean, look, as you say, look, you remember, in half one, so four months ago we upgraded for the first time after having a really strong first half. We delivered around 1.4 billion. Now three months later we're upgrading a second time where we're taking, as opposed to the 2.6 to 2.7, we're saying 2.75. If you step back, given our size, that's broadly a 50/50 split. I feel really good about how we've gotten there because we've gotten there by being the cheapest full-line grocer, by investing in colleagues, by investing in promotions, and frankly working with our suppliers.

So the way we've gotten there is very, very solid, and stepping back, given our scale that's broadly a 50/50 split. Now both ends of the halves have certain investments in, clearly we want to continue as we head into next year, be front-footed with our status versus customers, and therefore we will continue to invest, as you've seen our Clubcard double points or our 150 price cuts. That will continue to cement our position and I feel good as we enter next year with that momentum. I don't see it as conservative, I see it as a, broadly speaking, a 50/50 split, first half, second half, and that sets us up well to go into the next half.

On the second question, on promotions?

Ken Murphy: Izabel, it's a really good question. It's something we watch very closely because we are quite protective of our price file, and making sure that we have as much simplicity and clarity as possible to be able to maintain, A, our level of everyday low pricing, because that's a really important ... of our overall value proposition. And B, as you say, to avoid this sense of back margin and lack of transparency. So that's a real key tenet.

That said, inevitably there has been a drift up across the industry over the last 12 months of volume-on-deal, and that really is a consequence of what you saw in the previous year, which was a really strong switching into own brand proposition. And now what you're seeing is suppliers, branded suppliers, trying to win share back through deeper deals and more frequent deals. And that I think is a feature of today's landscape and a reality, but we'll work really, really closely and strongly with them to make sure we maintain that integrity of the price file.

Moderator: Thank you very much. And we're now moving on to Clive Black from Shore Capital Markets. Please go ahead.

Clive Black: Good morning and thank you. I'm sure the people of Kilkenny are particularly happy this morning. A couple of questions if I may. Firstly, given your comments in round about the National Living Wage, I just wonder if you could give us your expectation for the continuation of food inflation into 2024? And in that respect, maybe just give us a little bit more colour about the price volume mix that you've experienced over the last 19 weeks.

And then just secondly, maybe give a little bit more colour to as to some of the dynamics in Central Europe and your hopes and aspirations for that region as well. Thank you very much.

Imran Nawaz: Okay, sure. So let me take them. On the food inflation side, as you know well, I mean, just Kantar reported, what was it, 6.5% or so in the last read. We're meaningfully below that and continue to inflate less than our competitors. That's something we'll continue to do.

In our internal assumptions, our perspective hasn't changed. We continue to expect this disinflation trajectory that we're on to continue. As I look ahead into next year, now clearly commodities will do what they do, but I do think that we do expect to see some levels of inflation, albeit at a much lower level to continue next year, driven by the fact that labor costs are a headwind, so to speak, for everyone and have to be dealt with.

Your second question was on Central Europe, now clearly it hasn't ... In terms of the dynamics, you'll remember we spoke about Hungary being especially challenged, and the way I'm looking at it is that is driven by government actions and by the very high levels of inflation. Clearly we have invested more in Europe. I think that is right given the pressures that our customers are facing out there when you think about two-year inflation of over 30% or so. We will continue to invest.

And you're right, given that the environment is challenged, our focus was on protecting the market share, protecting the franchise. And I'm confident that as conditions get back to normality, which we're starting to see, that the business will gain back onto growth. And we saw that already at Christmas.

Clive Black: And just some colour on market share in Central Europe, please?

Imran Nawaz: Look, I mean I think we're starting to recover from the discounters and from all the other players. So I think overall in a good place when I look at the amalgamation of the free countries, a special strength in Slovakia to call out, and the rest are fairly broadly flat.

Clive Black: Thank you very much and well done, guys.

Imran Nawaz: Thanks, Clive.

Moderator: Thank you. Up next we have Sreedhar Mahamkali from UBS. Please go ahead.

Sreedhar Mahamkali: Hi, good morning. Happy New Year to you all. Three, hopefully quick questions, please. Maybe just to build on Clive's point, how do you characterise volume growth through the year? You referred to volume I think in Q2 and now you are more vocal about it. And do you see this volume growth continuing to build around, to your point about, continued disinflation, does that spur on a bit more volume growth over the coming quarters? That's the first one.

Secondly, it'll be super helpful if you could at all give some sort of colour around the puts-and-takes in terms of profit growth for the year ahead. I think people are modeling 50-60 million. Just talk us through your thoughts. And you've already referred to living wages, as one of those. Anything else we should keep in mind?

Third one, any comments at all, I'm going to try, but on the Bank process that seems to be going on behind the scenes to the extent you can share something with us. Thank you.

Ken Murphy: Thank you. Well, look, we'll take the last question first, which is a pretty short answer as we never comment on any speculation in the market and you wouldn't expect us to, I'm sure.

In terms of volume, I think the shape of volume over the last 12 months has been trending from negative volumes through to positive volumes from the first half through to the second half. And that trend is just continuing and continues to strengthen. We can't really legislate for what will happen in the coming 12 months, but what we are planning for is modest volume growth in our assumptions.

In terms of profitability, I'll kick it off and maybe hand over to Imran to give you the main drivers, but clearly we're expecting some headwinds from wages and some tailwinds from energy.

Imran Nawaz: Look, I mean, clearly we're going to talk in April more as to how we see the year pan out. I mean, just to give you a sense of how we think about it, we always go back to our framework on performance that we laid out. Every year is a fresh year and our aim is to hold and grow market share to translate that into profit growth, and then frankly deliver the cash so we can continue the returns that we have started. That's the philosophy we start every year, and every year is going to have its puts-and-takes as you call them.

And Ken is right, the big known known is going to be, there's going to be headwinds from energy. We do know that we are very confident in our ... Sorry, from wages. We know that we are going to have some benefits from energy, but still there's open position still to be concluded there so that's an ongoing programme. And then clearly we know that we will continue to invest into the customer at the same time, and the aim is to continue to hold and win market share.

Sreedhar Mahamkali: Thank you.

Moderator: Thank you. As a brief reminder, that is star one to ask a question today. And we're now moving on to Nick Coulter from Citi. Please go ahead.

Nick Coulter: Hi, good morning. Happy New Year. Three quick ones if I may, please.

Imran, I think you commented, but could you confirm you don't see deflation this year, please, as far as it's in your scope. And then a follow-up on promos, if I may please. Could you talk to whether branded is back into volume growth and if its growth is still lagging own label, and obviously that's nuanced given the tiers in own label are probably behaving quite differently over peak. And then lastly, could you talk to your non-Food performance across peak, please, from a sales and profit perspective, if possible? Thank you.

Imran Nawaz: Okay, so I'll start. I'll kick off on deflation. You're talking about the year ahead, right, 24/25?

Nick Coulter: Yeah.

Imran Nawaz: Look, I mean, the way I'm thinking about it, and then in a rational market with the headwinds on labour, my perspective is obviously commodities is always hard to call, is that we would be in a disinflation mode rather than in a deflation mode. So that's my current base assumption.

Nick Coulter: And would deflation trouble you, Imran, if that came into ... and would you do that as transitory?

Imran Nawaz: Look, I mean, I think one thing that we've proven over the last three years, whether it was during COVID, whether it was during cost of living, whether it was during supply chain, whether it was energy, we have learned to be agile and deal with these challenges or any challenges that are thrown at us. Look, our job is to be prepared for whatever scenario's thrown at us. Our current base case assumption is a disinflationary environment, but if it was anything different then our job is to make sure that we continue to protect the value to our customers, whilst making sure that we at the same time protect our P&L at the same time.

One example that I would call out that demonstrates how we've been doing that is our successful Save to Invest program, and to save over 1.1 billion in the last two years. Clearly as we look ahead into next year, we will continue to look for savings and have an active Save to Invest program.

Nick Coulter: Thank you.

Imran Nawaz: On non-Food performance, look, we actually feel really good about our non-Food performance. The first stat that matters most is probably to say that non-Food for us is around 7-7.5% of the total Business, so it's not significant.

Now as I look within that, we saw a slight step back on the total business around, call it, 3% sales decline in total non-Food. But if I exclude the actions that we've taken to prune out loss-making items such as electricals, we're actually in a broadly flat sales number and that's no bad thing. So I'm actually quite pleased with the fact that we were so proactive to take out loss-making items and benefiting from that at this stage.

Nick Coulter: Okay. So flat sales, but with profit dilutive sales removed. Thank you.

Imran Nawaz: ... Sorry, say that again?

Ken Murphy: Profit was up.

Nick Coulter: Flat underlying sales with profit dilutive items removed-

Imran Nawaz: Yes, correct.

Nick Coulter: ... a relatively healthy picture.

Imran Nawaz: Yes, correct. And in fact, what that ended up doing is our profits year-on-year grew in non-Food.

Nick Coulter: Thank you. And then on branded, please?

Ken Murphy: I mean, in terms of branded promotions or branded sales and performance overall?

Nick Coulter: Just whether branded is back in volume growth or if its growth is still lagging own label?

Ken Murphy: Yes, it is. It is.

Nick Coulter: I guess, are the promotions working, to a degree?

Ken Murphy: Yeah. I mean, I think as you'll have heard from the previous conversation, you've seen a meaningful uptick in volume-on-deal. And that has meant that you have seen volume growth in branded sales. And overall we've seen actually a positive mix effect from switching into premium proposition. So Finest obviously grew much stronger than the total Business, and you are seeing stronger growth in volume and branded sales this Christmas as well.

Nick Coulter: Okay. So the overall branded categories have moved into volume growth on the back of the promos.

Okay, thank you very much.

Ken Murphy: Thank you.

Imran Nawaz: Thank you.

Moderator: And we're now moving on to James Anstead from Barclays. Please go ahead.

James Anstead: Morning, Ken, Imran. Two questions for you. Firstly, one of your big competitors has said that while they'll always keep sharp on price, they feel the heavy lifting on price investment is largely done on their side. Given you sound quite pleased with where your relative pricing sits now, is that a sentiment you share with respect to your own business?

Second one would just be, sorry, it's a slightly technical one, but you quoted like-for-like of 9.2% in the four weeks to Christmas and 6.8% for the six-week period overall. If I do the maths on a very simple basis that seems to suggest quite a dramatic slowdown in the two weeks after Christmas. Is that the right way to think about it or are there some timing issues that makes that math a bit meaningless? Thank you.

Imran Nawaz: No, it's just a calendar effect, that's all. Nothing else.

Ken Murphy: It's where New Year's Day fell effectively.

Imran Nawaz: Yeah, correct. Yeah. So there was one trading day less in that. That's it.

Ken Murphy: Yeah.

James Anstead: All right.

Ken Murphy: On your first point, I mean, clearly we never comment on what competitors say. I think that our policy is that being super sharp on pricing is a fundamental tenet of being successful in this market. And given the competitive intensity in the market, we don't feel like you can relax or rest on your laurels from a pricing point of view.

So we'll continue to invest in price, we'll continue to be very focused on value. And we'll look to lead the market amongst the full-line grocers consistently as we have done over the last 14 months. So I don't think I've relaxed on value for a single day in the three and a half years I've been in this Business. I don't see that changing anytime soon.

James Anstead: I suppose to ask the question slightly differently, you've now got into this position of being the cheapest full-line grocer for 14 months. Are you keen to become not just the cheapest but even more dramatically cheap, or is being the cheapest enough?

Ken Murphy: We've always made, and this goes back to Imran's earlier point about our framework, our strategic framework, and at least holding and gaining market share, maintaining a rational market are key components of our business model. And so we'll behave rationally, but I just didn't want to mislead anybody by suggesting that the competitive intensity was somehow going to ease off.

Nick Coulter: That's helpful. Thank you.

Ken Murphy: Thank you.

Moderator: Thank you. And as there's currently no further questions, I'd like to hand the call back over to you, Ken, for any additional or closing remarks.

Ken Murphy: Well, listen, thank you all again for all the questions and for taking the time to join us this morning. I hope you feel as we do that this has been another strong performance by the team at Tesco across all aspects of the business model. We feel really good about where we are right now and where we are set up going into 2024, and we look forward to seeing you all again in April, if not sooner.

Thank you for your time. Take care.