Please note, this transcript has been prepared by our third party provider and is not reviewed by Tesco.

NTT

Transcription

TESCO Q3 and Christmas Results Analyst Call

{EV00099095} - {00:34:01}

09 January 2020

PRESENTATION

Operator

Welcome to the Tesco Q3 and Christmas Results Analyst Call. Throughout the call, all participants will be in listen-only mode and afterwards there'll be a question and answer session. Just to remind you this conference is being recorded. I'll now hand the floor to our host, Dave Lewis, CEO. Please begin.

Dave Lewis

Mark, thank you very much. Good morning, everybody and a very Happy New Year to you all. Joining me on this call this morning as usual is Alan Stewart and because after six Christmases, I know virtually all the questions will be about UK Christmas trading, I've asked Jason Tarry to join us on the call as well. Now I also know it's a busy morning today so I'll quickly share a few reflections on our performance and then open it up to your questions.

The UK retail environment is clearly subdued at the moment and growth isn't easy to win. So against that backdrop I'm particularly pleased that we've outperformed the market and delivered our fifth consecutive Christmas with growth. And I think it's particularly noteworthy given our very strong performance last year. We achieve this through an extremely competitive product offer, a very compelling customer proposition and a really strong operational performance from our stores and distribution network.

In terms of value, the cost of a typical basket of 21 important Christmas products was £2.28 cheaper than last year in the week leading up to Christmas. And on top of that investment, we have strong deals. From our [? 00:01:27] veg to half price beef and lamb joints. We also strengthened our ranges, introducing children [? 00:01:35] new or improved tested products, including a notable increase in our range of plant-based foods. Over the last year, we've expanded our range of plant-based foods by more than two-thirds with another 68 new lines launched just this week.

The investment we made in our offer was reinforced by a really strong Christmas marketing campaign, which built on our Centenary campaign of 100 years of great value and drove further improvements in quality and value perceptions. In November we also launched Clubcard Plus and the response has been very positive, helping customers to get even more value from their Tesco shop.

So a really strong offer and a clear proposition for customers. Underpinning all of that was a fantastic operational execution by Jason and the UK channels team. In fact, the best operational performance I've seen in my time here. Every part of the operation worked in harmony throughout the Christmas period, from the supply chain to distribution to stores. Availability was the highest in the last six years and customer satisfaction with their shopping tip improved further. In particular for ratings of 'ease of shop' and 'colleague helpfulness'. A combination of a compelling offer delivered brilliantly well helped us to outperform the market even against a challenging backdrop.

No to try and put that performance into context, on the 23rd of December we sold more food than on any other day in our history. And at our peak, between 12 noon and 1 pm we served 890,000 customers in just one hour. And in our online business over the 19 weeks we delivered more than 14 million orders.

Now if I step back and look across the full 19-week period, Booker continues to deliver strong growth in a subdued market and was also named best national wholesaler in November. Our acquisition of the assets of [? 00:3:31] logistics is on track and we anticipate completion in early March.

In Ireland our price campaign as well as a particularly strong contribution from our online business helped to drive positive growth.

And in Central Europe, [? 00:03:47] and the team continue to drive a very significant transformation programme. This has caused some self-imposed disruption with a particularly significant impact in Poland from our transition to a two-format model. To illustrate that, in our biggest stores we've taken out half of the floor space and in our compact hypers we've reduced the range from more than 40,000 SKUs to just over 10,000. Excluding Poland, sales declined by 3.7% over the 19 weeks; 3% of that impact is due to a combination of the closures, the right-sizing of large stores and improvement to the product mix.

We’ve continued to strengthen our offer for customers, including improving availability and a more compelling seasonal product offer.

Turning to Asia: Growth in fresh food was particularly strong and customers are responding well to our new convenience proposition. Total sales were level as we continue to optimise the mix of our product ranges and focus on sustainable, profitable ranges. With a 13% reduction in general merchandising sales having an impact of around -1.4% on overall performance.

We announced last month a strategic review of our operations in Thailand and Malaysia and as we said in the release no decisions have been taken, I don't have anything new to add today and a further announcement will be made if and when appropriate.

So across the group it has been an incredibly busy period and I'm very grateful to every colleague for their contribution. I've never seen the UK business running better than it was this Christmas and that's a huge credit to the whole team. We had the right plans, we executed them well and that's reflected in the growth we've delivered in a subdued market.

Thank you for listening and with that I'll hand you back to Mark and take your questions.

Q&A

Operator

Thank you. If you wish to ask a question please dial 01 on your telephone keypad now to enter the queue. Once your name is announced you can ask your question. If you find it is answered before it's your turn to speak you can dial 02 to cancel. So once again, that's 01 to ask a question or 02 if you need to cancel. There will be a brief pause now whilst we register your questions.

Our first question comes from the line of Bruno Monteyne from Bernstein. Please go ahead. Your line is open.

Bruno Monteyne

Good morning, and Happy New Year to everybody. My first question is on the Christmas like-for-like clearly seems a step up versus quarter three and that's actually the opposite of what the market was doing if we believe Kantar. So a few questions. What do you attribute that relative step up versus the market over Christmas? Is that Clubcard Plus? Anything else? And is it also a good indicator of the exit rate for the next quarter, or the next few months?

Second one, can you say a bit more about Tesco Plus? It was a bit short on numbers that was in the release. How many people are signing up? What kind of impact would it have on like-for-like already? And last but no least, I was looking at all these data points. Kantar has 0.2% growth in the entire UK, call that almost nothing. A lot more announcements of promotions even at the hard discounters and price cuts of competitors. Is UK getting materially worse in the last six months versus what it has been in previous years or is it the usual humdrum of trading plans in announcements? Thank you.

Dave Lewis

OK Bruno, why don't I try. I'll start and then I'll ask Jason to give some more colour if I may. I think first and foremost, the quality of the UK operation was significant. The availability I talked about was outstanding, so the quality of the offer that we put together was outstanding. Our value was very good and what you saw in terms of customer service was also really very good. So I think that, plus the investments in value that we made have really driven the performance in the UK.

When you talk about Clubcard Plus, it's eight weeks in. Really very happy with the way that it's started. It's not material, it's not having a material impact on the results today. So I think there will be more to say about that in the fullness of time. But I'm happy with the way that it started. It is having the impact in terms of increasing the size of the basket that we would want, but we won't call it – too early as I say; we're only eight weeks in. On your point about Kantar, but we've always said it's a data point. It has some relevance but it's not an exact replica of how we see the market or how we measure the business and I suppose the numbers today illustrate that yet again.

I think the only thing that I would pick out of what you said before I hand over to Jason is promotion. I see the commentary around promotions. It always steps up a little bit in the Christmas period. If you look at Tesco promotional activity this Christmas versus last year, it's ever so slightly down. Others of our competitors have stepped up compared to last year. We haven't; we're about the same and our performance has been relatively very strong, especially when you think about the strong base of last year. So that's the sort of sentiment I would give you. But Jason, is there anything more you want to add to that?

Jason Tarry

No, I mean, you talked about Q3 into Christmas. I mean, all I can say to you is we had a plan for the whole quarter, as you know, and as you would expect us to have, and we executed against that plan and weren't distracted and I think that was one of the key drivers of making sure that we focus on doing the right things at the right time.

In terms of the promotions, I think we, for a number of years now, we've looked at offering real choice in our offer, both in terms of our prices and also our promotions across all of the key areas and that was no different this year and we saw customers react to that very well. And in the round, when I walked in our shops versus others, I felt overall we had a very strong offer relative to across all of the product areas, whether that be produce, meat, non-food, booze, confectionery, et cetera.

Bruno Monteyne

But you do see a relative improvement in market performance in Christmas versus the pre-Christmas period, that's fair enough? Your relative position was getting stronger?

Dave Lewis

Indeed. As I think the numbers show, in UK core from like-for-like from -0.4 to 0.1, that's the step up that you see, so there's a relative difference. It comes to the shape of the plan as Jason said. But yes, your assumption is right, Bruno.

Bruno Monteyne

Thank you.

Operator

Thank you. Our next question comes from the line of Rob Joyce at Goldman Sachs. Please go ahead. Your line is open.

Rob Joyce

Hi, morning, guys. Happy New Year. Just a couple from me. No real mention in the release – it's a sales release – but no mention on profitability or consensus, I think. I just wondered if you could make a comment on how you see that EBIT consensus for FY 20? That would be very helpful. And the second one is, you talk of the £2.28 reduction in your prices over the period. Two questions there: Are you now starting to see almost deflation in the basket? And the second one is, could you just give us an idea of how that relative price gap has narrowed or widened versus competitor A and competitor L? Thanks very much.

Dave Lewis

It's a sales call so we won't talk about consensus. But I will pass it to Alan if he wants to give you any further details. In terms of, what would I say about the $2.28 – that was a basket of the most important items at Christmas time. We can give you the details if you are interested. I think that basket that you talked about – we checked it on the, that was the Jack's basket if you remember the eat [ph 00:11:45] basket. We checked it on the 2nd of January, is the last number I saw, and we were still cheaper than A and L.

We haven't seen deflation. I think Kantar put the number at 0.8 and we were significantly below that, but it wasn't deflation. Alan, do you want to say anything to help Rob with EBIT consensus?

Alan Stewart

Happy New Year, Rob. It is a sales call. In terms of consensus, we've got nothing really to add. The one thing I would say is that I think we're in a really good position from a customer perspective, we've always said that that's where we want to be. If you've been in store this week you'd have seen some new offers coming in and we are now in a really good position to be able to do that. But consensus – nothing to add.

Dave Lewis

As Alan says, we will continue to invest through the balance of the year.

Rob Joyce

Thank you.

Operator

Thank you. Our next question comes from the line of Andrew Gwynne at Exane. Please go ahead. Your line is open.

Andrew Gwynne

Good morning and Happy New Year. Two questions for me. Just on Europe, obviously it's quite a big miss versus the consensus number. I'm just wondering to what extent did it differ to your own internal plans. And connected to that, how should we think about that number going forward, because clearly we are all having a bit of difficulty modelling it. That's question one – I appreciate there's two. Then the second one is just on Booker. They had strong performance in Q3 and then it tapered somewhat into Christmas, so I'm just wondering what that differential was and which is the more reliable number to extrapolate going forward? Thank you.

Dave Lewis

On Europe: Obviously we know the plans that we've got; all of the changes in Europe are self-inflicted. It is a change programme. It's always difficult to forecast exactly how the business will respond as you make such significant changes. But I'm happy with the progress that we are making. We will continue with that transformation. We're about half of the way through where we wanted to be, particularly in terms of what we want in Poland.

Is it significant in terms of our plans against our own internal plans? No, it's not. So as I say, it's self-imposed, self-inflicted. It is a change that we want to do and we're happy with the progress that we're making. I would be very clear that you always have some sort of fluctuations and volatilities as you go through that change, but that's retail.

In terms of Booker, I'm actually really very happy with the Booker performance. I think if I look at ex tobacco, Christmas trading is 3.8 growth, so actually it's a small step down versus the 5% you talk about in terms of the like-for-like, but not significant. Christmas is not the biggest period for Booker. But no, actually, again in a challenging market and I'm pleased with the Booker performance.

Alan Stewart

And Andrew, if I can just a little bit to the CE comment. In terms of the change, as Dave says, we are halfway through it. We really started this change towards the end of the first half of last year. So this is the year of very significant transition in terms of the business and that's what we're seeing. In terms of the overall performance through the region, we will continue to see that in the first half of next year because it's only towards the end of the first half that we begin to annualise against the changes. In terms of significant change happening in stores this year, but the impact of that will move into next year as well from a sales number perspective.

Andrew Gwynne

So just to clarify on that, we should model a like-for-like loosely as negative into the rest of Q4, Q1, Q2 next year?

Dave Lewis

Andrew, we're going to have to leave the modelling to you, we don’t model like-for-like for ourselves. So I'm afraid I can't help you with that in that sense, so I'm afraid all we can tell you is we're halfway through the transition. We will see that in the sales line as we complete it.

Andrew Gwynne

Alright. Thanks guys. Thank you.

Operator

Thank you. Our next question comes from the line of Clive Black at Shore Capital. Please go ahead. Your line is open.

Operator

I think the line just went on hold for a second. Clive, can you hear me?

Dave Lewis

Happy New Year, Clive.

Clive Black

Happy New Year to you boys. Hope you're in good form. Couple of questions from me. Firstly, can you give us an indication of the format performance of your UK business? Particularly noting your comment, Dave, about Clubcard Plus and basket size. And secondly, any indication of the time expectation around the Best Food logistics deal? Thank you.

Dave Lewis

I'll take the second one and ask Jason to give you any insights in terms of formats, if that's okay, Clive. As I said in the release, we anticipate it being completed early in March – the Best Food logistics transaction, so that's the assumption that we're working to. Jason, do you want to say something in terms of format performance?

Jason Tarry

We were strong across all of our formats, to be fair, Clive. So online was ahead and the other formats were pretty much in line with where we expected, to be fair. And as Dave talked about before, Clubcard Plus, it's far too early to have any sort of [inaudible 00:17:55] on that.

As you know the mix works differently across the cycles. So you are particularly strong on large stores in the lead up to Christmas and then you end up with our smaller stores really kicking in as we get to Christmas Eve and beyond.

Clive Black

I guess it's in that respect – Dave is quite right to qualify the recent nature of Clubcard Plus, but you didn't see any – in terms of the effect it did have you didn't see anything coming through for example, in large baskets and trolleys in say extra stores?

Dave Lewis

Clive, I think what we should say is that eight weeks in, what we definitely saw was, we saw that the basket size of those people that were subscribers started to increase. Now, we're not yet at a place where we want to reveal or issue, because it's way too early, but are we happy that the way that it was being used by customers who signed up with the way that we had designed it and thought it might be helpful? The early signs are that that seems to be working as we thought it might.

Clive Black

Just one last thought on following Andrew's questions; Europe. Could you give us an indication just how food performed in central Europe, for instance?

Dave Lewis

Food was much, much stronger. As I said, in terms of the, we continue to trim the range on general merchandising, so fresh food was, I believe, just positive. So food continues to perform very well as we change the mix in stores. But you've got to be honest, the amount of disruption that we're talking about when you half the shelves, the floor space, is significant, so all categories are affected as you take a store through that level of transition.

Clive Black

OK, thank you, very helpful. And all the best, fellas.

Operator

Thank you. Our next question comes from the line of Andrew Porteus at HSBC. Please go ahead. Your line is open.

Andrew Porteus

Hi, morning, guys. A few from me, if I may. And also Happy New Year as well. But if I could just talk about the inflationary pressures you see. Obviously, there's been a bit of talk about inflation coming out of the system; sterling's obviously been quite choppy. Could you perhaps give us an update on what you're seeing from the supply chain about cost pressures now and perhaps going forward as well?

Second question was around Booker. The 3.8 seems quite pleasing. Could you give a split between where the catering and independent retail side of things looks? Because it seems like the independent retail channel had a particularly tough period from that perspective.

And lastly, could you give us an idea on mix? Did you see people trading up as expected over Christmas? Clearly, the industry didn't have a great Christmas. I'm just wondering whether you saw normal patterns of trading up or whether that was a little bit subdued?

Dave Lewis

Again, why don't I start and then I'll look to my colleagues if they want to want to add something to this, Andrew. And again, Happy New Year to you. So inflationary pressure, they're definitely there. They continue to be there and they're across a number of different commodities. I wouldn't call out anything particularly unusual at this point. I'd just reiterate the fact that what we try and do is we try as best we can to mitigate all of that pressure for our customers. That's an approach that's worked for us over the last five years and we will continue to do that.

I think the critical thing, we don't provide Booker splits in this trading update. We will give you more detail when we get to the full year. Actually, I was pretty pleased with, but what I would say is I was pretty pleased with the Booker performance, both in terms of independent retail and indeed in terms of catering food service, but we will give you that split when we get to the full year as normal.

And in terms of mix, we saw pretty much the usual element of mixed. Finest did better. There were some particular categories where Finest did better, but Finest always does better at Christmas. So the balance, I think, what Jason would – I'll pass you over to him – but actually what we liked best was the balance of what we had across the piece, but, Jason, do you want to add anything to what I've just said?

Jason Tarry

I think that what we generally saw was customers actually making their own choice on value throughout our offer really. So we saw customers buying into Exclusive at Tesco, but we also saw them buying into Finest in a bigger way, and we saw some really strong performances there. We sold out of Finest gammon. Our Fines. Prosecco was really strong for us because it's one which is Best Buy. Turkey crowns, very strong, and some really good retail festive food ordering. But we also saw in booze, in spirits, a real buy in to some of the premium brands. So, we did see that, but we basically saw customers making choices throughout the shop and where they can see the price and quality mix, it suited them.

But we definitely see some opportunities for next year as well, particularly in the Finest space, even though it outperformed the business.

Andrew Porteus

Brilliant, thanks very much.

Dave Lewis

Is that helpful?

Andrew Porteus

Yeah, really helpful. Thank you very much.

Operator

Thank you. Our next question comes from the line of Xavier Le Mene of Bank of America Securities. Please go ahead. You online is open.

Xavier Le Mene

Good morning, gentlemen and Happy New Year to you. One quick question. You are commenting actually your outperformance, for the first five weeks actually heading to Christmas, so would you say the same comment in terms of volume value outperformance for Q3 on the whole period? And if you see a bit of change is there, would you say that you were potentially more prepared for Christmas than you were in Q3 or you will see no change there?

Dave Lewis

Xavier, I think what I would say is, so if we look at IRI, which is what we use in terms of looking at market outperformance, in Q3 food was 0.1% outperformance and that was stronger in the Christmas period. But both in value and in volume we were about where the market, but slightly positive in Q3, but stronger at Christmas. Jason, anything else you want to add to that?

Jason Tarry

I think you've covered it, Dave.

Xavier Le Mene

And will you say – why do you have this chance actually, you said slightly above in Q3, better in Q4, so is it because you were prepared for Christmas better than you were in Q3 or is there any read across here?

Dave Lewis

Now I don't think so. I think it's about phasing and timing of plans. As part of our centenary offer, we ran a different promotional plan through the course of this year in terms of the centenary events, so that has an impact in terms of how Q3 played out. There were definitely some impact in Q3 from mix, but they were in the market as well. So I think it's not that we did anything particularly different at Christmas. As you know Christmas last year was particularly strong for us, but as I tried to say in the notes – and I'm saying this to spare Jason's blushes – the operational performance of our business in the UK in the run up to Christmas and during Christmas was fantastic and that, together with a very strong value proposition and compelling advertising campaign, led to the outperformance that we've talked about.

Jason Tarry

If I might add, it's a real example – we talked before about not being obsessed with like-for-like. We looked at the calendar from a customer perspective across Q3 into Q4 and we created our trading and operational plan accordingly in order to make sure that we had the most relevant offer at the most relevant time for customers and I think that's what you saw in the numbers, to be fair.

Xavier Le Mene

Okay. Thank you.

Operator

Thank you. Our next question comes from the line of Nick Coulter at Citi. Please go ahead. Your line is open.

Nick Coulter

Thank you. Good morning, and Happy New Year. Three quick ones, if I may. Firstly, can I ask about your GHS order growth across the period and how you balance that with the quality of the customer acquisition? Then secondly, on the Booker acquisition that is coming through: just to check, should we expect all of the one billion sales support across or might there be some natural churn as it changes hands?

And then lastly, on Europe. Please can I ask about the performance of the new lower range compact hyper format? It is obviously very early days, but presumably you ran some trials on that new format? Thank you.

Dave Lewis

We did, thank you, Nick. In terms of grocery home shopping, 14 million orders over 19 weeks, really very strong. Obviously it's a very strong period for us anyway in terms of grocery home shopping. The thing that was really interesting is basket size continued to improve and we were very keen that we invested in – we weren't chasing growth through aggressive couponing. We didn't feel that we needed to do that. The customer experience was fantastic, so our NPS score on grocery home shopping during Christmas grew by more than five points, which is a phenomenal performance. So it's a very good quality of execution in grocery home shopping.

In Booker, the Best Foods Logistics deal is sales of 1.1 billion. There are four very large customers that make up a large part of that. As we've gone through this, we have spoken to all of those. We anticipate all of those sales coming with the deal when its concluded into March.

And, Nick, I think you answered your own question on Europe. It is too early to tell and obviously Christmas is a very particular period on which to judge any change. What I can tell you is availability, customer feedback was strong in those stores that we'd done. But we're sort of halfway through those transitions. So we've got an awful lot more to do, but it self-imposed, it's controlled by us and it's eminently manageable in the context of the total plan for the total group.

Nick Coulter

Thanks. Can I just come back on GHS? Is it fair to say that it was a lower contribution to sales this period than in previous periods? Or how should we think about that?

Dave Lewis

No, it is fair to say because it's always been very high at Christmas, and in the first half of this year, I think the growth was around 7%. It was slightly lower than that in Q3 Christmas time, it's already a very well demanded service and we focused on basket size and we focused on the service delivery and that worked really very well. Alan, do you want to add something?

Alan Stewart

Nick, I think, absolutely just building on that, the flip side of it is, if you look at our overall performance, it shows the strength of the large stores and particularly the extras and how they are delivering that full customer offer, because the rate of growth across the 19 weeks in our online business was lower than we'd seen at the half year when we last spoke about it. So really given the overall performance, [? 00:29:37] strength to the extra format.

Nick Coulter

That's really helpful. Thank you.

Dave Lewis

OK, Nick. And the other thing I'd add is, you will have read it in the release as well. So just to add to Alan's point, the fact that we've got a 0.4 drag from GN in the period is also showing that the extras are performing in food really very well and that's where my example from the 23rd of December comes in.

Nick Coulter

Super. Thanks so much.

Operator

Thank you. And our next question comes from the line of Alyssa Gammoudy of ING. Please go ahead. Your line is open.

Alyssa Gammoudy

Thank you very much. Just to be sure, and perhaps I missed it, but the performance in Central Europe, it's purely driven by operational or is it also the market, which is deteriorating [ph 00:30:21]?

Dave Lewis

No, the market was quite soft in a number of categories but by far and away the most significant issue is the self-imposed transformation. The downsizing of stores, the changes to the operations. It was much more driven by our own activity than I could attribute to the market.

Alyssa Gammoudy

OK, clear. Thank you very much.

Operator

Thank you. Our next question comes from the line of Maria-Laura Ajorno of Morgan Stanley. Please go ahead. Your line is open.

Maria-Laura Ajorno

Thank you very much. So just two very quick questions from me. So with respect to the UK and the impact that you mentioned coming through from general merchandise and how you're working on the offer, just wondering when we should expect you to complete that refinement in the offer, and maybe on an underlying basis, some thoughts around what is it that you're actually doing.

And the second question is more around wholesale and maybe if you have any comments around the competitive environment and where you stand from a pricing standpoint there. Thank you.

Dave Lewis

Maria, I think again, I'll start and I'll let Jason add something if he wants to. I think that we will always be adjusting. I think one of the things that I've been very keen that we do with Tesco, and thinking about the mix of products we sell, is that we keep it constantly under review. But habits change and we should move and if profitability profiles change then we should adjust the space and the priority that we give. So I suppose what I would say is whilst the big majority of what we have to do in terms of unprofitable general merchandising is being done, I would look to Jason and indeed the other three CEOs to constantly, actively be managing mix. But I don't think there is a point where I would say to you this is all done and it's over. I want them to be constantly thinking about mix.

In terms of wholesale, the competitive environment is tough and I think it comes back to the subdued market. When it comes to pricing, what Charles and the team do every day and every week is they look at the price indices versus key competitors and we've managed to keep our price indices consistent through Q3 and Q4. So yes, it's tough. We continue to be price competitive. There isn't anything that I could particularly point to you that was different in this period versus any other period that we've reported on.

Jason Tarry

I haven't got anything much to add to general merchandising apart from the fact that we still see plenty of opportunity going forward in terms of product mix and space.

Dave Lewis

Okay, Maria?

Maria-Laura Ajorno

Thank you very much. Thank you

Operator

Thank you. Once again if there are any further questions on the line please dial 01 on your telephone keypad now.

There seem to be no further questions coming through at this point, so I'll hand back to Dave for the closing comments.

Dave Lewis

Thank you very much, Mark. And as I said earlier, I'm really very pleased with the way that we ran the business this Christmas and every element of the operation played its part in delivering a fantastic offer for customers. With that, I wish you again a very happy new year. Thank you for joining us and I look forward to seeing you at the full results in April. Thank you very much.

Operator

This now concludes the conference. Thank you very much for attending. You may now disconnect your lines.