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Transcription

Tesco Preliminary Results Announcement

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08 April 2020

PRESENTATION

Mr. Dave Lewis (Chief Executive)

Good morning everybody and thank you for joining us this morning as usual, but a safe two metres socially distanced away. I'm joined by Alan Stewart, as normal. We're both sorry we won't see you in person today, but I'm sure you understand why and we both hope that you're safe and well.

Today we're going to announce the results of the year up to the 29th of February, and whilst I'm sure we'll all agree that the 29th of February feels like a long time ago, I just wanted to say by way of introduction that I'm very pleased with the performance of the business last year. We finished a turnaround plan that we started five years ago, and indeed we were able to exceed all of the goals we set.

But as I say, a lot has changed since the 29th of February. So, what we can do this morning is I'm going to ask Alan to take you through the full year results, and then the second part of the presentation, I'm going to talk to you about COVID-19. What's happened so far? Give you some insights there. Share with you again what we're doing and share with you a little bit about how we're thinking and how we're talking about scenarios in our business, to give you some insight about how we're managing and thinking about managing in future.

But before we go into any of that business perspective, I just wanted to acknowledge the very real and the very serious human impact of this virus. It affects our whole Tesco family around the world, our colleagues, our customers, their families and loved ones. Nobody's untouched and our thoughts are with everyone who's been impacted.

So, with that as a perspective in the back, I'm going to hand over straight to Alan to take you through the full year results, and then I'll come back and talk about COVID-19 and plans there.

Mr. Alan Stewart (CFO)

Thanks Dave and good morning everyone, just to remind you that this was a 53-week year for us in the UK and Ireland businesses. But the numbers I'll talk about today are on a 52-week basis in order to give a proper comparison. If we move to the first slide on group performance.

We were pleased with performance in the year with profit growing to 3 billion pounds and retail free cash flow growing to 2.1 billion pounds. Reflecting the performance last year and given our strong liquidity and balance sheet, we are proposing to pay a final dividend of 6.5 pence per share, taking the full year dividend to 9.15 pence per share. The final dividend will result in a cash cost of approximately 635 million pounds payable in the current year.

We move to the segmental performance. This shows a summary of our key sales and profit numbers by segment. This includes a total for the retail businesses which we've introduced to give clearer visibility of our different profit streams where we saw profit growth of 13.9% year on year.

Taking each of our retail businesses in turn in UK and RI, sales increased slightly against the backdrop of subdued market growth. Profit growth of 16.9% was driven by improved product mix, our simplified operating model and strong focused synergies.

In Central Europe, sales and profit growth, particularly in the second half, reflected the significant transformation we undertook within the business. We resized, simplified and improved the relevance of our businesses in the Czech Republic, Hungary and Slovakia, and transitioned in Poland took a two-format model. This has involved fundamental changes to space store layouts and profit ranges, which are now largely complete. As a result, we're seeing a more efficient operation and improved availability for customers.

In Asia, strong profit growth reflected our actions to improve product mix and to accelerate cost-saving initiatives. You will be aware that in early March we announced the proposed sale of our businesses in Thailand and Malaysia and I'll talk more about this later.

Turning to Booker, I'm pleased to say that the benefits we outlined at the time of the merger have now been delivered. We've achieved our three-year target for cumulative synergies one year early. Booker is EPS accretive to the group in its second year and returns are well in excess of the cost of capital. As anticipated, we had completed the acquisition of Best Food Logistics on the 7th of March and this will enable more customers to access Tesco sourcing capabilities. We see many opportunities to unlock further benefits from the merger. With Booker as an integral part of our UK and RI business going forward.

Moving now to bank, we continue to focus on providing simple products to our retail customers. In line with this we sold in mortgage portfolio during the year which is reflected in lower lending balances. We also closed our current account to new customers.

The bank has a strong balance sheet with a total capital ratio of 23.1%, and its resilience to various stress scenarios is regularly assessed. That being said, the coming year will undoubtedly be challenging. The economic conditions arising from COVID-19 will affect banking profitability across the board, and we expect the bank to be impacted by a reduction in income from all of its activities, which, together with provisions for potential bad debts, means it's likely that the bank will make a loss in the current year. We expect its capital ratios and liquidity to remain strong.

If we turn now to sources and uses of cash, I've shared this waterfall many times and it represents how we think about these. As a reminder, this reflects our free cash flow definition, including repayments of obligations under leases as required under IFRS 16.

I'm going to call out the most notable items starting with the 4.5 billion pounds of cash we generated from our retail operations. The net inflow from working capital was 163 million, which includes the reversal of last year's 210 million impact, which you'll recall related primarily to the implementation of our general ledger.

Our planned progress for the year was held back by the timing of non-trade payments. The deleveraging effect of lower sales in central Europe and the continued prioritisation of availability for our customers. In line with our disciplined approach, cash capex came in at just under 1 billion pounds. We've provided the usual breakdowns by region and type in the appendices.

Net interest and tax was just over 1 billion pounds, approximately 100 million pounds lower than last year, mainly as a result of the debt maturities and the bond tenders with new issuances at a significantly lower rate of interest then retired debt. The benefit from dividends, acquisitions and disposals of 345 million primarily relates to 270 million pounds we received from the sale of our 20% share in the Gain Land China joint venture which we completed just before the year end. Overall, this resulted in the retail free cash flow of 2.1 billion pounds in comparison to 900 million pounds last year.

In the current environment, I felt it was important to touch on the strength of our balance sheet and our liquidity position. We are a highly cash generative business with significant liquidity. We have 3 billion pounds of committed facilities which are undrawn, and we have proven access to capital markets in both euro and sterling.

During the year, we regained our investment grade credit ratings from Moody's and S&P such that we are now investment grade with all three agencies.

In line with how we manage our debt on a portfolio basis, we repaid 1.3 billion of debt during the year, through the combination of maturities and some liability management exercises and we issued around 1 billion of new debt at attractive interest rates.

Our total indebtedness was down 900 million since last year at 14.7 billion. This was driven by reduction of 900 million in our lease liabilities reflecting the purchase of our partners stake in the Atrato property JV as well as the capital repayments we made during the year. This is partly offset by a slight increase in our pension deficit to 2.6 billion pounds driven by a fall in corporate bond yields.

Subject to shareholder and regulatory approval of the sale, we're anticipating using 2.5 billion of the proceeds from the sale of our businesses in Thailand and Malaysia to eliminate the funding deficit.

Our total indebtedness ratio has continued to improve to 3.1 times, driven both by an increase in retail EBITDA of 400 million pounds and a 1.1 billion reduction in net debt during the year.

We've continued to take further actions to simplify and strengthen our business. As mentioned, the sale of our 20% share in Gain Land, resulted in net proceeds of 277 million pounds, as well as giving us the ability to continue to focus on our core operations. We generated 258 million pounds of property proceeds in the year relating largely to the sale of properties as part of our central European transformation. Overall, our group freehold property proportion increased to 60%, primarily as a result of the JV buyback of 15 stores and two DCs I mentioned a few minutes ago.

On 9th March we announced the proposed sale of the businesses in Thailand and Malaysia, subject to shareholder approval and regulatory approval in both markets, we expect to complete in the second half of 2020 and we propose to use the proceeds to eliminate the pension deficit, return around 5 billion pounds cash to shareholders, and strengthen the balance sheet.

As usual, either slide summarising our key technical guidance based on a normalised year. Please note that the guidance assumes that we complete the disposal of our Thai and Malaysian businesses in the second half.

As we announced in early March, we expect capex to be within the range of 900 million to 1.2 billion pounds going forward. There's no change to our guidance for net finance costs. On tax, we now expect the effective tax rate to be around 21% in the medium term following the reversal of the previously enacted 2% reduction in the rate of UK corporation tax. In the coming year, we expect an increase in the effective tax rate to around 24% as we revalue the deferred tax in line with this reversal of the corporate tax rate.

We maintain our given dividend guidance in the full year pay-out ratio of 50% and we are planning for our interim dividend to be 35% of the prior year's full year dividend going forward.

Following the disposal of the Asian business, we are targeting a total indebtedness ratio of around 2.5 times and we no longer expect to make pension deficit payments once we've used the proceeds of the Asia transaction to pay off the funding deficit. Our Asia segments will be treated as a discontinued operation for the current year.

We made significant progress in our turnaround over the last five years, focusing on serving our customers better, re-engaging our colleagues and resetting our relationships with suppliers. As a result, we've added value for shareholders. I wanted to give you some colour on this over the next few slides. You will see that customer perceptions have improved across our range of measures with a particularly pleasing improvement to pass 29 in the Net Promoter score and strong improvements across all measures of brand, quality and value.

We see similar improvement for colleagues in our store for 'great place to work' is around 10 points higher than the global retail benchmark. I would also particularly call out the colleagues' feedback in our culture and importantly their engagement in our purpose to serve customers a little better, every day.

Our supplier scores show some of the most marked improvements reflecting the fundamental changes we've made to our ways of working. As we've rebuilt trust and transparency with our supplier partners. And finally, our shareholder metrics reflect the progress on profitability, the cash, and our balance sheet.

Our progress through the turnaround across all of our stakeholder groups mean that we are well positioned to deal with the challenges of COVID-19.

Looking to the current year, our plan had been for this to be a year of investment with profit more weighted towards the second half. But clearly this has changed with the global measures to combat COVID-19. Dave will talk through some of the financial impacts in a moment.

So, in summary, we delivered a strong performance in the year and our liquidity and funding them, positions remain robust and as we look to the coming year, we continue to operate within our capital allocation framework. The proposed sale of our businesses in Thailand and Malaysia will release material value that allow us to further simplify and focus the business as well as returning significant value to shareholders and securing the pension scheme for its members. With the turnaround complete and the balance sheet strong, we're well placed to support colleagues and customers through the current very challenging times. And in the long term, to reinvest into the customer offer. Thank you for your time. I'll now hand back to Dave.

Mr. Dave Lewis (Chief Executive)

Alan. Thank you very much indeed. So, obviously we've shared with you the results of last year but we're also very clear that what will be on your mind is the current situation around COVID-19. So, the second part of the presentation is to share with you a little bit about what's been happening, what we're doing about it, and a little bit about how we're thinking about the future.

So, some of this you will know. This is the food sales since our week 46. These are Tesco weeks on the bottom here and as you know the market was flat, subdued if you like, coming into the end of our year in the first part of January, February period. And then we saw a phenomenal spike and when we talk about that, we're talking about a 50% increase in food sales, about a 30% increase in sales for Tesco across those peak weeks.

We then saw it go slightly negative as the stay at home guidance was issued and if I look back to last week, we see us back into growth. So ahead of before the crisis, but obviously at a significantly lower level than what we saw in those peak weeks.

Just wanted to give you some insights into how that stockpiling happened because it informs some of the decisions we took and how it is we run our business. But the interesting thing is actually most of the stockpiling was driven by a small number of customers and you see from the channel on the left-hand-side: 10% of customers took 30% of the volume during that. And a further 20%, so 30% in total took 60% of the volume. And we saw that there was a strong correlation between affluence and their ability to stockpile. And what you also saw was that while sales were increased across the whole country, they were significantly enhanced in the South East and particularly around London.

If I give you more flavour in terms of what - some of this you will know - but just to give you some examples, be it baked beans, be it peas, be it toilet roll, and so on and so forth, some phenomenal increases against a typical week in terms of the volume that was purchased and you would have seen the challenge that that was in-store and the challenge that was for the food supply chain. I just want to be really clear that the vast majority of these things are now resolved, we chose because of stockpiling to introduce the limit. You would know that across the store and we reduced the promotions because multi-buy promotions against limited supply didn't allow that everybody had access to product, so those are the decisions that we took.

The vast majority of categories in our store are now back onto our shelves. One or two where we need to be careful but as they recover, we'll take those restrictions off as well, and the availability in store is now significantly better and improves every week as the sales normalise. Let me talk now a little bit about the impact on mix, because there's been a lot of conversations about the strong food sales but I thought I would give you just a little bit more indication. Some of you will know this but just for the avoidance of doubt, I'm talking now really about the UK.

We did see a strong growth in stores. Total first period store growth around 10% in the UK, but the online business significantly added that. And, as I speak, the online business is growing at closer to 30%.

The interesting thing is as you know, if I take the margin lens to this sales mix, online is less profitable than stores. So, the impact on mix here of more online business is negative, right. When I look at product, food was strong. Now food in a margin sense is about the average of the group, alright. So, if you assume now that it’s the average of the group, clothing, where in the last few weeks sales have been 70% down. Actually, clothing margins are accreted, to the group, as indeed is the general merchandise that we still sell, and we've seen significant declines in general merchandise.

Fuel sales in last few weeks, with the lockdown are down 70%, but obviously the margin on fuel is very, very small indeed. So not a big impact in terms of margin mix. In Booker, the positive is that the Booker retail business is growing at around 30% as I speak, but the catering businesses significantly down, nearly 60% down, given the closures of some of the businesses that we serve.

From a margin mix point-of-view, you'll remember that actually catering and delivery catering is actually a more profitable part of the Booker mix, so sure that's down. The reason for giving you that is, you got some insight in terms of how the sales mix is, but you can also overlay and think about what the margin mix is, and therefore there is some challenge in the mix as we go forward.

Moving to the next slide, this is how I'm going to attempt to share with you a piece of work that's going on. We have a team within Tesco which is looking at the demand curve for the medium and long term. We have a team in Tesco looking at the supply strategy for the medium and the long term and we’re trying to model what might happen.

And so, I think the one thing I have to say as a caveat here is the one thing that we know is none of the forecasts we have are going to be accurate. As one of my colleagues said when we went through it: they’re all precisely wrong. And we have to recognise that nobody knows. But we thought we would do is try and share with you the assumptions that we are making, and as things unfold, we’ll see how those assumptions actually play out.

So what you see here is, down on the left-hand-side, is what are the impacts on our business and what we're assuming. So in terms of stockpiling, you've seen it. It's in the base case. We think it happens once, so that's something that we've seen, and it's been positive in terms of sales over the first period of the Tesco year. The other thing that's significant, obviously, is the shift from eating out of home. So from our strategy the idea of being in home and out of home is that, however, the market moves were in a strong position to be able to service it.

I've read a number of reports from different people about how much of food consumed out of home will come into retail. Just to be transparent, we've assumed 25% does in terms of those calories that shift, and the biggest single assumption is for how long. There's a base case assumption and you'll see in a second we're talking about a base case which has a 12-week impact, a 16-week impact, and then one which is a 20-week impact and those relate to the three scenarios you see there.

So, depending on how long pubs and restaurants are closed, we have one, two or three impact. The other thing that is significant and we model is what's going to happen to holidays and to a lesser extent, school closure. So, the view is given the restrictions that this year is going to be a year of staycation in the UK and as a result obviously there's more consumption from people staying at home than the loss of tourism into the UK. And again, if that's the 12-week impact, then we have the first column. If it lasts for longer then we'll see a benefit that lasts for longer and so on and so forth. General merchandise and clothing we see continues to be negative in terms of sales mix. However long the period is and likewise, obviously the impact on fuel.

If I present that to you in a slightly different way, this is our sales from the first part of the year from week one, and you see my base case for further restrictions in the longer term restrictions and you see what we think might happen in terms of the curve depending on which of those assumptions play out. And I repeat, I'm happy to share with you the assumptions that we’re making, but we all are very, very conscious that we don't have perfect accuracy here, and we're going to have to be very adaptable. But I'm sharing with you scenarios. What I do know for sure is that adapting to these scenarios has some very significant costs.

Now let me share with you a few facts here as we shared on the call. So, at the moment we have just under 50,000 colleagues absent from Tesco, but we, since the 20th of March have recruited 45,000 new colleagues. There's a very significant added payroll cost in stores, and what you see here is the base case. If the restrictions go on for longer and our longer term restrictions means that payroll in stores could cost something between 280 million and 405.

In distribution that range, because we're recruiting in distribution also, is between 135 and at worst case scenario 175. Store expenses significantly stepped forward and this is everything from hand sanitisers, cleaning, and we can go into some detail if you're interested. There's quite a lot of property and maintenance, increased cleaning routines, the change of property around social distancing. And again, depending how long they go on for you can see the numbers on the screen. We made some changes in technology and we've obviously had to increase communication around the changes that we made.

So net-net, what we can see depending on how long this scenario carries on, that there could be an incremental cost to the UK business of between 650 million and 925 million. They're significant costs. We prioritise always doing the right thing, keeping everybody safe but keeping the business running. And whilst there is comment and I'm sure you'll have questions, I put that additional cost against the business rates relief that's been offered by the government in England and Scotland, and what you can see is it is a contribution, it's a significant contribution. It is welcome, but it's only a part of what we think that this is going to cost, and Tesco is obviously investing significantly as well.

So that's where we are. What have we been doing?

And if you've been following the message to customers, you'll know some of this. But let me recap, we do believe that if we can engage everybody; our colleagues, our customers, and our suppliers around this, that together we can do this. We focused on four things. Food for all, safety for everyone, supporting our colleagues, and supporting our communities. Let me give you a bit of detail as to what that actually means. So, when we talk about food for all, I've touched already that we introduced the limit initially of three items per customers per product. We've now removed that on the majority of products, we removed many of our multi-buy promotions so that the food could go further. We introduced special hours in store for NHS workers, and more vulnerable, disabled, elderly customers. We've expanded the online capacity by 20% which is nearly 150,000 new slots and we continue to expand that on a daily and weekly basis. We've worked with the government to prioritise those delivery slots.

We've obviously in our store had to change the offer. We temporarily closed cafes, counters, phone shops and concessionaires of clothes also. Very importantly, it would have been very much easier to run the operation if we reduced the store opening hours. We didn't. We maintained the store opening hours because as we put in things like social distancing and changes, we needed to keep stores open for as long as we could in order to serve as many people as possible. And to help there our office colleagues have been working in store where possible and we have some work with suppliers to simplify ranges to prioritise volume so that more essential food could reach more people.

I picked out, because I thought you might be interested, what that means in grocery home shopping specifically. Some of you will remember that our capacity and our ongoing normal rate, excluding Christmas, around 660,000 weekly slots going into this crisis. Initially that capacity went South, it declined. It declined because of two things. The very strong traffic in store meant that our picking capability capacity was affected, but also the number of items that people were ordering was also significant.

If I give you some colour on that, all of last year the average items per order would be about 44 – 45, at the time of those two weeks peak, it rose to about 130 items per order. So the orders were significantly larger. We introduced so that we could spread and can keep the capacity for all, a limit of 80, but actually in the last week the average orders have been more like 61 - 62 items per order.

So, managing that and increasing the amount of picking time. So, in some of our 345 dot com stores were picking from 2:00 AM. We've increased the weekly slots to 805,000 and will continue to increase that capacity so that we can serve more people and in that increasing capacity we've been working with the government on their vulnerable list. Now, for those of you who are not familiar, the government have identified 1.3, nearly 1.4 million people in the UK, they considered to be clinically vulnerable. Over a million of those have a support network already in place, and they believe there's around 300, maximum 400,000 that they believe have not got that support in place.

They came to us and other retailers to say could we help? And on Friday of last week to give you an example, we received from them a list of 110,000 people on that list. We were able to match in a matter of a few hours 75,000 of those that we had details for within Tesco, which meant that they had some contact with Tesco before. We wrote to all of them and offered them the priority slots and that was all done within 24 hours of reaching that list. And if I update you to yesterday I think as the government continues to send us the list at the moment something like 95,000 of those 300,000 are being offered a priority slot with Tesco and the standard-- and that brings me sharply into relief with the one at the bottom. At the moment we're making about 120 deliveries a minute in the UK as we speak.

So that's what we're trying to do to get food to all. Safety for everyone. Crucially important. Now, I don't know how many shops you've been in. If you're doing the shopping, you would have seen the new social distancing measures. We summarised that in a colleague advert that was shot in-store overnight with colleagues and one cameraman. We've created a one-in-one-out system to help us limit flow and we've created one-way aisles so that customers can safely social distance as they walk the store. There are directional flow markings everywhere to help. I'll show you a picture in a second – we've introduced protective screens at checkouts. We've enhanced the cleaning routines and there are new cleaning stations in our stores as you walk in and we've encouraged payment by card, and we are progressively introducing a higher contactless payment from 30 to 45 pounds to help that. An interesting stat for you is last week, the amount of payments in Tesco that were done by card reached 80% which is a significant increase on where we were before.

I thought I'd put, given that not everybody would have been, is that if you walked into one of our Tesco's stores, these are the sorts of things you would see. Outside in the queue, there are two metre lines but when you come in, there are sanitization systems so your trolley and your basket is cleaned for you and then passed to you or rolled to you in most cases and then we encourage customers to follow the flow. And the markings on the floor keep people two metres apart, and as you can see, we've got a one-way system operating so that people don't collide.

Let me move to colleagues. Because this is obviously crucial as well. Let me tell you about the approach that we took when this became the crisis that it became. It was very important to all of us that we never had a colleague that felt compromised between what they needed financially and the decision about whether they should go to work or not. So immediately we instituted that colleagues would get full pay from the very first day of absence, not waiting for the normal three day period. We were very clear with all vulnerable colleagues that the 12 weeks of self-isolation that they were required to do would be paid. As you know, we've introduced the bonus for colleagues and we did it quite a while ago, to say thank you to colleagues working across stores, distribution and the customer engagement centres.

We've introduced new school closure leave policy so that we can help families who are isolated with young children at home. And as I said earlier, 45,000 new colleagues have joined us since the 20th of March, including pickers, drivers, store colleagues, distribution centres and we have extended the colleague discount to 15% and made that for the whole of the month of April to support our colleagues too.

Now, if you'll allow me, this feels like the time to say a word, a personal word about our colleagues. What I've seen over the last few weeks – now, I've always been proud of being part of the Tesco team, but never more so than the last few weeks - what they've done is nothing short of awesome, their commitment, their courage, their empathy with the situation is humbling. I've seen it first-hand. I've seen how it is that Tesco colleagues tried to look after customers and try to look after each other. And I'm just so proud of what they're doing and the way that they are doing it.

Given the size of our business, we know that we don't get it right every time, in every situation. Customers have been fantastic. Colleagues have been amazing. I think it's interesting there's a pride in Tesco for what's being done today. I've seen huge challenges as I continue to visit stores and distribution centres across the country, but I've also seen humanity that I haven't seen for a long time. And I'd just like to say very clearly, and very publicly I could not be more proud of the team that are leading and operating the business of Tesco today.

Now look, you will have seen through all of the presentations that Alan and I have given over five and a half years, but supporting the communities in which Tesco operates has always been a key part of what we've done. But at times like this, you do more. So we have, as you know, three million in any in any ongoing month we donate about three million pounds with the food by the community food connection and our distribution centres and we carry on and we carried on doing that.

But we boosted it with 15 million more of food over the next 12 weeks, and we also gave a million to help cover the extra operating costs of FareShare and Trussell Trust, because their demand is obviously higher as well. We're focusing the two million funding from bags of help the charities helping the most vulnerable, and we're building on the partnership that we have with the British Red Cross donating 2 million for support, those in need. And we've given a million pounds of funding to stores to help the most needy of local stores.

We – you would have read this week – we are donating food for 1,000,000 meal parcels for NHS workers so supporting the Salute the NHS initiative that Ron Dennis set up and we're constructing our first dedicated NHS Nightingale Hospital pop-up store in Birmingham and we have plans to do more.

I suppose the one out of this that's worth focusing on is the food donations. As I say, we do three million a month, any month. We boosted that with 15 million over the next 12 weeks and we've made that contribution to operating costs. So this year, over 50 million will be invested in making food donations to the community partners that we have had in some new, very needy institutions as well.

Let me look ahead if I may – look, there are material impacts from COVID-19. We know that we are incurring significant additional costs, particularly in payroll, but literally across the whole of the UK operation.

The precise impacts, I'm sure, I hope you appreciate, are hard to predict. I've shared with you the range of scenarios both in terms of time period, which is the most significant assumption in all of them, but also in terms of those features and how they might affect us in terms of the sales rate going forward. We don't give guidance. We're not prudent to provide profit guidance for 2020 and '21.

What I can tell you is though, if we base ourselves on a scenario that returns to, let's call it "normal customer behaviour" by August, we believe that the retail impact that we're experiencing can be broadly offset by, yes, some volume increases in food, the support that we're getting from the business rates relief, and some prudent operational decisions that we can take as management and we need to make as management in order for us to cover all of the costs that we have.

So with that, let me try and summarise. Over the last five years, we've focused on serving customers better, re-engaging our colleagues, resetting the supply relationships, and creating value for shareholders. In Alan's presentation, he gave you some of their KPIs of how we compare last year versus five years ago, and I have to say, if I'm allowed, I'm really pleased and really proud of what the team delivered last year. It means that we're in a very strong operational and financial position to deal with COVID-19. But we do have significant extra cost in feeding the nation and they're only partially offset by the business rates relief.

I've seen, as I said already, an outstanding contribution from colleagues and I can tell you there's a very strong belief inside the business that if we all continue to engage, stay flexible, understand that things change, that together we can indeed do this. So thank you very much for that. We're going to now open it up to questions. Can we try and observe as we were in the stock exchange? We tried to give you a full presentation, but can we still keep to the idea of, if there are detailed modelling questions, let's pass those to Chris and Sarah in subsequent conversations, and one significant question each, please.

Q&A

Operator

Thank you if you wish to ask a question, please use the phone line and press 01 on your telephone keypad. If you wish to withdraw your question, you may do so by pressing 02 to cancel.

The first question comes from the line of Andrew Gwynn from Exane. Please go ahead.

Andrew Gwynn

Hey, morning all. So just come back to this chart if we will - so very useful, thank you very much for providing those. Scale would always be nice, but I guess that's normal form. The 25% out of home consumption, transferred from store sounds to me pretty conservative, and wondering what your thinking is behind that and loosely what that equates to in terms of the [inaudible 00:38:21] sales up there. Thank you.

Dave Lewis

Yep, Andrew, Good morning. I think you would be. I've got a very delicate line to hold here, which is how do I give you insight so that you can understand but without giving away competitively sensitive information. So hopefully that's been a path we tried to walk before and will continue to walk through it here, in the way that we presented the chart. The 25% is based on looking at the mix of what it is we sell to bookers to the different customers and look at each of those occasions and saying what of those would become a retail event and then what it is we would satisfy. So there's some very detailed work behind that. As I say, all I can tell you is it will be precisely wrong.

But there is, I think what we have to recognise, is that there's an element of out-of-home food consumption, which is just not happening at all and will be lost consumption because those occasions are not there. And so I think when you look at the total market, you need to discount the total market for that. But I think the thing that's interesting is, whilst we've seen a big impact on those catering businesses, we also see some of them start to experiment with ways that they can open up. So, Pret are opening five stores which have social distancing and trying to find different ways. So again, we've got different assumptions about how that sector will evolve. But you could. I can completely accept that you might disagree with the 25%. I'm just telling you which assumption we have made.

Andrew Gwynn

Okay, that's all clear, thank you. Cheers.

Operator

The next question comes from the line of Andrew Porteous from HSBC. Please go ahead.

Andrew Porteous

Andrew, are you there? muted?

Operator

Hello Andrew, your line is open.

Andrew Porteous

Hi. Sorry I was muted. Hi guys. Just thinking about a couple of issues. Could you tell me how supplier income works in this sort of environment? Things like overrides and the like. Do you have to renegotiate them or does that sort of continue as normal? The second question was really on the non-food side of the business. Could you talk perhaps through inventory risk and markdown risk as we move through the year on that, given the sales declines that you're seeing there, particularly in clothing?

Dave Lewis

OK, so in terms of why don't I talk about supplier income and let Alan say something around inventory and non-food. Look, the truth of it is most of our commercial-- You know that we move most of our commercial income from the so-called back margin to front margin. So most of our commercial income now comes through the case price with straight case price. Those elements which are overrider written and there are still some for sure, we would operate those as normal. So we've not renegotiated overriders as a result of this, they operate as normal. The bigger question in the area of supply has been about capacity planning and being able to source. So there has been some conversations about simplification of range, prioritisation of pack sizes, volume, so on and so forth, but the work that we've done over the last five years to build strategic relationships with partners so we understand each other's business is really helping as we recover the supply chain, but it's not a fundamental change in commercial practices or commercial gross margin. Alan, do you want to say something about.

Alan Stewart

Yeah, Andrew, you actually asked two questions, but we will answer them. The general merchandise and clothing are obviously non-perishable but clearly there are- If demand isn't there, then we have to think about when we turn that stock into cash and particularly with general merchandise, there's no real risk, generally we can store it and that's what we will do. Clothing is a little bit different, but for us they are relatively small parts of our business, as Dave's said, from a mix perspective they are margin enhancing and therefore there's a drag if we're selling less in them. But for us, I wouldn't call it out as a significant risk as against our overall business. Even clothing, you can always put into storage and bring out if there's seasonal elements of clothing, but we'll manage it very much on a- as the market develops.

Operator

The next question comes from the line of Xavier Le Mene from the Bank of America. Please go ahead.

Xavier Le Mene

Yes, good morning gentlemen. Just quick one from me actually on Europe. Can you give us a bit more colour on the recovery you are potentially experiencing of what you expecting? What was the first sign since you significantly changed the business over the last 12 months?

Dave Lewis

Yes, so it's a great question. So look, we made significant changes in Europe, by far and away the most significant those in Poland. So as Alan says, we stopped, we've sold a number of stores in Poland. We basically reset our whole Polish business model around two formats, so a supermarket format and a convenience format. We've effectively sold out of our hypermarkets business. We've significantly reduced the cost of running the Polish business as a result, and changed the offer very fundamentally for our customers. We saw a big impact in that in the second half of the year as we went through it and in terms of its impact into the Christmas trading period. Quite frankly and honestly, it was a little bit more than we had anticipated, so we had to face into that.

Elsewhere in Central Europe, we continued to make the simplification changes. We've taken a lot of excess space out, so a big programme in Hungary, in particular, around downsizing in places like Czech, we've come out of department stores. So Xavier, there's been a huge amount of change within Central Europe. I'm pleased with the way that we're coming out of it. It's hard for me to delineate some of the things which are COVID-related into the sales trends now, but if I look at the changes that we made to the offer to the sale space, to the cost base of the business, we managed to execute through a very difficult situation - the change that we wanted. And I suppose we'll have to give you an update in October as to what a more normalised sales level would be. Because at the moment, whilst there's been a positive impact on sales in central Europe, it's been nothing like the level that we've seen in the UK and Ireland.

Xavier Le Mene

Okay, thank you.

Operator

The next question comes from the line of Rob Joyce from Goldman Sachs. Please go ahead.

Dave Lewis

Hi Rob?

Rob Joyce

Sorry. Hi, sorry a similar mute issue, I'm afraid. Just one clarification from me and a question if you don't mind. So, thanks very much for taking these and congrats on all the work you doing at the moment. But on the clarification side, just so I understand, under your base case scenario as it stands, your best guess is that after the benefit of the rates relief, the retail business in FY21 is broadly neutral based on the COVID-19 impact with potentially an additional 200 million or so negative impact from the bank? That's just the clarification on that. And the second one, is, just could you give us - you very helpfully said online sales now running at around 30% growth. Are you seeing significantly different growth levels in the different channels of your business, convenience, superstores and extra hypermarkets now as we settle down into a more normalised trading?

Dave Lewis

Thank you, so very cheeky. We've got a clarification and a question. The clarification is like we've given you. We always intended to split out retail profitability and banking profitability so that you could see the dynamics and we've done that. In terms of the retail part of it. If I use the calendar so it helps, the assumption's basically get us to- the base case assumption is end of July, medium assumption is end of August and the longest is the end of September. And as I say, we don't know whether they're right or not. We're just sharing with you the assumptions that we made.

What I said was whichever of those assumptions, the combination of some food volume, the help that the government are putting in, and other decisions that we might take, we hope to get ourselves to a place, that on a 52 week basis we can offset the challenges for the business at a retail operating level. That's what we aspire to do, but there's obviously a lot of moving parts. In terms of channel specificity, and then I'll Alan talk about the bank, it's exactly as you would expect, so we've seen a very significant growth in food sales across every channel. Large stores, small store convenience and indeed online. The large stores are obviously affected by the GM and the clothing, so the headline number would be slightly lower, but we've seen convenience shopping also increase as people use their local store for a bigger basket. So I'm trying to think of numbers I can give you that would be helpful. So in that, across that period, we talked about a 30% growth number. Food was significantly ahead of that. We talk about large store food sales through the whole of the first period of five weeks of being just under 10%, and we talk about online food being closer to 30, I mentioned, and convenience sales between those two. Interestingly, if you take the Booker angle. Booker retail partners, which are convenient stores through Londis, Budgens and Premier growing at 30% as we speak, so that's a little sense of how the channels are. And Alan, do you want to talk about that bank?

Alan Stewart

In terms of the clarification, yes, the bank, we fully expect it to come back in the year after this, but the bank's activities are impacted to the extent that customers take advantage of the moratorium on paying interest that obviously impacts their income as well, the bank's income. And then of course there's IFRS 9 where all potential bad debts are taken up front rather than on an as-incurred basis, which was the old standard. So there is a pretty big one-off potential bad debt charge which is taken. But I think the other thing just to remind you about the bank, is that the bank we operate totally separately. We only expect a dividend of 50 million per annum in terms of the cash flow contribution so whilst there is an earnings and operating profit impact, the cash impact on the group is relatively minor and the bank obviously we will take decisions on the bank's dividend, as we do each year, we receive the dividend in respect of the year ended last year and we'll see what happens, but it's a relatively small contribution to the cash flow of the plc.

Rob Joyce

Thanks Alan. From memory, the bank dividend's [ph 00:50:14] up 50 million, right?

Alan Stewart

It is 50 million and that's what we factor in and that's the basis on which the bank operates on growing its own business normalised. So in terms of the group cash flows, that's, dare I say, a relatively small part of overall cash flow to the group.

Dave Lewis

And the bank board makes that decision each February.

Rob Joyce

Thank you very much.

Operator

The next question comes from the line of Victoria Petrova from Credit Suisse. Please go ahead.

Victoria Petrova

Good morning gentlemen. Thank you very much, especially for scenario analysis. It's extremely helpful. I have also a sort of a clarification question. You mentioned that business rates relief should be around 585 million pounds, and as far as I understand, last year it was around 650 million pounds. Where does the difference come from and do you expect any other form of state support? Maybe some compensation of salary payments, or maybe even some lease payments or any other form where the government could support you in the current environment? Thank you very much.

Dave Lewis

OK, so let me give you some of the breakdown on business rates, Victoria, and then I'll talk about the state support in a second. So our total business rates is a little more than 700 million. That's total total total. All payments, all property, all geographies. The element which retains to our retail stores on which the relief is given is a little bit more than 600 million. If you are aware, the Welsh government took a decision not to support the UK, so Wales, our stores in Wales will not get this relief and so that brings it in England and Scotland down to the number of 585 million of relief that we anticipate.

So that's the delta between the two. In terms of state support. No, we don't anticipate anything else. We appreciate what is here. Your question allows me to say very candidly, we have not furloughed anybody inside the Tesco business. We have given 12-week, full paid sickness to our colleagues and we've taken on 45,000 new colleagues, so employing people who have been laid off elsewhere into our business. Also, I don't know if you heard me talk earlier this morning about where other forms of state aid are available and the one I was thinking of was VAT. The government has given the ability to delay, defer VAT payments. Because of the financial strength of the business that we talked about, we've chosen not to take advantage of that and so last week at the end of the month we paid 200 million of VAT to the government as we normally would. So, our working assumption is that we will take the business rates relief but that will be the extent of it.

Victoria Petrova

Thank you very much.

Dave Lewis

Thank you.

Operator

The next question comes from the line of Nick Coulter from Citi. Please go ahead.

Nick Coulter

Hi, good morning and thank you for taking the question. Could I ask about the sales shape projections? I guess it's slide 27 of 44. I guess that's GB in NI and as you have quite rightly articulated, they are precisely wrong. But could you talk through this shape over the extended projection? It looks like you go into sales declines on that project. So I just wanted to clarify that and your thinking with respect to that shape and how out-of-home impacts and what the drivers are. And then if I may, it'd be interesting to get some comments on the present run rates in the bank, thank you.

Dave Lewis

Okay, let me take the first one and Alan can talk about the bank as well. Nick, as you say, they say there precisely wrong, but the assumption is this. There are two things that I could say to you which are interesting is - we've seen the pattern of trade change. So since we've gone to interlock down, social distancing, all the changes I mentioned, what we're seeing is a much more even trade over the week. So, it's daily. So, what we're seeing at the moment is Monday, Tuesday, Wednesday, Thursday are bigger than before, but weekends are actually lower than they were before, because people are basically shopping their trip. The number of transactions is declining, but the size of the basket is increasing. So, if I take last week because those numbers are on the top of my head, number of transactions down 48%, basket size up 50%. So that's where the growth comes from.

The assumption is that flat pattern – so, because of the out-of-home, lack of holidays, the things I mentioned, we see some growth in each of those scenarios, for the next 12, 16, 20 weeks. But we are also clear that when it comes off of that element of growth, that there really is some stock that's in people's homes, that they will begin to use up, and so there is an assumption, Nick, that when we do get back to that so-called normal state, that people will run down some of the stocks that they have built up through this period. But that's the assumption, Nick, and I know if you press me on the precision on all of it, I would struggle, but there is an assumption that not everybody has eaten all of the beans that they bought so far. Therefore, we've built into our assumption that maybe there is a dip after we come out of this, of the stockpiling on wines. But that's the main thing. We also have a small assumption that actually people may choose to go out of home a little bit more than they did, given that they've been in a different scenario for a number of weeks. But those are our assumptions. That's all I can say.

Alan Stewart

In terms of the bank, they just- so the key that the bank is focused on customers and the bank is focused on treating customers appropriately and properly and supporting customers at this time. But the lines of activity that the bank runs of broadly their loans, their credit cards, there's travel money, their ATMs and their insurance. Both are key elements and all of those are impacted, insurance being seasonal or annual is less so at the moment, it is difficult to really draw anything but loans quite significantly down. Credit cards - people obviously are not spending as much because they are at home and therefore credit card balances and volumes are quite significantly down. There's no travel going on as you can expect and you've read about some of the providers in that market and then ATM activity is significantly down because people aren't out and about and raising money and plus, as Dave mentioned earlier, there's a shift towards cashless from cash.

On top of that, there's the moratorium on payment if you feel that you are in under some stress of payment, then you can apply to the bank and not pay interest on your outstanding balances so those all impact the volumes which the bank is seeing. Again, very difficult to see how to project, what will change, but that's behind the thinking of the call out on the bank one-year profitability impact. And then you've got the bad debt on top of that.

Nick Coulter

Thanks gents, all the best.

Operator

Once again, if you have a question, Please Press 01 on your telephone keypad now or press 02 to cancel.

The next question comes from the line of Maria-Laura Adurno from Morgan Stanley. Please go ahead.

Maria-Laura Adurno

Thank you very much for taking my question. Just based on the current scenario that you're actually running, I was just wondering if from a capex standpoint, we could actually expect this to come down for this year.

Alan Stewart

Our guidance, difficult to say, we would expect not. As Dave said, there are some costs which we will incur because of the extra volumes that work that are going through. We haven't at this point factored in any expectation of that 900 to 1.2

billion changing, but obviously as the year goes on, we'll see. But again, just to stress that where capex is necessary and more than 50% of our capex is maintenance capex, and we will continue to spend that.

Okay. Any more questions?

Now is that the end of the questions, just checking?

Operator

There will be a brief silence while participants register for questions.

Alan Stewart

Thank you.

Operator

There are no further questions registered so I will return the call back to you.

Dave Lewis

Thank you very much indeed, and thank you everybody again for taking the time this morning for joining Alan and myself. What we try to do is obviously share with you the results of last year and I emphasise I was very pleased with the way the business performed. We did deliver and exceed all of the turnaround goals we set for ourselves, but the business has moved on. The world has moved on and we're now facing a completely different situation. We tried to share with you what's going on and how we're thinking about the future. I know we all like a more exact, more predictable future, but that's not the case. But what we tried to do is share with you the assumptions that we're making, but also safe in the knowledge that we know that they won't be exact.

The last few weeks have been extraordinary in lots and lots and lots of ways at every level. I've been hugely proud with the way that the whole of the Tesco team has stepped forward and it's been nice to see the pride that Tesco colleagues have taken in serving Britain's shoppers this week. I feel extremely proud to be part of the team. There's lots of change to come and we will continue to be agile will continue to be flexible, but we will continue to play a very active part in however it is we can help the country deal with this crisis. Our criteria will stay food for everybody, safety, supporting our colleagues, supporting our communities and protecting the business for all of the stakeholders in it. Stay safe and I hope I'll see you all soon.

Operator

This now concludes our meeting. A replay and transcript of this call will be available on the Tesco PLC website shortly. Thank you all for joining. You may now disconnect your lines.

Dave Lewis

Thank you very much indeed.

Operator

Thank you, thank you very much, bye.