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

First Quarter Results 2020

Friday, 26th June 2020

Presentation

Dave Lewis

CEO, Tesco Group

Thank you. Good morning everybody and thank you for joining us. As usual our CFO, Alan Stewart, is with me this morning. This will be my last trading statement and I might say a few words about that after the Q&A, but first, the trading update.

Tesco is a people business and in every trading statement since joining in 2014, I’ve tried to recognise the contribution of more than 400,000 colleagues who work for us around the world. Never has that been more appropriate than now. In the most extreme circumstances our colleagues have been completely selfless in their commitment to serving shoppers better and keeping food available for all. On behalf of the board, the senior team and dare I say everyone, I’d like to say a heartfelt thank you to each and every one of them. They have been and continue to be awesome.

The results of Q1 clearly show the impact of the pandemic and the unique competitive advantages of the Tesco business model. Let’s start with the UK and Ireland, where total sales increased by 9.2%. Growth in the UK was driven by a 12% increase in food sales offset by discretionary categories such as clothing, which declined by around 20%. In the UK, we continued our long term strategic investment in our value proposition with the launch of the Aldi price match in March. With our focus on everyday low prices and strong availability, promotional participation reduced from 28% to 14% as we continue to look at opportunities to bring even greater value to customers including by extending our Aldi price match to nearly 500 Tesco and branded products.

Our price match allows customers to get Tesco quality at Aldi prices or better. Customers tell us that they see through Aldi’s misleading price comparison of branded goods in the big four versus Aldi’s own label. That proposition together with our wider range and the feeling of safety shoppers feel in our stores, has resulted in positive switching from Aldi into Tesco for the first time in over a decade.

The embedded reach of the UK business and the investment in capability we’ve made over the last five years was also invaluable in the first quarter. The investments in the grocery home-shopping website, picking algorithms, delivery planning software, as well as the additional 12,000 pickers, 4,000 drivers and 400 vans that we brought in, enabled us to ramp up our online capacity, increasing total slots from around 600,000 to 1.3 million in around five weeks. This allowed us to support 590,000 vulnerable customers with slots as cheap as £2 in their hour of need, and was significantly cheaper than some of the solutions offered by our rival. The UK online business grew at almost 50% in the quarter, rising to nearly 100% by the end of the period.

In Convenience, growth was strong, up 9.9% as customers look closer to home for bigger baskets of essential food. In large stores, transactions declined by 33% but basket sizes grew by 57% as customers reverted to a bigger weekly shop. Our range, availability and safe shopping environment were appreciated and it’s reassuring to win the Grocer awards for service and availability for the second year in a row.

Investments in loyalty and technology are paying off. Clubcard Plus pre-Covid showed an increase in incremental basked size that was three times our pre-launch assumption and now presents even greater value, given the rise in basket size. The growth in card payments was significant, with 72% of payments made by card versus 61% in Q1 last year. The increase in contactless limit to £45 helped but the real differentiation was Tesco Pay Plus, which allowed contactless payments up to £250.

In Ireland, sales grew by 19.7%, driven by a larger portion of out-of-home consumption transferring to retail sales. Online growth was also significant, reaching 62% in May, and the investment in a safer shopping environment was clearly appreciated by our Irish customers.

At Booker, sales grew 6.1%, with significant growth in retail offset by a decline in the catering business. Growth in the Premier, Londis and Budgens fascias was nearly 25%, reflecting even more strongly the same trend we saw in the Tesco Convenience business of customers buying more food closer to home.

While the challenges for the catering industry are clear to see, we're in a particularly strong position to support these customers and expect the – we expect to exit the crisis with market shares well beyond the original levels. Booker has also supported the Tesco online business, and we added 100,000 click and collect slots by using HGVs from the Best Food Logistics food service business to create new sites.

In Central Europe, sales increased by 3.3% excluding Poland. We announced last week the sale of the Polish business to Salling Group, which will allow us to focus on our business in the Czech Republic, Hungary and Slovakia, where we have strong market positions, achieve margins, cash flow and returns which are accretive to the group.

So those are the retail trading headlines from around the group in a quarter of significant change, but if I were to call out one area where the change has been most extensive, it would be online grocery. Last June we held a capital markets day where we shared the opportunity to double our online capacity in the medium term. At that time, nobody foresaw the circumstances we found ourselves in just a year later, nor in fact that we would double our online capacity in just five weeks for just £4 million of CAPEX. At the run rate we're seeing currently, we anticipate online sales in the UK to be north of £5.5 billion this year, up from £3.3 billion last year. The feedback from new online customers has been phenomenal and we are confident that we can retain this new customer base. We will continue to find new opportunities to scale our business and we're pleased to announce that our first urban fulfilment centre in West Bromwich will begin serving orders next month. The flexibility of our online model, with very low CAPEX, is a distinct competitive advantage.

For customers who are able to shop in-store rather than online, we have transformed the whole store to make it as safe as possible. The cost of doing all of this is very significant, as are the costs from self-isolation of vulnerable colleagues, general absence levels and the need to double cover with temporary colleagues. At our peak, we had 52,000 colleagues absent. By the end of the quarter, that had reduced to 32,000 and while absence has continued to fall since, it still remains high.

At the full year, we said our additional costs for the UK business would be between £650 million and £925 million. Our current view is that our UK costs will be towards the upper end of that range.

Many have written about the business rates relief, and I want to re-emphasise that every penny of the relief has been invested in making sure that we're able to protect the availability of food through an extremely difficult period for the nation and ensuring that we're able to provide that food in a safe environment. We have not furloughed any colleagues, nor have we taken government loans or deferred VAT payments.

Further afield there are some additional costs in Central Europe but also significant was the loss of income from temporary closure of shopping malls. I'm pleased to say these are opening up again already.

Looking to the rest of the year, our latest forecast is that retail operating profits will be broadly flat at a similar level to last year, with a significantly different first half-second half split versus last year.

At Tesco Bank, capital ratios and liquidity remain very strong. However, some of the external assumptions used to estimate future credit losses have changed, particularly in terms of GDP and unemployment, and so we have increased our provision for potential bad debts. In April, we said that we expected the bank to be loss-making this year and based on the current macro-economic forecasts, we now expect this loss to be between £125 and £200 million.

Over the last three months, our industry has changed beyond imagination. The changes we have seen in recent years will only accelerate and at Tesco we have to stay ahead of that trend, running our business as efficiently as we can and keeping our absolute focus on what it is customers want. We also know that our customers have very clear expectations about the type of recovery they want to see as this crisis eases, and that means a green recovery. Our ESG commitments remain as strong as ever, so even when we face some short-term challenges in recent weeks, for example in our work to remove plastic, we're still absolutely committed to our long-term plans. And through the pandemic, we've focused our efforts on making a difference where it's needed most, continuing and extending our support for food banks, the British Red Cross and local community organisations helping to tackle Covid-19.

If I can wrap up right back where I started, with our 400,000 Tesco colleagues. I'm incredibly proud of the way they've responded in the last few months and the contribution they've made, working around the clock to keep the nation fed. At every turn, they have been – they have repeatedly gone above and beyond for customers, with real humanity and a brilliant community spirit. And I'd like to finish by reiterating my thanks to them for everything they've done. Thank you for listening and I'll hand back to Gino for your questions.

Q&A

Andrew Gwynn (Exane BNP Paribas): Hi there, good morning all. And I suppose just first off, Dave, big congratulations on all you've achieved at Tesco. It's going to be a shame to see you go but all the best for the future.

Dave Lewis: Thank you very much.

Andrew Gwynn: Just running through the questions, I mean obviously the online piece as you mentioned a big, big component of it. Very, very capital-light but obviously at the moment you're rolling out that – the UFCs as you call them. Do you think there's a big change coming? Do you think you'll be rolling out more in the way of urban fulfilment centres going forward? Obviously you've got 25 in the pipeline but could we see materially more than that?

Dave Lewis: Andrew, it's – look, it's a really good question. I think we've got a plan for 25. I visited the one that is being commissioned last week, really quite excited about how that augments and adds to the model. But the core Tesco model is to use our existing assets, the stores that we have, that are closer to customers, and that will continue to be the mainstay. But if we can augment those stores with some automated picking, we further enhance the economics. So that's the model going forward, it'll be a combination of the two. The 25 is an addition of capacity but the core is still using our stores, so that low-CAPEX expansion that we've seen by changing our operating model is hugely significant. And I think, you know, supports the view we've always had that using our existing assets in this way is the best way of delivering grocery home shopping for the UK market.

Andrew Gwynn: Just – sorry, just as you look round the industry, would you anticipate sort of broader changes from the competitors? I mean obviously you've seen even Aldi going down the online route. Would you think these sort of changes would last or – in your view, is there something uniquely suited to what you're doing?

Dave Lewis: No, I think those – look, as I said in the statement, I think we've seen some trends in retail recently before we got to the Covid crisis. I think some of those trends will continue and indeed accelerate as customers change the way they want to shop. So I think it will be incumbent on all business to respect that change. I think the – you know, we gave a pack in addition to the usual trading update because we were very aware that people have not had the chance to see what's going on in the market in the same way that they normally would, by being around. So we try to be a bit helpful. If you look in there, you will see that we – in the online piece, we do look at some of the comparisons, cos actually I believe that Tesco has a competitive advantage in terms of how we deliver. So I don't know whether other people will come into the market but what I have seen is through the crisis, we offered a delivery to people at £2 and when I looked at some of the other solutions that were out there to try and help, the size and the cost of delivering them was significantly more than the alternative that Tesco was providing. So I think you see there Tesco's unique ability to be omnipresent and commercially very competitive.

Andrew Gwynn: Yeah, we do indeed. So thanks again and all the best, once again, for the future. Thank you.

Dave Lewis: Thank you very much.

Rob Joyce (Goldman Sachs): Hi Dave. Just want to firstly reiterate Andrew's thanks and well wished for the future. And three questions if I may. Just the first one, just a follow-on on the online questions. I think – are you basically saying now you think online penetration at these levels is sticky here? I think the guidance would imply it stays pretty elevated for the rest of the year. And if so are you able to tell us how you can make this business more profitable? Are you seeing people more willing to pay a higher delivery fee maybe further down the line when things normalise?

Second one is just on the promotional levels, which have halved. Again, is this something you see now as a more permanent shift? And how does this impact profitability going forward?

And then the final one on Booker, which does look to be making material share gains, as you suggest. I think historically Booker have said they've got around £2.5 billion or maybe 50% almost of additional capacity within its existing network. Can you give us an update on where it's at, at the moment? Thank you very much.

Dave Lewis: Okay, very good, thank you Rob. Look, in terms of online, at the end of the quarter, online as a percentage of UK sales had gone from 9% of sales to 16% of sales. So, close to that doubling that we had seen in three years has happened in less than three months and we've been able to match that opportunity but there was more that we could have gone for. So yes we do see it sticky. We do see that sort of 20% of the market as being something that's absolutely out there and we see ourselves as being uniquely placed to service it. The feedback from people who are trying our grocery home shopping for the first time has been phenomenally good, so I'm – that's why we're confident of it staying.

In terms of profitability, look we know that online is dilutive versus the core but we've worked very hard over the last five years to make it a positive contribution. It is fair to say that in order to expand so quickly because the country needed us to, we relaxed some of that in order to ramp up the availability. But we can see and we have a very clear plan to profitability. There are two things that drive that, Rob. One is there are definitely productivity improvements. When you bring so many new people on and new assets on, there's a learning curve, so we can see that. I think we'll also see productivity improvements as people – you know, during the crisis people wanted to go back to having items individually wrapped. We'll see that come off as things go, so that will change the economics positively again.

And there is definitely an opportunity to be more commercially orientated in the way that we put delivery prices together. We did make a decision – we changed nothing. Even though the demand – you know, we used – just to give you a fact, we used to get something like 700,000 to 800,000 hits on the website a week. During the crisis that became 8 million at one point. So there was clearly a lot of demand out there. We took a decision not to change any pricing at all during that period and keep everything as available as we possibly could, because we felt that's what customers needed at that time. But do I see a situation into the future where pricing becomes more rational? Yes I do. But you know, time and place.

In terms of promotional level, look, our priority – this started from a place which is our priority was about availability and promotions at a time of the spikes in volumes that we've seen, unhelpful in the supply chain full stop. So we have and we continue to make availability the priority and I'm really happy with the levels of availability and service that are there.

I genuinely think there's an opportunity in the industry for us to rethink how it is we give value to customers. There's been a lot of volume in food so far and therefore the idea of chasing volume through promotions is probably not the most commercially savvy way to do it. We want to be really clear with our supply base that if there is to be some recessionary pressures and potential inflation, that actually we don't want the historical approach of raising prices and then dealing back into more and more promotional investment. We'd rather try and keep cost increases negative and then reduce the amount of promotions and give every day good value. You see that in Aldi price match. If you look in health and beauty you'll also see a significant in the last four weeks to take promotional levels down, but give every day greater value.

So, strategically that is an opportunity. We're going to continue to push in that direction. You know, I've given you the year on year, but when I started our promotional participation was over 40%.

Your final question, Booker. Look, the interesting thing is I honestly don't know what Charles has said about Booker's standalone capacity. What I do know is the combined network capacity is significant. We've been able – the thing that's been really good through this time is we've used two mothballed warehouses that Tesco had to support Booker and used them in an integrated way. So I'm not at all concerned about the opportunity and our capability to support market share growth in food service and we gained another site with the acquisition of Best Food. So there's a lot of upward capacity, Rob, across the Tesco group to support that Booker growth I was talking about.

Rob Joyce: With very limited extra CapEx, I assume.

Dave Lewis: Indeed. They're existing assets already, so…

Rob Joyce: Brilliant. Thanks very much Dave, all the very best.

Dave Lewis: Cheers mate, thank you.

Andrew Porteous (HSBC): Yeah, hi guys. And Dave, I echo everyone else's wishes and congratulations on a job very well done over the past few years. In terms of questions, just thing about Booker and sort of building on that, the share gains you're seeing, are they coming from competitors or – are you taking their business or is more outperformance due the fact that Booker's got a lot more independents that have probably been a bit more resilient from a demand perspective through the current period?

Second question, could you talk about the impact reduced social distancing would have on the business? Does that help you operate a bit more efficiently?

And then lastly, just coming back on the economics of online, you know, in a world where basket sizes are 30% larger and you're delivering a lot more orders and therefore your drop density should be much better, do the economics of online on a continuing basis look a lot better than they were pre-Covid?

Dave Lewis: Okay, Andrew, thank you very much. If we talk about Booker, if you look in the pack that we gave you, I think it's page 8, the market share – the two points we talked about is the market share in retail increases 24% to 25%. And that's about serving more convenience outlets.

You've seen the growth that we've had across Premier, Budgens and Londis, so that's a reflection of just that region continuing the great work that's been in Booker for a while. The big growth in catering is partly because we've acquired Best Food, obviously, but our ability to attract customers, it's – look, it's…. Andrew, there's – the opening up of the hospitality sector is delicate for a lot of those businesses and entrepreneurs because they take on a lot of cost as they open when they don't have the full sales potential and so that puts a huge amount of pressure into that supply chain, and this is a place where quite a lot of the competitors entered the crisis in not the strongest financial position.

So, relative to our competitors, Booker is in a unique position; operationally brilliant, you know that, but also financially really, really, really strong. And so as you think about opening up then Booker looks like a much safer, surer competitive bet than it did before, so we're gaining customers as they think about opening up because we're prepared to invest something in that working capital to support this phased reopening. So that's what we see in terms of Booker and I'm really, really pleased with the plans that Charles and the team have.

In terms of social distancing, look, the truth answer is we obviously don't know. We've seen the new guidance from the Prime Minister; the team are working through what the consequences are of that. What I would say to you is we've made safety the priority all the way through this; we will not compromise that going forward. So if there are opportunities to improve and ease the shopping trip for customers and make it easier for colleagues for sure, as a result of the new guidance, we will look into that and take it, but we won't compromise on the safety. So let's see how that develops.

And look, I think to your point on – you know, the basket size is interesting, both in large stores and, indeed, in online. Obviously, we put in a limit for the number of items during the time in order, again, to maximise that availability and delivery. That's one of the things that we have the opportunity to revisit as things normalise a little more, but – and what I would say is I think the underlying structure of the business model of using our stores to deliver to home for those people who want it, when I put together stores and then the added benefit of urban fulfilment centres as we grow that capability, then the underlying economics. If we can charge, and we believe we can, a reasonable price for delivery, a competitive price for delivery, then actually really very happy with the underlying economics of the grocery home shopping business plan that we have today.

Andrew Porteous: Thank you.

Dave Lewis: Thank you.

Xavier Le Mené (Bank of America Merrill Lynch): Yes. Good morning gentlemen and Dave, congratulation actually, all the best, you know, for your future. But one question actually, you're talking a lot about every day low price or every day, I will say, value for your customers. We've seen less promotion, so how should we see – you know, 2020, it's also an opportunity for you to potentially reset price, seeing if you can feed down and to accelerate sales growth going forward, does that potentially mean that, going forward, we should expect higher sales growth but potentially lower margin? So that will be my first question. And second one, just on the Bank am I missing something? Tom, actually, was talking about £200 million impact from provision, you know, at the full year results, but now you're talking about £175 to £200 million operating losses, so am I missing something here or is it just due to more provision, more costs, or if you can elaborate a bit more on the Bank?

Dave Lewis: Okay. Xavier, why I don't take the – your question about pricing and sales growth and I'll ask Alan to comment on the Bank for you. So, look, the – we've seen significant volume growth. We've been on a – you know very well that we've been on a trajectory for the last five or six years to make Tesco's value proposition sharper and sharper and sharper, so this is just a continuation of what we've been doing. We got ourselves to a place, last year, where we were very price competitive and with a good level of margin. I said, when I did the results, that I saw this year as a year of investment, that we wouldn't be looking for margin expansion; all the improvements in our business I would invest in increasing the competitiveness of the business.

We're investing in a slightly different way to what I anticipated, given the COVID crisis, but we've continued to invest in the value proposition and we will continue to do that. So Aldi Price Match is about setting an easy reference point for customers; they clearly appreciate it. It's working in terms of the switching that we're seeing and it's helped by the fact that customers appreciate the shopping environment at Tesco at the minute, so it's the right time for us to continue. I think promotions start from a place – we – you know, when I started we had more than 40% promotional participation, it was down to 28%. We've halved it, nearly, as we've gone through this crisis, first and foremost to protect availability, absolutely the right thing to do, but also as we go forward there's a once-in-a-lifetime opportunity for us to introduce real efficiency back into the supply chain by taking out that noise of promotional volume. And, yes, I have been clear that, as we face into the pressures post-COVID as an industry, I wouldn't like to see the old model where suppliers look to increase cost prices and then deal something back in increased promotional investment because we don't think that's the value that customers most want, and Tesco needs to step in and champion great value for customers.

So we will continue to do that as we walk through this and I think if the industry were rational it would do something similar, but as Tesco we should make our own destiny and lead from the front, and that's how we see this year. So will we see sales volume? Look, I asked my colleagues last night, when I shared the trading statement, 'when was the last time the Tesco Group was more than 9% sales growth?,' and nobody could remember. So the sales growth is there, it has some short-term profit impact but we see that as an investment in our business. Net-net the idea that we would be around flat year-on-year for our retail operations, and with that growth and with the investment in new capability and new value proposition it would be a hell of a year and I'd be delighted if that pans out as we plan it, and so far so very good, really.

Alan, Bank, do you want to…?

Alan Stewart: Yeah. Hi Xavier. In terms of the Bank, if I can just take us back to April we spoke about two drivers for our view on the bank in April. One was the business activity and the second one was the IFRS 9 provisioning relative to the loan book, whether that's credit cards or loans itself. The business activity, there's been no change in terms of what we see. So on – if you look at page ten of the deck, where we talk about the Bank, the lines of income which have been – we've given you some colour on how those shape up, but there's been no fundamental underlying change in that as regards – and also as regards the new loans we're taking on whilst those are down, again no real change.

So all of the change and the firming up in expectations is linked to the provisioning we're making against the existing loan book. And the figure 35 there gives you some sense of how we were looking at the external measures as we saw them and as viewed by the market, and that's what the Bank factors in as of April and now, and the two key drivers of those are GDP expectations, particularly in the short term, and unemployment. So quite a significant shift downwards in terms of those expectations; unemployment is expected to be greater, GDP impact, certainly to the current financial year, is expected to be deeper impact, and that drives a more than £100 million increase in provisions from where the position was as of April and where it is now. I would just remind you that this is a non-cash impact, it's a provisioning, and the liquidity ratios, which we also point out on that slide, figure 34, and the capital ratios are stronger year-on-year than they were, and that's having taken those extra provisions. Clear?

Xavier Le Mené: That's very clear, thank you.

Dave Lewis: Thank you.

Maria-Laura Adurno (Morgan Stanley): Thank you for taking my questions, just two on my side. Perhaps if you can provide us with some comments and update on the partnership that you have with Carrefour. And then the second question, perhaps, is with respect to the UK you can provide us some comments with respect to how non-food has been performing, and also if you have any comments at both levels with respect to where does non-food inventory stand and whether there – whether you still see risk into the summer of some write-downs? Thank you.

Dave Lewis: Okay. Thank you, Maria. Look, the relationship with Carrefour continues. We continue to negotiate together international agreements with the big branded suppliers. The focus over the last week while has been about looking to the opportunity across our own-label purchases together and goods and services not for resale. So, yes, clearly a disruption to some of that work because of COVID, but the relationship is – continues.

In terms of non-food, the bit of colour that I can give you is that we started from a position where general merchandising was very strongly down at the start of the crisis, but actually started to improve as we went through. So if you look into the deck that we gave, we gave some of that category breakdown. So I'm just going to find you the right figure so I can refer it to you. Page four, yeah, sorry, I flipped over that. So, look, in that sense I was pretty pleased with the way that general merchandising turned out, so it was 0.4% negative, so driven by toys and electrical; as people were staying at home there was purchasing that was happening in that space. So no issues for us in terms of general merchandising stock. Clothing started significantly negative. We ran a very successful sale towards the end of the first quarter, and so, yes, whilst clothing is down 18% it's a significant outperformance versus the market, nearly a 20% outperformance versus the market, and it's also been very good in terms of clearing any potential back stock. So as I sit here today I'm really – I feel very good about the stock provisioning and where we are on general merchandising and clothing.

Maria-Laura Adurno: Thank you very much, thank you very much and best of luck. Thanks.

Dave Lewis: Thank you.

Clive Black (Shore Capital): Good morning, guys.

Dave Lewis: Thanks, Clive.

Clive Black: Thanks for the Q&A and hope you're looking forward to some nice lie-ins Dave. Maybe be the odd[?] –

Dave Lewis: Three months yet.

Clive Black: – maybe the odd glass of beer in the evening. Couple of questions from me, if I may? Firstly, you know, you indicate with the Bank on figure 35 your expectations for the UK economy, which, you know, compared to February are grim. How do you think this will pan out with respect to the nature of the grocery market in the UK as you see it? And then, in relation to that, I guess, how, with your Booker hat on, do you see the food and beverage market evolving and to what extent could that be a structural boost, ongoing structural boost, Dave, to retailing? And then, just finally from me, could – I know it's a trading statement but you have provided a lot of detail, would it be possible for you to give us an indication of some of the cashflow dynamics within the business over recent times? You've talked about costs, but, you know, what about working capital –

Dave Lewis: Yeah.

Clive Black: – within the grocery business and maybe also fuel, given it was such an impediment at your results, please?

Dave Lewis: Okay, I'll start. Well, look, why don't I talk about the grocery and the Booker and I'll let Alan talk about cashflows and your last question, how's that?

Clive Black: Great.

Dave Lewis: Look, I think – look, you know, the assumptions that are in the Bank come from an external body and the Bank refers to them, but I think, look, depending which view you take, Clive, there is a view that things are going to get tighter as the – from an economic point of view. The degree to which it gets tighter is a matter of some debate. I think what I'd say to you, from a grocery point of view, is if that were to happen, and, you know, we studied, Alan and I studied previous recessions when we came into Tesco, and actually Tesco historically, with only one notable exception, 2008, came out, managed better in a recession by stepping in and helping its customers. It didn't do that in 2008. We won't make that mistake this time.

So the desire for greater value, which is what customers want, is something that we have to listen to, and completely reflect in the way that we run the business. And that's why you see the continuation of getting a basket in Tesco which is the cheapest in the market is a trend that we've been on, will carry on, will continue to expand that proposition more and more broadly. As I said, I have a point of view that says it is better for us to be giving everyday great value rather than relying on promotional ups and downs. What, actually, people need in harder times is a consistent low price rather than an occasional low price. So, we do have a point of view that it would be better for all the industry to be investing in lower prices rather than, but we'll see how that pans out. But as Tesco, we've got a point of view we should lead, we should set our own agenda, and we've got a clear plan to do that.

I think in terms of Booker there are two – I think there are two things I would say on Booker. Your structural boost to retail question, Clive, is, clearly, at the moment, we are seeing a lot of the calories that were consumed out-of-home some of it transferring into retail. We still have different scenarios as to how much of that stays in retail, depending on how the lockdown is loosened, and actually when customers feel that they either feel comfortable, feel safe, feel financially able to go back into the dining and the entertainment hospitality space. But there will definitely be, I think, for a period of time still some benefit in retail from the hospitality sector being more constrained because of the crisis.

I think the other thing I would say about Booker is I do genuinely feel very positive about Booker's relative strategic position in that market. You know, there was quite a lot of challenge, financial challenge, for competitors to Booker going into this space. And, so, the inherent strength of Booker, but Booker now being part also of the Tesco Group, means that the offering and the financial wherewithal that Booker enjoys means that we have a very, very competitive offering. And that's why I say, I see us exiting this crisis with market share significantly enhanced in Booker as we go through that change. So, I'm really very positive about that even though we've had to take the short-term [inaudible] Asian business being in lockdown.

Alan, do you want to talk about…?

Alan Stewart: Yeah. So, Clive, in terms of working capital, the working capital position is very strong. And arguably, it's never been stronger given what we are seeing in the business and seeing the growth rate that we have experienced over the last quarter. But you are right, there are some elements in here. Fuel, in particular, is an area where there are two impacts on fuel. One, is the drop in the volume of fuel we're selling. And the second one, is the drop in the price at which fuel is being sold. And we saw fuel in the quarter hit very, very low levels – multi-year low levels. So, we'll just have to see how the volume picks up. And equally, the market price on that is something which we just have to absorb and it flows through. But given the size of that as a working capital element it is something which can move it. We are, and will continue to work with our suppliers to make sure that we get the optimum terms there, and we've got very good relationships.

And that leads into the other working capital point, Clive, is that as this crisis enveloped, we looked very, very specifically at our payment terms. We did support suppliers, particularly small and even some medium suppliers. And that support was either because of the impact on their business, sometimes negative. But, equally, as they saw volumes growing very, very significantly they felt a working capital strain, and we supported them, and we continue to do that. It's not a big callout in term of quantum on our numbers, but really important in terms of our relationships with suppliers.

This year is a particularly challenging year to predict working capital flows, and I just leave that out. Because, as we get to the half-year, we'll clearly have a position which we'll see. But underlying cash generation very, very strong.

Clive Black: Yeah, indeed.

Dave Lewis: Okay, Clive?

Clive Black: Wonderful. Thank you for that. And enjoy yourself, Dave. And you're not too far behind either, Alan, you have a good final season as well.

Alan Stewart: I think I've got three more interactions, and I'm looking forward to each and all of them.

Dave Lewis: Yeah. There are three months to go, so you've still got to sit longer yet.

Clive Black: All the best. Thank you.

Dave Lewis: Thank you, Clive. Thanks.

Alyssa Gammoudy (ING): Thank you very much. In terms of the shift from out-of-home to at-home consumption, to what extent do you expect increased competition from the food home delivery platforms like Deliveroo and Just Eat, I think is the other – the main companies in the UK? Can you tell me a little bit more about that? And, also, can you confirm that indeed in the online consumption, online ordering, there is across all demographics the increase is driven by all demographics?

Dave Lewis: Okay, very good. So, clearly, the options for customers to eat at home at the moment are provided by the businesses that you referred to. So they are clearly there. I think the, look, we model going forward different scenarios as to how much of that out-of-home becomes in-home. Our focus is, we don't – as you've seen from the growth already, so whilst there is a home delivery from those competitors, it's not having any impact on people's propensity to want to have grocery home shopping from Tesco. I think the opportunity for us as we go forward is how do we further enhance the offer. Because what customers tell us in research which drives some of our scenario planning is they like the convenience of some of the solutions you mentioned, but they worry sometimes about the health aspect. So, we have done some work before about providing meal kits that people can actually prepare themselves. One of the things that's been really interesting is the growth in scratch cooking that's happened as people have stayed at home. And actually we're in a unique position to be able to satisfy that.

So there's definitely the competition you say there is there. But the other thing, I don't know if you know this, but, obviously, Booker is a supplier of the food to a number of the companies that you talked about. So, we still have sales in there whilst we have the grocery home shopping sales as well.

The online composition, yes, it's across all age groups, but it tends to be families. So it's not a pure demographic. It's more about families and family sizes. But we've seen all family sizes and all demographics respond to the announced offering in grocery home shopping.

Alyssa Gammoudy: Thank you very much.

Dave Lewis: Thank you.

Victoria Petrova (Credit Suisse): Thank you very much. My first question is on your everyday low price comments. I totally understand that you want to be very well-positioned into the potential economic downturn. But do you think that the super high demand environment comment suggests is – and extremely high cost you are seeing on your labour – is the right time to invest in prices? Also, I looked at counter data, maybe it's not fully indicative, but you're obviously winning market share over Aldi, but Lidl seems to be outperforming versus Tesco in the last month. Are you targeting Aldi specifically, and do you think that's what drives this discrepancy in performance or is there anything more specific there? That's my question number one.

And my question number two would be on your comments regarding online profitability. In April, you mentioned that online is dragging your profitability down, and this is quite a significant cost contributor. Has anything changed since April, given your extremely high like-for-like sales growth in online towards the second half of first quarter of around 48.5%?

My very last third question is on milk – sorry about that. You just mentioned that you are looking at this area. And, obviously, when I look at HelloFresh market cap that should be a lucrative business, which is appreciated by investors. Are there any barriers of entry there? Or pretty much any retailer can enter this business? Thank you very much.

Dave Lewis: Victoria, thank you very much. Look, I think when it comes to value and everyday low pricing, look, we think the thing that drives when you should be investing in prices is when customers need it most. And customers need it most. So the time now is right. It's a continuation of a six-year trend, it's not something new. The fact that we've had the growth that we've had, the opportunity to come away from promotions because we've had that volume, and to work with our suppliers in a way which is to reinvest in everyday sharper prices for customers we think is the right thing to do economically. We think it's exactly what our customers want, and it's the challenge that we take on. We've got ourselves into a financial position such that we are able to do that. I said that the results that we saw this year is a year to invest, having recovered the profitability of the business. We are investing. Yes, some of the investment is slightly different to what we anticipated when we came in, but we continue to invest in value. And we do see coming out of COVID a once in a lifetime opportunity to take – to accelerate that trend in the way that I articulated.

Your – you make the point. Look, the reason that we pick Aldi is that in the mind of customers when we set this, they were seen as being the price leader in the minds of customers and therefore that's the right place for Tesco to set as the benchmark. It also is very important – this is detailed but might be important – is that in the way that UK advertising and marketing regulation works, in order to draw a comparison, you need to pick one to be able to justify all the claims that you make rather than a multiple, which makes that validation even harder on a daily, sort of, weekly basis. So that was the reason behind it.

I think when you look at Aldi over time, what you've also got to remember is their store opening programmes. So Lidl store opening programmes are greater than Aldi in this last period. And one of the things we do is we look at switching analysis X new store opening. And you see very positive positions there. But if I'm not wrong, and I'm looking at Chris across the table, I think in the last quarter they reporting a positive switching from Lidl as well. So whilst I pick Aldi, because it was the strategic intent. I think there are signs that we're gaining shoppers from both of the German retailers and indeed the discounters more broadly.

In terms of online profitability, we've always been clear that it's diluted. We've been on a journey over the last five years to take it from loss-making to be a positive contribution, but it was diluted. We've always been clear about that. We had a plan and an approach of how we would improve that over time, so that we would get truly to be neutral from a profit point of view. Wherever anybody wanted to shop in the Tesco network, we want that to be equal. It's fair to say that because of the crisis we chose to invest. So, we probably made that more diluted by opening up the capacity as quickly as we did. Again, I see that as an investment – what customers needed, particularly those vulnerable customers. So to invest in our brand, in our business at a time of great need, we think is a very appropriate thing for us to do. And I continue to believe that the underlying economics of the online business will improve.

I still think in the next 12-24 months it will still be diluted versus the average. But with the UFCs, with productivity improvements and the opportunity around the delivery pricing there's lots of things to improve. And I suppose the way of saying it is it's diluted but it's not dragging the profits down. That's why we've been clear that given all of this, we can keep retail profit probably in line with last year.

Meal kits, there is some interest. We've been doing this for a while. But there aren't any barriers to entry. It's more about an operational change. And it's always been for us about where does it sit in the pecking order of priorities, and we had done some other things first. So if that trend emerges post-COVID then Tesco is in a very good position to be able to meet that demand. But there have been other bigger priorities given the crisis that's all.

Alan Stewart: Victoria, if I can just build on the space question, and you will know this, but just to remind. If you put on 10% space two years ago, then you would expect, everything else being equal, to get at least 10% growth this year in terms of your counter numbers. Because last year, it's not a like-for-like. 10% space two years ago becomes this year's like-for-like. So that's the way that I think in terms of the economics of the business and how intense that business is performing, how well it's performing, that's I think one of the important things to look at as that relativity measured by counter.

Victoria Petrova: Thank you very much, that's extremely helpful. And congratulations, Dave, it has been a great performance. I am relatively new to stock. While initiating, I was almost at a year – over a year of development in Tesco since you joined. Thank you very much.

Dave Lewis: Thank you very much.

Dimitri Dimitriou (Schroders): Good morning, I would like to start by also congratulating you, Dave, for your time at Tesco, and I think some amazing performance during the last few years. I only have two very quick questions. So one of them on online, on the point you just made. So can you – are you implying that online is at the moment profitable as a standalone business? And my second question is on the guidance for flat operating retail profit for the current financial year. Just when looking at the margins of the business as it's done now, it looks to me that that requires an assumption that the growth that you have seen in the first quarter would be more or less sustained throughout the year – just simply by looking at the margins of the business how much additional sales you need throughout the year to make up for that £840 million, so a one-off COVID-related cost. Is this an underlying assumption that you will sustain growth throughout the year of a similar extend to Q1 in order to have a level of operating profit or is there something else more specific there? Yeah, that's my question. Thank you.

Dave Lewis: Okay, I'll try and give more colour, and I'll ask Alan to help me as well. So let's start with online. Dimitri, just to sort of put it into context, a little bit of background just in case it's not familiar for everybody. Look, when we look at the online business and its profitability on a standalone basis and we charge it with an element of a fixed cost from the stores and the distribution centre that supports the stores. And on that basis, we got it to where it was loss-making six years ago, we got it into positive territory. But we also look at it in a slightly different way, which is – because the truth is if I didn't have the online business in that store, I wouldn't save those fixed costs. So, we look at it on a contribution basis as well. The cash contribution of the online business was getting to be really quite strong and positive as we went into the COVID crisis, and that was a continuation of where we were going. And we were being very disciplined about the way that we did that. And that's where UFCs and how we augment the offer going forward was planned over the next three years.

At a time of great need, we used the capacity that we had to feed the country. And so, we opened the capacity that we have in a very short order. And I was delighted with how well the business responded to that. Were there some short-term costs to doing that? Yes, there were. You know, I talked about the number of people that we picked that we got to help us pick and drive. So there were short-term costs and there were costs also in terms of opening stores to pick from 02.00 in the morning rather than 06.00 and 07.00, which is where we were before.

So that additional cost would have diluted the profitability of the business even more, because we didn't change any delivery pricing. We didn't think that was the right thing to do. Even though there was excess demand, you know, you could have priced more. We didn't. We didn't think that was the right thing to do for customers at that time. And, so, we took a hit in terms of the profitability of online.

I can see the improvements in productivity. I can see the improvements of that position as we go through the balance of this year, while still keeping the demand at 1.3-1.4 million slots and above. So, I'm comfortable with the underlying. It won't get to a place, as I said before, it doesn't get to a place where it's as profitable as the retail business in the forecast plan that I have, but it does get to a place where it is a positive contribution. And, as I said before, it might be margin diluted, but it's not decaying overall profit, and now was the right time for us to invest in that business, and I'm really pleased that we did.

Look, when we talk about guidance, if I start, that a portion of that is flat operating profit, right, so in a quantum term. We are – we have made – there's some help from business rates but that comes each month in the way that you see in the appendix that we said, but our costs are all front-weighted. So there's some offset from government, but the rest of it is an investment that we're making in doing the right thing for customers at this time. We're able to do that, and keep our strategy, and keep the profits flat, and drive the growth that you're seeing. So there's no assumption that the growth stays the same in the second half as it has been in the first quarter. We have a view about how this will tail up – we'll see whether we're right or not. But it's not about assumption on profit. Flat operating profit is not predicated on the sales rate staying at the level that you see in the trading statement.

Alan, do you have anything?

Alan Stewart: Yeah. Just to build on it, Dimitri, as we went through the turnaround, we felt it was helpful to – for guidance and the way that we are thinking about the business – to talk about margin and the margin range. And this, remember, is a margin which was pre-IFRS 16, is actually what we originally spoke about.

But as we then exited, we were very clear and remain of the view that actually what we're really interested in is the way the business is performing and the cash profit we're generating from it. So, in that sense, we're looking at the cash profit we're generating, which is, of course, a function of the commercial margin and the cost of running the business. But looking ahead, as we take in all of the moving parts this year, the best view we have as we look to the year-end is that, that retail operating profit will be flat year-on-year. But we're not particularly focused on sales and what that means for margin as we think about it.

Dimitri Dimitriou: Okay. That's extremely helpful. Thank you very much.

Nick Coulter (Citi): Thank you very much. Good morning, Dave and Alan; best wishes to both. Three quick ones, if I may, as I'm at the bookends of the Q&A queue.

Firstly, just to clarify Booker’s catering performance, excluding Best Foods, it’s simplistically saying that existing customers are very understandably buying less, but that you're seeing an influx of new customers. And I guess the figures seem to suggest that this is happening already, given the outperformance in lockdown.

And then, secondly, if you could quickly update on Asia, please. I think implicitly everything seems to be on track, but it would be great to get that reassurance.

And then, lastly, it would be rude not to have the last question on the call online. But would it be possible to get a sense of the split between pick-up and delivery in P3[?] when you're running at this this new, enlarged capacity, if possible, please. Thank you.

Dave Lewis: Okay, Nick, I'll give you my assurance on the Asia, but I'll let Alan talk to that specifically. Look, in terms of Booker, in terms of catering, you're right about the outperformance. I think what you've got – and if you look in the appendix, the helpful things that we tried to show, you see we gave some breakdown of Booker. And what actually is really happening is, different sectors of catering are opening up at different paces. So be that, what's called here, cost catering, which is some of the facilities that we serve, they've obviously not changed very much, so we've been able to keep that business. As you know, Booker services prisons, and things such as that, and government institutions; that stayed pretty flat during the period. And it's really about the mix, whereas pubs and restaurants have been much more tightly locked down.

We've seen in our fast-food, and this is where having Best Food as customers has actually been helpful, because actually these are the places that have been opening up, and Charles and the team have been very active with them in terms of trying to support. I think the thing that is meaning, why are we winning new customers? And this comes back to the financial strength, as well as the capability within Booker is, in this sector, working capital is crucial. And the idea about how do you open up and buy working capital in food wholesale when the demand is uncertain and, you know, be not at all sure about how that will open up. We're able as a group to be able to support that working capital expansion probably better than most. And that's helpful for people who are starting to open up their businesses earlier than some.

So, that's why I say very confidently, I'm very confident that Booker will come out of this crisis in food service in a significantly stronger relative position than it went in. But the makeup of the numbers, Nick, is a little bit more in the detail of sector by sector, than might otherwise have been apparent.

Asia is on track and good, but I'll let Alan talk about that. And, honestly, I don't have the P3 split of click-and-collect versus online, but I can go away and get it and get one of the IR team to share it with you. It's predominantly delivery. Click-and-collect is important, and it has expanded rapidly, as well, as we've gone through this. Actually, there are a group of people to drive through our car parks and pick up, has been very helpful. And so, we continue to expand that; but I honestly don't, I just don't have the split in my head, so I'm not going to make up a number. I'll get Chris or Sarah to give you a call with that after this call, if that's okay.

Alan Stewart: In terms of Asia, it's absolutely on track. There were essentially two conditions that we needed to bring. One was the shareholder approval, and shareholders overwhelmingly approved that back in May. And we are absolutely on track for the competition clearance, which is the second element. And that's both with regards to Malaysia, much smaller, but also Thailand. Once we have those approvals, we then go back to shareholders with the capital distribution. And then, in case anybody's questioning, absolutely no change to the pension fund, either, in terms of the 2.5 billion, we’re paying with that. And that process of formality with the trustees is no change and on track. And finally, this allows me also just to talk about Poland, which also is expected to go through competition clearance and close in the second half of the year.

Dave Lewis: Very good.

Nick Coulter: Thank you, gents, all the best.

Sreedhar Mahamkali (UBS): Good morning. Sorry, I think I had an issue there, morning team. Dave, again, I echo what everyone else has said, repeating congratulations for all the great work and really wishing you well for the future. So thank you.

Two, three, I guess two questions, key ones for me anyway. Firstly, thank you on the update on COVID-19 costs scenario. But do you have any thoughts now in terms of the shape of sales that you were thinking about? I think in April, you're talking about scenarios, all of which actually pointed to pretty sharp growth, I think, from week 14[?], actually, I'm looking at the charts here. Does that still feel right? And how should we be thinking about it? That's the first one.

Second one, you referred a few times to the switching gains from Aldi and Lidl and discounters in general. Clearly, I think from externally, what we see, is the drivers are being online and largest stores with perception of better social distancing implementation and safety. But with ClubCard data, are you able to identify who these are, what else they value in Tesco and what gives you confidence that you can actually retain them, once social distancing actually eases and people just fall back into the type of the regular customer behaviour, as in they go back to Aldi and Lidl. Those two will be the key questions for me. Thank you.

Dave Lewis: Okay. Thank you. I think in terms of COVID costs, you know, the costs look pretty clear and you can see the assumptions we've made about timing. It falls between scenario two and three that we had before in terms of the cost profile. And that's why we've updated as best, we have them to just over £600 million. In terms of the shape of sales, we continue to run different scenarios and there are three things that I – because I'm not going to give you a shape of sales, I've got a number of different scenarios, but I will tell you what's driving the assumption.

The first is, what is the state and the level of opening of the hospitality sector and what is the adoption of that by customers when they come. It's one thing for restaurants to be open again; we still have different views as to how quickly people will readopt that habit, based either because of a concern on COVID or concern financially. So we've got different scenarios for hospitality, and how much of that out-of-home demand stays in the retail model. I think we shared last time, we were modelling how many people would stay at home for holidays, and what that would mean in terms of a potential impact. I think it's pretty clear that there will be more staycation in the UK, but as holidays opened internationally last week, there was a jump in people. So that is a variability. It's not insignificant, but I don't know exactly what that will pan out, but we've got different scenarios. And then, obviously, there's the question that everybody has, which is, where there to be a recession after furlough stops in October, what impact would that have?

So we put all of those three together. I'm very comfortable that we're competitive against the market as we go forward. That's why I focus so much on the value equation, but also the range and the service that we're providing, that's key. And so we will be relatively strong, but I haven't got the shape of sales for you. I can just tell you what it is: we're modelling as we go through that.

But when you talk about the discounts or gains, I think the truth of it is, yes, online, also convenience have been important, but so has the fundamental core offer in the store. Never has it been more important to people to be able to go to one shop and get everything they need, and have that safely and at good value. And that's why we've chosen to invest disproportionately in this time to make sure that that's what they get. You've heard me talk before that the turnaround of Tesco has been all about taking away reasons why anybody needs to shop anywhere else. We have penetration and reach as competitive advantages. We lost people. We lost some of their visits and their frequency and their basket size because they felt they could get something better elsewhere, 5-6 years ago. And every time we've taken away a reason for them to go do that, we've grown our business.

So now this is where Aldi price matches, the thought is so important. So if I can get 500 of the most important items in Tesco at the same price or better than what people historically thought was the price leader, and at Tesco quality in a shop which is safe, and I get all the range, that's the reason, we think. And that's how we want to try.

Now, as we drive into the second part of loyalty, we built some models that allow us to reward loyalty in a unique and differentiated way. And you saw some of that in ClubCard Plus; not the time to sell a subscription at the minute, but the mechanics works really very well. So that's a piece of ammunition that we can bring back to the piece. And you'll see other things from us in terms of rewarding loyalty, so that we can keep people who are attracted by that fundamental core offer of great value, great quality, great service, and a safe shopping environment, because that is crucially important.

Sreedhar Mahamkali: Thank you. Just coming back on the sales and costs, should sales remain meaningfully elevated, not necessarily as strong as we've seen in Q1; do you see costs continuing to rise through the second half of the year? Or do you think costs are pretty well calibrated and any additional sales is probably going to be giving you more leverage?

Dave Lewis: I think there's a level of precision that I think, you know, we would all... What we try to do is give you the costs as we understand them by quarter. And that's based on the assumption, of a gradual easing off. If there were to be any change, then we'd have to change the assumptions. I'm really happy that, with these costs, we can continue to invest in the business and keep the profitability of the retail business flat. I'm very confident that we can do that, whatever the situation is, but I can't with any accuracy talk about what the cost profile will be, other than the large degree of detail that we've provided in figure 31.

Sreedhar Mahamkali: Thank you very much. Thank you, Dave.

Dave Lewis: Thank you very much.

Ladies and gents, thank you very much. As I said, it is my last trading update. Over the next three months we'll ramp up my handover to Ken. He starts from the 1st of October, so he'll be in the seat when you come together on the 7th of October.

I just wanted to say thank you, if I may. First and foremost, to my Tesco colleagues. You know that, when I joined, I didn't have a retail background. They have been unbelievably welcoming to me. They've been very generous in the way that they've shared their expertise with me. And it has been and continues to be a privilege, to be part of such an amazing team. And they have my 100% commitment until the very last day of September.

But I'd also like to say thank you to you, for your questions, for your challenge, for your support. I don't think you realize how much of an integral part of the turnaround journey you have been, and I'm sorry that I won't get the chance to say thank you in person to you, as a group. I hope our paths do cross again. But it would be remiss of me not to say a heartfelt ‘thank you’ to you for all of that challenge and support.

Stay safe, stay well. And thank you very much, indeed.

[END OF TRANSCRIPT]