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Half Year Results 2020/2021

Wednesday, 7th October 2020

Serving Shoppers A Little Better Every Day

Ken Murphy

Chief Executive Officer, Tesco PLC

Agenda

Good morning, everyone, and welcome to the interim results presentation for Tesco. My name is Ken Murphy. I am the CEO of the Tesco and I'm joined by my colleague Alan Stewart, our CFO.

Let me briefly introduce you to the agenda for today's presentation. Firstly, I'll talk you through our highlights, then I'll pass to Alan to go through the first half results. And then I'll talk to you a little bit about why I joined Tesco and why I'm so excited about this role and the future of Tesco. And then we'll finish with some Q&A.

My Background

Before I start, let me just give you a brief introduction to me. I've been 25 years working across wholesaling and retailing, initially, with Unichem back in 1995. And then through a series of mergers, ended up working in retail, firstly, with Boots in the UK and then latterly with Walgreens in the US.

And I have to say I'm really excited about joining this business. I think it's an absolutely fantastic business. And before Alan talks you through the financial metrics, let me tell you about some of customer and other stakeholder metrics that we're really proud of for this first half performance.

Highlights of Performance

The first thing to say is that we've got over a million customers more loyal to Tesco at the end of the first half of this financial year. We've seen net switching gains from Aldi for the first time in over a decade. We've more than doubled our online capacity in just five weeks. If you remember, we had 600,000 delivery slots at the start of the pandemic and now we're operating at 1.5 million.

We gave 12 weeks pay for vulnerable colleagues; in fact, full pay from day one of absence. And we sheltered over 26,000 colleagues who were vulnerable during the pandemic. During that time, at one stage we had 50,000 colleagues absent initially and we had, over that period, to recruit 47,000 temporary colleagues in just two weeks. And I'm delighted to say that a number of them – over 16,000 – will be staying on with us permanently.

From a supplier view point, our satisfaction score improved by 7% despite the crisis. And I'm really, really proud of the fact that over that period, we doubled our food donations at time of extreme need from £15 million to £30 million in the first half. And, of course, Booker did an amazing job in supporting small community retailers across the country during the crisis.

So, really, really strong performance across a number of different aspects of our business.

I'd now like to hand over to Alan who'll talk you through the first half of financial performance.

1H Results

Alan Stewart

Chief Financial Officer, Tesco PLC

Group Performance

Thank you, Ken and good morning everyone. I'll now give you an overview of the performance in the first half. The numbers I'll share with you today exclude Asia and Poland as they are both now treated as discontinued operations.

Clearly, the effects of the COVID-19 crisis shaped performance in the first half, with significant changes in shopping behaviour and a substantial impact across all our operations. Sales grew by 6.6% at actual rates to £26.7 billion, driven by strong demand in the UK and Ireland.

Retail profit increased by 4.4% to £1.2 billion as a substantial level of COVID-19 related costs were more than offset by the contribution from sales volume and business rates relief. The bank made a loss of £155 million in the half, driven by an increase in the potential bad debt provision and a decline in income. We generated £554 million of free cash which was in line with last year on an underlying basis before a higher level of store buybacks and other property proceeds which makes it down 14.1% year-on-year at a headline level.

In line with our dividend policy, we are proposing to pay a dividend of 3.2 pence per share as an interim dividend, set at 35% of last year's full year dividends. The interim dividend will result in cash cost of approximately £350 million payable in November.

Segmental Performance

This slide shows a summary of our key sales and profit numbers by segment, including the Bank's loss in the half. Group operating profit before exceptional items decreased by 15.8% to £1.037 billion.

UK & ROI

I will now talk about each of our four segments in detail – each of our segments in more detail, starting with the UK and Ireland. The effects of stockpiling early in the half contributed to a like-for-like of 8.2% in the first quarter and the strong top line growth continued into the second quarter, reflecting the ongoing shift from out-of-home to in-home consumption. We saw material changes in the customer buying patterns, including as customers sought to shop less often, average basket size increasing by 56%, while frequency of visits declined by 31% year-on-year.

Our Response to COVID-19

Our response to COVID-19 continues to be based on four key priorities: providing food for all, safety for everyone, supporting our colleagues and supporting our communities. Providing food for all has involved collaboration across our supply base to maintain availability, as well as the significant expansion of grocery home shopping business. We more than doubled capacity and as Ken said, now offer 1.5 million weekly slots.

We have also worked with the government to prioritise the most vulnerable customers and now have 674,000 customers registered with us for priority deliveries. As you know, we invested to ensure we keep our stores safe with the extensive social distancing measures, additional cleaning routines and protective equipment implemented in all stores.

Colleagues who are ill with COVID-19 or are in isolation, as Ken had said, continue to receive full pay from their first day of absence. We also took measures to protect our most vulnerable colleagues by supporting them to stay at home with full pay for 12 weeks from March. To support our store colleagues, we recruited the 47,000 temporary roles that Ken mentioned and helping to backfill the absence and to serve the increasing customer demand, especially, in online.

We've delivered on our commitment of a £30 million community support package, making an additional £50 million of food donations over 12 weeks on top of our usual monthly donations. And increasing our support for local communities, including £2 million donations through our partnership with the British Red Cross.

Sales Mix

We've seen a significant shift in demand across our channels and product categories, resulting in a substantially different sales and margin mix. Sales grew across all channels. Our convenience stores, particularly in neighbourhood locations, were well placed to serve customers closer to home, resulting in growth of 7.6%. Our online grocery business grew by 69% in the half, with the rate of growth reaching 90% in the second quarter.

We worked closely with our supplier partners to maximise availability in food where sales grew by 9.2% year-on-year. Demand in household and grocery categories was particularly strong during the earlier period of stockpiling. This was followed by increased demand for products in our meat, fish and poultry category and also in beers, wines and spirits.

Sales in discretionary categories such as clothing declined, although volumes were strong and we outperformed the other major supermarkets. Our general merchandise performance was resilient, benefiting from increased demand for electricals and homeware.

Our fuel business declined by 41% but had recovered to around 75% of pre-COVID-19 levels by the end of August. In Booker, the retail side of the business performed well as we supported our retail partners to broaden their grocery ranges in response to customer demand. The catering business was impacted as pubs and restaurants closed, however, sales started to recover from the end of the first quarter.

COVID-19 Costs

Turning to COVID-19 costs, this table is an updated view of the estimate I shared with you in June. In the first half, our most significant cost related to payroll, including 12 weeks paid leave for the 26,000 vulnerable colleagues and the recruitment of the 47,000 temporary colleagues I mentioned earlier. These costs were lower than we'd estimated in June as colleagues were able to come back to work earlier than we'd expected. As a result, the total cost of £533 million for the first half was £63 million lower than our previous estimate.

While forecast is still highly likely to change, as always, we're going to give you an update in costs as we currently see them for the full year. Our latest estimate is for £725 million of COVID-19 related costs, including an ongoing payroll cost and additional safety consumables. Business rates relief of £532 million is the same as the estimate we shared in June.

Online

Moving now to online where the extent and speed of change has surpassed what any of us could have envisaged at the start of the year. We ramped up capacity from around 600,000 to 1.5 million delivery slots. And whilst profitability was challenged in the first quarter as we prioritised responding to increase customer demand, we made a number of operational enhancements across the second quarter which improved productivity.

Complimenting our store-picking model, our first urban fulfilment centre is now delivering to customers, with two more planned in the current financial year, the first of which is in Lakeside. The continued roll-out of this technology will enable us to capture growth well beyond our original ambition, with the sales run rate from our online business for the full year of at least £6 billion.

Brand

Turning now to our overall shopping trip. Our focus on delivering the best shopping trip for customers in very challenging circumstances has resulted in the some of our strongest brand scores to date. Our overall branding index reached its highest level since 2011, with improvements in customer ratings across the board. It's particularly pleasing to see that our quality and value scores have again both stepped forward by 350 and 530 basis points respectively. Further to this, safety has, clearly, been a primary concern for customers in recent months, with around 90% of our customer rating our stores as a safe place to shop.

Value

Following the initial launch in March, we recently extended Aldi price match to over 500 products, including brands and own label. You can see from the chart that our relative price position has improved strongly through the half. In addition, we're working alongside our supply partners to simplify ranges, remove pack size variants and reduce promotional rotations. In the half, we reduced our promotional participation to 22%, down from 30% last year.

Loyalty

Reflecting the strength of our customer shopping proposition, 1.1 million customers have become more loyal to Tesco during the half. Whilst we've not sought to accelerate the take-up during the crisis, our Clubcard Plus product is seeing a basket uplift around 300% higher than our original expectation.

And as part of our programme to reward loyalty, last month we started the extension of Clubcard prices to around 2,000 products across the store, giving our 19 million Clubcard holders access to exclusive offers every week.

Booker

In Booker, sales were 11% in the half, including a 9% contribution from Best Food Logistics which we acquired in early March. We saw exceptional growth in the retail side of the business, up 23.5% in the first quarter. Sales remained strong in the second quarter with growth of 21%, including a significant uptick in tobacco.

Sales to catering customers declined by 12% overall due to the temporary closure of restaurants from March. We then saw a consistent recovery from May onwards, first as we supported restaurants to switch to delivery and takeout model, and then as they started to reopen and customers began to eat out again.

During this time, we were also able to utilise spare capacity in the Booker catering business to support Booker retail and the UK online grocery operation, including using their distribution fleet to offer an additional 100,000 click-and-collect slots for customers during the peak of demand.

Having delivered on our merger commitments, overall, we are very pleased with the ongoing potential for the Booker business. Booker continues to hold leading positions across its market segments and the acquisition of Best Food Logistics has brought further scale with approximately £1 billion of additional sales in a normalised year.

We also see significant opportunities to realise value from the combined Booker and Tesco businesses, including the roll-out of Jack's products into stores operated by Booker retail partners.

Central Europe

If we move now to Central Europe, we saw similar changes in shopping behaviour as in the UK, with strong online demand and high sales growth in essential items. The Central European markets remain highly competitive and in the second quarter, sales declined as we came out of lockdown and traded over one-off activity last year.

Having completed the transformation of our range in space, changes in these stores, we are well placed to better serve customer needs in the region.

While underlying profitability improved, this was more than offset by COVID-19 related costs, a decline in income due to temporary COVID-19 related mall closures and a £11 million impact of the new sales tax in Hungary which was introduced in May.

Tesco Bank

In the Bank, COVID-19 has had a material impact on our performance due to a marked worsening of macroeconomic indicators, particularly, unemployment and GDP. Our provision for potential bad debt was around £140 million higher than last year. In combination with a reduction in income across the Banks' activities, this drove an operating loss of £155 million in the first half. We continue to expect an operating loss in the current year between £175 million and £200 million. Despite these challenges, the Bank's balance sheet remains strong, with a total capital ratio of 24.3% and its resilience to various stress scenarios is regularly assessed.

Earnings Per Share

On this slide, we've shown a pro forma, adjusted EPS measure. Our usual measure of adjusted diluted EPS is not meaningful as it excludes earnings from our discontinued operations, but does not take account of the expected share consolidation.

Our pro forma measure adjusts for these factors. Whilst the precise impact of the share consolidation we will make later in the year will depend on the share price at the time, we've approximated this based on last week's share price. This gives a pro forma adjusted diluted EPS of 7.56p in comparison to 9.01p last year, which we feel better reflects the underlying performance in the half.

Sources and Uses of Cash

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

I'm going to call out the most notable items, starting with the £1.8 billion cash generated from Retail operations. The net inflow from working capital was £170 million, which includes a £93 million drag due to lower fuel sales, more than offset by the benefit from increased purchases in food and reduced promotional activity.

Exceptional cash items were a similar amount to last year, with the largest component being costs associated with the settlement of legal claims in the period. In line with our disciplined approach, cash CAPEX was just under £370 million. We've provided the usual breakdowns by region and type in the appendices. CAPEX spend was around £40 million higher year-on-year, reflecting higher maintenance and technology spend.

Net interest paid of £319 million was £45 million lower than last year, primarily driven by better rates on our medium-term notes, loans, and bonds. Cash tax paid in the half was £125 million, which is in line with last year, although there were a number of moving parts. We had two additional quarterly payments and a one-off tax charge on the exceptional item. However, these were offset by a credit on Bank losses and a tax deduction relating to the £2.5 billion one-off pension contribution we'll make later in the year.

The main driver of the net property transactions was a spend of £148 million, buying back five stores. This was £59 million higher than last year, reflecting additional opportunities we saw in the property market. Overall, this results in Retail free cash flow of £554 million.

Liquidity and Debt Profile

Our balance sheet and liquidity position is strong. In line with how we manage our debt on a portfolio basis, we repaid €200 million during the half through the early redemption of a euro bond and we issued £500 million of new ten-year debt at attractive interest rates. We recently renewed our committed facility for three years at £2.5 billion.

The rate of interest payable on the utilisation of these facilities is linked to delivery of three of the Group's ESG targets. The new facility is also the first syndicated loan transaction in the UK that uses risk-free rates rather than LIBOR. The facility is undrawn and we have significant cash liquidity of £2 billion. Our credit rating is investment grade with all three agencies.

Total Indebtedness

Our total indebtedness was £15.9 billion, up £982 million since the year-end. This was primarily driven by an increase in the IAS 19 pension deficit due to a reduction in the discount rate, partly offset by an increase in the assets. I remind you that the IAS 19 deficit is totally independent from our actuarial pension deficit and does not drive contributions to the pension scheme.

We've agreed to the triannual pension valuation as at 31 December 2019 with the trustee. This is subject to the completion of the sale of our businesses in Thailand and Malaysia and the payment of the £2.5 billion one-off contribution to the sheme. This payment will eliminate the actuarial deficit and significantly reduce the likelihood of ever having to make any further pension deficit contributions.

We've provided a pro forma view of total indebtedness on a post-Asia transaction basis. On this basis, total indebtedness for the half would be £13.2 billion. The most material difference relates to the payment of the one-off contribution to the pension scheme.

Sales of Thailand, Malaysia, and Poland Businesses

The proposed sale of our businesses in Thailand and Malaysia was approved by shareholders in May. We expect to receive regulatory approval and to complete the sale before the end of the calendar year, following which we will seek shareholder approval for the return of capital in the form of a special dividend.

The sale of our businesses in Poland will generate £165 million of proceeds on completion, followed by an additional around £140 million of proceeds from the sale of properties. Cumulative proceeds from the sale of our loss-making business in Poland are expected to reach over £500 million.

Guidance

As usual, I have a slide summarising our key technical guidance. This remains unchanged from our preliminary results in April, other than in relation to tax. We now expect the effective tax rate for the current year to be around 22%. This is lower than the 24% guidance we shared previously, primarily due to the tax credit and the Bank's operating losses. In the medium term, our guidance remains at around 21% for the effective tax rate. We expect CAPEX for the year to be in the middle of the range that we gave in April of £0.9-1.2 billion, so, around £1 billion.

Summary

In summary, we entered the year in a strong place and this has enabled us to be agile in responding to the challenges in the half. We saw strong top line growth. This volume, along with business rates relief, offset the significant additional costs relating to COVID-19.

For the Bank, we continue to expect the operating loss of £175-200 million for the year, but its liquidity and capital ratios remains strong. The sale of our businesses in Thailand, Malaysia and Poland are progressing well.

We're continuing to invest in great value to help customers in increasingly challenging times. As a result, we expect to broadly even balance of Retail profitability in the year. While there's still clearly significant uncertainty, we now expect Retail operating profit to be at least the same as last year on a continuing operations basis.

Thank you for your time. I will now hand back to Ken.

Joining Tesco

Ken Murphy

Chief Executive Officer, Tesco Plc

A Great Business

Thanks very much, Alan. I think you'll agree it's a very strong set of results, given the challenges that every business has faced during this COVID pandemic. I'd now like to take a couple of minutes just to talk you through why I joined Tesco.

I think the first thing to say is that this is a company that is values-led – something that is hugely important to me personally, and something that I really look for in any organisation that I seek to join. And I was really happy to commit to Tesco because I felt that they have a very strong set of values.

The second is a statement of the obvious, but it is the UK market leader and, therefore, has scale with 440,000 colleagues across three regions.

We have the UK's largest loyalty programme. And we have some really strong and enduring supplier partnerships that have meant that we have been able to stay in stock and continue to support customers right through the crisis, but also partnerships that will help us innovate for the future.

And of course, last but not least, our reach is a huge strategic advantage. No matter what the changing habits of customers, we're there to support them. Whether it be big-basket shops and large stores, we have almost 800 of them. Or small local shops and convenience stores, where we have nearly 2,000. Or, indeed, the fastest growing trend, online, where we have increased our capacity to 1.5 million grocery slots per week, of which 363 are click-and-collect locations. And of course, through Booker, we serve 88,000 community retailers and over 400,000 catering customers. So, it's really a business with unrivalled reach in this market.

A Great Team

The next thing I'd like to talk about are our people. And the outside-in perspective of Tesco sometimes can be seen as a bit cold and functional, but I've found exactly the opposite since I've joined. I've found a very warm and welcoming environment. I have felt fantastically supported by the people since I've joined this organisation.

The second thing you're struck by when you join is the capability that we have within the organisation. It's truly humbling to see some of the amazing experience and some of the can-do attitude that you see around the business. It's something that's really runs deep in the Tesco organisation.

This is definitely an organisation that has a bias for action. And this really came to the fore during the crisis where the whole organisation stepped up to the plate and did an amazing job for customers.

And of course, that kind of response doesn't just happen when you need it. It only comes from being led for a number of years to wanting to do the right thing for customers, to wanting to do the right thing for each other, and to building a really strong team spirit. And that's something that's really in evidence in this business and sets us up really well for the future.

Things That Resonate

The things that really resonated for me in that is, is the relentless customer focus I see in the organisation and it all stems from the brand purpose of serving shoppers a little better every day. And, of course, doing things a little better every day adds up to some really big things over time.

And you can see it in everything we do, from the Aldi Price Match and Clubcard prices to the improvement in our customer interaction through our loyalty card, through our willingness to look after colleagues who are vulnerable, regardless of the cost. It's been really, really fantastic to see.

And, of course, all of that is only possible if we're hugely cost-conscious. And we only spend money on things that really, really will make a difference for customers and seek to get rid of all the costs that don't. This is something that was started under Dave and the Leadership team here in Tesco and it's something that we will absolutely be seeking to continue with, as time goes on.

Many, Many Opportunities

And, of course, we are awash with opportunities. There are too many to mention. We've put a few up here on the slide. But this is a company which really has put itself back on a very solid footing, is very innovative, has huge capabilities in a number of areas. And therefore, I feel really excited about the future potential of the business.

What You Can Expect From Me

So, what can you expect from me? The first thing is a relentless focus on doing the right thing for customers and for the brand. To integrate our passion for nutrition and sustainability into everything we do; make it a core part of how we run the business. Through all of that, I have every intention of maintaining a disciplined approach to managing cash and capital allocation, and to seek out profitable growth through serving customers a little better every day.

What's Next?

So, what's next? Well, the first thing to do is to take the time to listen and to learn. So, I'm going to spend as much time with colleagues as I can, customers, supplier partners, out in stores, out in our distribution centres, out in our Booker depots, really getting to know our business. Time with the Bank team, time with the Central European team. This is really a time for me to do less talking and more listening.

The second thing, of course, is to maintain the momentum of the Asia sale, complete it, and to return £5 billion of capital to shareholders.

And the last, but definitely not least, is supporting the team to deliver a great Christmas for customers. This has been a really challenging time for many, many people in our communities. And this is really the moment for us to make it as best a Christmas as absolutely possible in the circumstances, and you can count on us to do that.

So that concludes the presentation, from a formal perspective. We'd know like to throw the forum open for some question and answers. Thank you.

Q&A

Operator: Thank you. If you wish to ask a question, please dial star and one on your telephone keypad now to enter the queue. Once your name is announced, please go ahead and ask your question. If you find it is answered before it's your turn to speak, you can dial hashtag to cancel.

So, once again, that's star one to ask a question or hashtag to cancel. If you are asking a question, please remember to mute your online webcast to avoid any feedback. There will now be a brief pause while we are registering your questions.

Thanks for waiting. Your first question comes from the line of Andrew Gwynn, Exane BNP Paribas. Please ask your question. Your line is now open.

Andrew Gwynn (Exane BNP Paribas): Good morning. Morning, team. Two questions, if I can. So very, very big picture, first for you, Ken. Anything obvious that you think needs changing – anything you think that Tesco has been doing wrong? I know it's a very open question, but just quick thoughts there maybe.

And the second one, which I'm sure is going to come up quite a bit in the Q&A, but it's really around online profitability. Clearly, a very, very significant step-up in capacity during this period. I think the question that many investors have is really around the profitability of online. So, maybe some thoughts [inaudible] integrating [inaudible] capacity? Thank you.

Ken Murphy: Great. Thank you for the questions, Andrew. So, I think the first thing to say is that my focus really is on maintaining momentum through Christmas, and you should consider me happy with the strategy of the business until you see a change in stores. So, really, right now the organisation isn't focussed on change, it's focussed on delivery. And I think that's absolutely right, because that's really what's going to make the difference for customers this season.

In terms of online profitability, it's true that we had to obviously react really quickly to the demand surge and demand for online slots at the start of the pandemic. And this incurred a number of costs as we did it. However, as we moved into quarter two, we worked hard on improving productivity and profitability in our online space, and we were helped by a number of factors. The first is, of course, the average basket size increased substantially during COVID. The second is that we also had better van utilisation. And the third is that almost a third of our slots are actually click-and-collect slots, which are just structurally better from an economic perspective.

And, of course, we're not finishing there. We are continuing to work on improving online profitability all the time. And the UFCs, which we're in the early stages of developing, with the first having landed in West Bromwich, will be another step towards us improving productivity, lowering costs, and improving the options available for customers over time.

Andrew Gwynn: A very quick follow-up to that. But do you think online can be as profitable as the stores in time?

Ken Murphy: Well, I think online is here to stay, Andrew. So, it's our job to make sure that we integrate it and make it as profitable as it can be in – over time. And I think that we're on a very good trajectory to do that.

Andrew Gwynn: Thanks, Ken, and welcome.

Ken Murphy: Thanks, Andrew. Appreciate it.

Operator: Thank you. And our next question comes from the line of Sreedhar Mahamkali from UBS. Please ask your question your line is now open.

Sreedhar Mahamkali (UBS): Yeah. Hi, good morning. Ken, welcome. A couple of, again, probably big picture questions, perhaps. First one, you've referred to capital allocation. And I think previously, Tesco talked about achieving 2.5 times net debt-to-EBITDA as a threshold for the Group to start returning cash to investors by way of buyback. Do you think that's still the right way to think about it? I appreciate it's very early days for you, but any thoughts really helpful there.

The second one, I guess, in terms of Aldi Price Match and how you think about it, I guess it's connected to the move to EDLP and away from promotions. So your thoughts on how you see it; is it a tactical thing that you are doing with Aldi Price Match? Is it a strategic thing and how do you fund it, if it's a longer-term thing? That's the second question.

And maybe just one quickly for Alan. I'm still trying to understand your commentary or guidance on full-year retail a bit being maybe slightly ahead because I think you said at least the same as last year. Is that instructed by some caution that you're seeing in recent trading or is it just a case of a lot of prudence? Because I think, looking at the bridges, you've absorbed almost £300 million net hit to the first half profit from COVID costs versus rates relief. That clearly becomes a pretty big tailwind in the second half, so I'm curious to see how you think about the full-year retail profit outlook? Those are the three questions. Thank you so much.

Alan Stewart: Ken, shall I take the – I'll take the second – the third question, and I'll touch on the rating, and then you maybe want to mention – talk about capital allocation more generally –

Ken Murphy: Perfect.

Alan Stewart: – and then hand back on Aldi Price Match.

In terms of the first half, second half, we're giving the best possible view with the COVID-19 costs. £725 million for the full year is our expectation today. Clearly, if the situation changes significantly from what we see today, then things will change.

In terms of the shape of the first half, second half, again, in terms of the expectation that our retail profits will be at least equal to last year's, which was £2.3 billion, that's the best view that we can say today. We are continuing to invest, and we are very clear that we invest. We've rolled out the 2,000 products on Clubcard prices, we've got the 500 products under Aldi Price Match. So, we continue to invest. We continue to keep really close to the customer and offer great value. And Ken, I'm sure, will come back to that.

In relation to the indebtedness ratio, we've never made that close linkage, that direct linkage, between the indebtedness ratio and excess cash and capital which we have said we are likely to return to shareholders by way of share buyback. What we set out is a framework for capital allocation in terms of how we look at capital and that remains the same. So, whilst it's a target, it's never as closely linked quite as your question might have implied.

Ken Murphy: Thanks, Alan. So, Sreedhar, I think that answers the capital allocation question. And regarding the Aldi Price Match and EDLP, I think the one thing I can tell you is that strategically, Tesco is committed to providing value to customers. And we don't anticipate any changes to that, particularly in light of future challenges we may face from recession or whatever. We will really stay in touch on value at all times, and I think the Aldi Price Match is a part of that.

Sreedhar Mahamkali: Maybe just a quick follow-up on that. In terms of the move to EDLP, clearly, you've succeeded in the first half to take down promotions in a meaningful way, and I know you are talking about migrating on a long-term basis to suppliers. Can you give us an update on how those conversations are going? Because I think there was quite a lot of news flow around July time with suppliers pushing back on the timelines, and your expectations on that will be helpful.

Ken Murphy: Sreedhar, I don't think you will be surprised to hear that I can't comment on conversations between ourselves and suppliers, other than to say that as far as I can see, our suppliers are fully on-board and support the Aldi Price Match initiative.

Sreedhar Mahamkali: Thank you, Ken. Welcome.

Ken Murphy: Thank you, Sorel.

Operator: Thank you. And the next question comes from the line of Nick Coulter from Citi. Please ask your question, your line is now open.

Nick Coulter (Citi): Good morning both, welcome, Ken. Three if I may. Firstly, could you talk about your promotional shape across the half and to the extent that you can disaggregate, I guess, the impact of the crisis initially and what that meant for promotional shape. And then, I guess, how your more strategical or tactical decisions evolved across the half with regards to promotions.

And then, secondly, please could you expand on your comments around the online operational improvements from Q1 to Q2, because it sounds like you've been hard at work with respect to the productivity.

And then, lastly, if I may, Ken, would it be possible for you to talk a little bit about the main avenues or opportunities for growth that you see within Tesco? Thank you.

Ken Murphy: Thank you very much.

Alan Stewart: Shall I take the first two, Ken?

Ken Murphy: Yes, sure.

Alan Stewart: In terms of promotional shape, I think it's worth stepping back to our expectations for the year. We entered the year, we felt, in a very strong position. We had achieved what we set out to achieve and we had strong momentum behind us as we entered the year. It's a year when we expected to invest for customers, and so we were set out to do that.

Now, clearly, the impact of the COVID-19 pandemic and the resulting surge in demand meant that some of what we'd had to do, we had to rethink and step back from. And that definitely impacted some of our thinking about shape. But, I think it's fair to say, Nick, that the reduction from 30% to 22%, which I referred to, is something which is consistent with what we are aiming for, which is the everyday low pricing; we had to temper some of that in terms of the demand.

But as you can see, towards the end of the half, we really are stepping up the momentum in that. And that's something which, as you've heard us say before, you will see it first in stores and in front of customers before we tell you about it. But it's something which we continue to be focussed on, and that forms an important part of our thinking through the second half of the year.

In respect of the online operational improvements, little more than I can add, other that what we've already spoken about in terms of the move from satisfying the demand, increasing the capacity to meet that demand, and then improving the operational delivery behind it. So, great that we can get the online delivery vehicles utilised more quickly. We continue to look at ways that we can make our routing schedules most efficient, which takes out cost, gives more time, and ultimately, means that we can serve more customers. And we continue to look at ways that we can make it more efficient. But little more that I can add than other what we've already said.

Ken Murphy: Thanks, Alan. And Nick, in terms of main avenues for growth, I think I alluded to it in the earlier part of the presentation when I talked about our reach and our capability to adapt to whatever change there are in customer trends, probably better than most of the competition. And so, I feel like as long as we stay focussed on customers, as long as we stay focussed on value, as long as we anticipate their needs and seek to remove pain points and make it as easy for them as possible to shop at Tesco, we won't be short of opportunities of growth.

Clearly, the specifics, we shouldn't go into it because they are competitively sensitive. And you will see them as soon as they land in stores.

Nick Coulter: Thanks a lot. All the best.

Operator: Thank you. And then next question comes from the line of Clive Black from Shore Capital. Please ask your question, your line is now open.

Clive Black (Shore Capital): Thank you. Good morning, gentlemen. And again, welcome and all the best, Ken, in the new role, and happy holidays, Alan, for next April. One question, novelly, you mentioned nutrition and sustainability in your presentation. I just wonder how you see shareholders benefiting from the work that you plan to institute, please.

Ken Murphy: Hi, Clive, great to hear your voice and thank you for the question. I'm really glad you ask that question because I think this is at the very heart of how we want to lead this business going forward. We think that democratising nutrition and being able to provide great nutrition at great value and in a sustainable way is at the very core of how we want to run the business going forward. Our view is that if we do the right thing for customers, the right thing for communities and the environment, that customers will reward us. And then, of course, shareholders will be rewarded as a consequence of that. So that's really how I see the link.

Clive Black: And then can you just – I respect the point you both made about not wishing to encroach on commercially sensitive information, but in terms of what's visible to us today coming into Tesco, what would you highlight as key achievements that we can hang our hats on?

Ken Murphy: Well, I think, Clive, I hesitate to talk about past achievements simply because they were not mine, they were the teams that delivered them in the past. But, I think you can look at Tesco's leadership in food waste, which has been really impressive, and we have food waste over the last five years in the UK. You can look at our food donations in terms of how we've supported food banks. You can look at the work we've done on sustainability. And also, we have, in terms of our innovation process, every own brand meal, every own brand product we launch typically has to have better nutrition values than the product that went before it. So, those are – it's already an embedded way of working in our business.

Clive Black: Okay. Thank you very much, Ken. All the best.

Operator: Thank you. And the next question comes from the line of Xavier Le Mene from Bank of America. Please ask your question, your line is now open.

Xavier Le Mene (Bank of America): Yes. Good morning, thank you for taking my question. Two if I may. The first one just back to online, I'm trying to think a bit longer term. So, significant sales increase. What potentially is the impact in the long-term of your stores and how do you see that in terms of expansion, potentially reducing space? So, what is your view on that?

And the second question is about the challenge you mentioned for COVID-19 and Brexit, of course, going forward. And you said how Brexit could impact the business going forward and potentially a word on inflation, for inflation for the next 12 months.

Ken Murphy: So, I think the first thing to talk about in terms of expansion of online and the impact on our stores, the first thing to say, of course, is the vast majority of our online business is serviced from our large stores. So, it's very much been a symbiotic relationship between the large stores and our online business.

The second thing to say, and I think this has been a big lesson from COVID, is that you never know how the customers' habits are going to change. And what's most important is that you're there to respond and you have the capability to respond. And I think this is what Tesco has shown over the last nine months, that no matter what changes we see in the marketplace in terms of customer shopping habits, we have the capability to respond and to fulfil those needs. So, I feel very comfortable about that point.

The second is Brexit. So, Brexit, clearly, this is not our first time having to face into the prospect of Brexit. We've had a dry run before, so the business is well prepared for the eventualities that may occur. There is not much point in speculating about what those individual possibilities are because we don't know the terms of the agreement yet. But we feel like we're well prepared no matter what they may be. And I think regardless of those terms, we plan to provide great value to customers in the future.

Alan Stewart: With regards to inflation, what we've said before is that whenever there is inflation, we seek not to pass it on. If it's valid and our suppliers are incurring it, then we will understand it, and to the degree that it can't be mitigated, then we will try not to pass it on. If it does get passed on, then we will always seek to be competitive in the market. You will have seen most recently that food inflation is running actually at slightly negative levels, chiefly because of the drop-off in promotion and some of the underlying dynamics. But, we don't know what the future will hold but that's the way that we think about it.

Xavier Le Mene: Thank you.

Operator: Thank you. And the next question comes from the line of Maria-Laura Adurno from Morgan Stanley. Please ask your question, your line is now open.

Maria-Laura Adurno (Morgan Stanley): Thank you very much for taking my questions, I have two. The first one is at the beginning of the presentation you mentioned you had added 500 products to everyday low prices, and I was just wondering what your thoughts were in terms of continuing to expand this strategy, so any colour would be helpful.

And the second question, you talked a lot about Christmas, and I was just wondering from that standpoint, do you see – are you preparing for anything different this year versus last year? And perhaps if you can provide some thoughts on this, that would be helpful to understand. Thank you.

Ken Murphy: Thank you Maria-Laura. So, the first thing on EDLP and the Aldi Price Match. So, we have, as you quite rightly said, added 500 products to the Aldi Price Match. This is a strategy that we are happy with, that we will continue with, and one that we believe is working for us. We have to wait and see what's right in terms of whether we add more and in which categories, and I can't really comment on that at this point. But our commitment to value is here to stay.

In terms of Christmas, we're not planning anything dramatically different for Christmas this year. We think that demand will continue to be high. We think that our customers want to celebrate Christmas this year. Clearly, family sizes, gathering sizes will be smaller, but we're anticipating a strong Christmas season and we're preparing for it as such.

Operator: Thank you. And the next question comes from the line of Victoria Petrova from Credit Suisse. Please ask your question, your line is now open.

Victoria Petrova (Credit Suisse): Thank you very much. I have a couple of small remaining questions. First, is on your price investments. In the beginning of the year, you already mentioned that 2020/2021 were supposed to be the year of investment. For you now, it seems that you are going through with that. Is it necessary right now? We are seeing other markets where this shift to home cooking, home eating is actually supporting profitability of existing retailers, and we are also seeing everyone else being pretty aggressive on pricing as well. How do you look at it? How do you avoid the situation of a price war in the UK food retail sector given your size and leadership in the market?

And my second question is a follow-up on your online. How do you see it, and you mentioned that it is there to stay, it's a new reality. What do you expect it to be as percent of your next five-year sales? What do you expect to be your key channel – click-and-collect versus delivery? What automation level do you target or what do you expect a certain combination of pick-up versus your UFCs? And is there any chance you can capitalise on your Booker facilities in the context of online? Thank you very much.

Ken Murphy: Thank you, Victoria, a very comprehensive set of questions. So, the first thing to say is that as the market leader, our commitment to value for customers, I think, is really important. We don't and haven't taken any advantage of the crisis to move away from a value position because we just thought that was the wrong thing to do for our customers. And we maintain that position, and we will do that for the foreseeable future.

In terms of our online business, it's actually quite difficult to predict where the market will top out. It may top out at around 20%. It's currently at about 11%, between 11% and 15% depending on the – on which part of the year you target. But we see growth continuing in that channel and we are planning for that.

And I think the UFCs, the productivity improvements, the streamlining of our service and our click-and-collect model are all components of that. And we will respond and use those components to serve customer needs as they change.

And of course, Booker is a part of that. Booker has helped us to increase our number of slots by 100,000 this financial year. So, Booker is definitely a key component of any strategy going forward.

Alan, is there anything you want to add to that?

Alan Stewart: No. Sorry, the one thing I would add is that you remember that when we spoke about the UFCs originally, the urban fulfilment centres, we spoke about them as helping us get to that doubling of our capacity. Now, for the reasons which we all know and the spur that was given to us, we have already more than double the capacity. The UFCs potentially help with the economics and the underlying efficiencies. And if they help to serve a greater demand, then we'll be ready for that. But they do form an important part of our – of the development of our online business.

Victoria Petrova: Thank you very much.

Operator: Thank you. Once again, if there is any further questions, please dial star one on your telephone keypad. And the next question comes from the line of Rob Joyce from Goldman Sachs. Please ask your question, your line is now open.

Robert Joyce (Goldman Sachs): Hi. Thank you. Welcome Ken. Just a couple from me. So, firstly, just – sorry to add to online, but as you've laid out, you continue to see online growing, basket sizes are elevated. If that really stayed as it were, does this stay – is this a permanent profit impairment, profitability impairment for the industry? And would you be able to maybe help us understand how much more profitable using UFCs versus a pure store-pick model is?

And then the second one, just noticing in terms of the online slots you are now offering, it seems to have flat-lined at that 1.5 million for about the last three months in the bar chart you gave there. Is that because you've now satisfied all the demand out there, or is there still a lot more demand that can be satisfied at the moment from online? Thank you very much.

Alan Stewart: Thanks. Yeah. Look, so in terms of the second question first, Rob, the – at the moment we are – that's – the slots we are delivering are the maximum that we can within the system. We do continue to look at them, but we are – there are times when that capacity is reached. Around a third of the online slots are click-and-connect, and that's a part of the business that providing we can get picking – this is where the UFCs come through – the more we can pick in a time period, the more we can deliver. So – and whether that's then delivered or click-and-collect, we will see.

But at the moment, having moved from 600,000 to 1.5 million within the period from beginning of March to now, that's really where we are.

In terms of the other elements, I think it's difficult to say exactly what happens because the growth is there and has been there, but clearly as customers began to eat out, we saw some lessening of that very, very strong demand. So, it is linked definitely to how much food is being consumed and where it's being consumed.

The other thing I'd say in terms of the economics is that our business, as Ken has said, is essentially a pick-from-store model. And we get an efficiency from that already invested capital. Now, there are some extra marginal costs and we've borne those during this year. So, I think for us, we will continue to make – to deliver to customers what they want and then if we – and then it's up to us to make that as efficient as we can behind the scenes.

But moving from an already invested store base is for us not only economically viable and sensible, but it's also, as we've shown, a very agile and responsive way of serving customers.

Ken Murphy: Thanks, Alan. I'll just add a couple of points to that. The first is that clearly the UFC represents a chance to further enhance the productivity and the cost-effectiveness of our online distribution model. The second thing to say is that, as Alan alluded to, a third of our slots are click-and-collect and the economics of click-and-collect are obviously better than deliver to home.

And the last thing I'd say is that you need to look at our model holistically. What we found is that customers who shop us across multiple channels – convenience, online, large store – are typically much more loyal, and therefore, more profitable customers. So, really our strategy is about serving customers regardless of their preference and trying to make sure that their lives are as easy as possible. And we're reasonably convinced that over time if we satisfy those needs, regardless of the channel, the overall profit mix will be right.

Robert Joyce: Thanks very much. One quick follow-up. Does the £1.50 charge I think for click-and-collect, does that cover the picking costs? Do you break even on that – on a pick basis?

Alan Stewart: Rob, we don't go into that level of detail. But clearly there's an element of cost and we're seeking to help customers understand. We've spoken about this before, you remember, that if it's actually delivered to you in your home, that for us is the most costly and you should recognise that. And we would seek to help you recognise that through what we charge for it.

If it's convenience and you're walking to it, it's likely to be a bit more expensive than if you drive the furthest distance to a large store and you do it yourself. Click-and-collect, large store pickup, you've gone there, clearly there's an element of you made effort, so the pricing will reflect that. But the specific economics we don't go into that level of detail externally. We clearly do understand it ourselves.

Robert Joyce: Good to hear. All right. Thanks very much. Cheers.

Operator: Thank you. And the next question comes from the line of Andrew Porteous from HSBC. Please ask your question, your line is now open.

Andrew Porteous (HSBC): Hi guys. And welcome Ken to the sector. A couple for me, small ones tidying up. Just on the online piece again. I know people have asked about the profitability of online. But I just wonder whether you feel there's anything – asking another way, whether you feel there's anything within your model, any structural advantages that you have that mean that it will be difficult for any competitors to replicate the profitability that you – profitability levels that you generated online?

Secondly, I just wanted to talk about Clubcard prices. Obviously, it's something that's fairly in new in store. I'm just wondering whether there are any early learnings from that initiative.

And then lastly around Aldi Price Match, again something very prominent in store across your offer. What sort of engagement have you seen from customers on that? And are they shopping that part of the ranges when they're coming into store?

Ken Murphy: Andrew, hi. Thanks very much for the welcome and for the questions. So, the first thing to say is I do believe that Tesco have some structural advantages in the online space. The most obvious one is our scale and our reach. As far as I'm aware, we're over 99% of reach in terms of every customer in the UK.

I think the second point is that Tesco has a really, really deep and long-standing competence in this space and continues to improve on that and work on that all the time. And I think that's very hard to replicate. I think that a number of the other players were later to the game. And so that also is something that we'll be looking to, for the future.

And the third thing, of course, is as the habits of customers have changed, as we've seen basket size increase, as we've seen van-route utilisation improve, that makes the economics structurally better all the time for our players as large and as established as we are.

In terms of Clubcard prices, Clubcard prices really is a refinement of our promotional strategy to give our most loyal customers the best possible deals. And we've been really impressed and surprised by the response of customers to this initiative. It's been really well received in the market. And one of the things that, of course, was part of the strategy is to increase the level of Clubcard participation and also the downloading of the Clubcard App to increase the levels of engagement with customers across a number of different areas.

So, I think it's early days, but so far so good. We're very pleased with the progress on Clubcard prices.

Last but not least, the Aldi Price Match. I think, look, the evidence is in how customers perceive us on value. And I think that Alan alluded to it in his presentation that we've seen a substantial improvement in value perceptions from customers. And I think that's the clearest indication that this is working and, of course, yes, people are shopping those ranges, absolutely.

Operator: Thank you. Once again, if there are any further questions, please dial star one on your telephone keypad now. And the next question comes from the line of James Grzinic from Jefferies. Please ask your question, your line is now open.

James Grzinic (Jefferies): Yeah. Thank you. Good morning, Ken and Alan. Ken, I have a quick one for you. I presume as you are shaping your view of growth versus margin versus cash flow for Tesco and you look back at history and where the Tesco relative price position was going to, I guess, the end of 2008 and how things developed in 2009, where do you find the business to be now, post Aldi Price Match, post what you're doing on sharpening on Clubcard prices relative to 12 years ago? That'll be very interesting. Thank you.

Ken Murphy: Thanks very much for the question, James. So, I think the first thing to say is that we – it's a completely different world in Tesco today relative to 2008-2009. And I think it would be wrong to talk about Tesco's value position just in terms of the latest initiatives of Aldi Price Match and Clubcard prices, because I think the value journey started some time ago, probably six years ago when Dave joined the business and the current executive team formed.

And they've been very clear throughout their tenure that value is hugely important to Tesco and to Tesco customers. And you'll have seen through the last number of years, through the farm brands initiative, through the sharpening of price points generally, through the promotions that Tesco has run over the last number of years, a commitment to value. And you will see no change in that as we go forward.

So, I'm very committed to making sure that whatever the economic environment going forward, Tesco is very strong on value for customers.

Operator: Thank you. There seem to be no further questions coming through at this point, so I will hand back to Ken Murphy for the closing remarks.

Closing remarks

Ken Murphy

Chief Executive Officer, Tesco PLC

Ken Murphy: So, listen, guys, all I want to say is a huge thank-you for taking the time to join us this morning. Thanks everybody for your questions. They were greatly appreciated and the interest in Tesco is greatly appreciated. As you can see, these are very uncertain times but actually times where Tesco feels it's in a great position to look after its customers and look after its colleagues.

I just want to close the session by saying a huge thank-you to all our colleagues, who have done an amazing job during this period. I'm very humbled and very proud to be part of this great team and you can count on us to continue to look after our customers in the coming months and years ahead. Again, thank you and goodbye.

[END OF TRANSCRIPT]