TESCO

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Tesco plc Full Year Results 2020/21

Wednesday, 14th April 2021

Opening Remarks

Ken Murphy

Chief Executive Officer, Tesco plc

Welcome

Good morning everyone and welcome to the Tesco annual results for the financial year 2020/21. First and foremost, I hope in the last couple of days you've all managed to make it down to your local pub to support them and have a pint, albeit in relatively fresh conditions, so I hope you were well wrapped up. I'd like to start really by thanking everyone for joining us today but also to say a special to thank-you to our colleagues, our customers of course, all our partner suppliers and all our stakeholders and shareholders who have supported us through what has been an exceptional year by any circumstances.

Introduction

And in this exceptional year, of course you will see some significant impacts on our results from the pandemic. However, it's been a year of real underlying strength for the business. When the COVID impact hit we reacted incredibly quickly and with great agility. In a matter of five weeks, we more than doubled the number of online slots available to our customers. We had almost 50,000 people out of the business, many of whom were shielded because they were vulnerable or extremely vulnerable. And so we had to hire over 45,000 temporary colleagues in a matter of weeks, all of which we did without skipping a beat. And availability for our customers remained incredibly strong all the way through the pandemic.

And of course, by doubling those slots, we were able to look after over 890,000 vulnerable customers throughout the year, making sure they could get their shopping without actually having to take any personal risk or leaving the comfort of their home. So, really a heroic performance by our colleagues. And really they are everyday heroes that I just wanted to celebrate for a moment their contribution, not only to the business this year but also to society in general.

By doubling this business online, by building on all of our inherent strengths, by having great value, we have really built a fantastic platform to build on for the future. A really customer-orientated platform and I'll tell you a bit more about that a bit later. Of course, this is also Alan Stewart's last results presentation and he retires at the end of the month after an incredible service to the business. And I know he'll want to say a few words himself, and I'll speak a little bit more about it later, but he has been a tremendous partner since I started in the business.

So, without further ado I'll hand over to Alan to present on the financial results of the year. Alan.

Full Year Results

Alan Stewart

Chief Financial Officer, Tesco plc

Thanks Ken. Good morning everyone. I'll start with an overview of performance in the year. The numbers I'll share with you today exclude Asia and Poland as both have been treated as discontinued operations. As a reminder, last year was a 53-week year in the UK and Ireland on a statutory basis but the comparable numbers I will present today are based on 52 weeks, just as we treated this last year.

Group Performance

As Ken said, the COVID-19 pandemic had a material impact on all areas of the business. We saw significant sales growth of 7.1% driven by the retail businesses as customers consumed more at home. In December, we announced our decision to return business rates relief. We've included £535 million of current year cost as usual in our reported operating profit before exceptional items. Taking account of this, retail profit declined by 14.7% to £2 billion as a substantial level of COVID-19 related costs were only partially offset by additional sales demand. The Bank made a loss of £175 million, driven by a reduction in banking activity and an increase in the potential bad debt provision.

We generated £1.2 billion of free cash which was 29.8% lower than last year, driven by lower profits and last year's inclusion of £277 million proceeds from the sale of our associate in China. We're proposing to pay a final dividend of 5.95 pence per share. This brings our full year dividend in line with last year, at 9.15 pence per share. This is an exception to our policy and reflects the importance the board places on dividends paid to shareholders and the confidence in future cash flows. The payment of the final dividend will result in a cash cost of approximately £460 million payable in July this year.

Segmental Performance

This slide shows a summary of our key sales and profit numbers by segment. Total retail sales were £52.7 billion and grew by 7.9% year-on-year. Retail profits were £2 billion. Including the Bank, Group operating profit before exceptional items decreased by 28.3% to £1.8 billion. Over the next few slides I will cover the performance of each of these segments in more detail.

UK & ROI

I'll start with UK and Ireland. The effects of the COVID-19 crisis impacted how customers shopped, with a shift to home consumption driving 6.8% like-for-like growth in the year. I've added this chart on the right to show the shape of sales through the year. In the first quarter we saw an initial period of stockpiling. This was followed by a period where growth stabilised as the hospitality sector reopened in the summer. As we returned to more stringent restrictions in the second half, we saw growth accelerate again.

We saw major shifts in buying patterns, including strong growth within the online channel where we substantially increased capacity, as Ken said, in response to customer demand. Ken will give more colour on this later, and the continued opportunity we see in online. As customers sought to shop less often, basket size increased significantly while the number of trips fell. We continue to see strong sales momentum into the current year while restrictions remain in place.

ROI

In the Republic of Ireland, sales grew by 14% in the year, driven primarily by our large stores. There were similar demand peaks in the first quarter to those we saw in the UK due to an initial period of stockpiling, with growth remaining strong throughout the year as the out-of-home market, which is very large in Ireland, remained closed. We saw sales growth across all categories and formats. I'd like specifically to point to the performance of the online business in the year, which grew by 61%, with sales participation increasing from 6% to 9%. We remain the clear online market leader. Customers rated our store safety and service highly, which contributed to growing customer net promoter scores and a record high score of 25 in the fourth quarter.

Booker

In Booker, sales to retail customers were strong, increasing by 18.5% as we expanded our grocery ranges in response to demand from customers aiming to shop closer to home. The closure of pubs and restaurants for much of the year drove an unprecedented decline in the hospitality sector and led to a 40.8% reduction in our catering sales. Catering demand was highly correlated to the severity of national lockdown. We exited the year with a stronger market share as we supported our catering customers throughout this period, offering a full range of food and consumables. You will remember that we acquired Best Food Logistics right at the beginning of the financial year. As catering demand fell away due to COVID-19 restrictions, colleagues there were redeployed to support the Booker retail business and the Tesco Grocery Online business. As Best Food Logistics sales have recovered throughout the year, they've contributed £0.7 billion of additional sales to Booker. We continue to see lots of opportunities for Best Food Logistics as it enables more customers to access our world-class sourcing capabilities.

UK & ROI

In the UK and Ireland, operating profit was down 13.5% which includes the repayment of the £535 million of business rates relief. We incurred £892 million of COVID-related costs, mostly in payroll, as we prioritised safeguarding colleagues and customers. These costs were only partially offset by higher retail sales. In addition, Booker profit was significantly impacted by the decline in catering sales which have higher margins.

UK COVID-19 Costs

To give a bit more colour on the UK COVID-19 costs, they are summarised here and total £892 million. They're mainly related to additional payroll costs, safety consumables and other costs incurred in making our stores safe for customers. This is higher than the estimate we shared in January of £810 million, primarily due to our decision to pay a third frontline bonus to recognise the outstanding efforts of our colleagues. We expect the majority of these costs now to fall away, with the amount remaining being dependent on lockdown conditions throughout the year. Our current best estimate is for around a quarter of these to repeat in the current year.

Central Europe

In Central Europe, like-for-like sales were down 0.4% reflecting highly variable COVID-19 restrictions across each country in this market. Market conditions and customer behaviour were very different to those we saw in the UK and Ireland. Customers were encouraged to shop locally and non-food sales were restricted for part of the year. The out-of-home market is much smaller in Central Europe so we didn't see the same level of switching to in-home consumption. As you can see in the chart on the right-hand, as a result sales in our hypermarkets fell by 3%. Smaller supermarkets were more resilient with a strong underlying performance in food. Our online business grew by 89% year-on-year as we responded to increased demand. Operating profits of £124 million were held back by COVID-19-related costs and the £25 million sales tax in Hungary which was introduced in May last year.

Tesco Bank

If we move now to the Bank where the economic impact from COVID-19 had a material effect on performance, driving a loss of £175 million in the year. Macroeconomic indicators weakened significantly in the year, mainly unemployment and GDP, which increased our provision for potential bad debts. We also saw a reduction in income across all activities as retail spending fell, customers paid down credit card balances and demand for lending reduced. We took an impairment charge of £295 million against Bank goodwill, mainly due to an increase in the discount rate, in addition to a reduction in anticipated future cash flows. The Bank's balance sheet remains strong with a total capital ratio of 28.2% and sufficient levels of liquidity to absorb ongoing volatility in trading conditions.

As previously announced, we expect to complete the acquisition of our partner's stake in the Tesco underwriting joint venture later this year. This will allow Tesco Bank to create an end-to-end insurance business that is uniquely positioned to help Tesco customers. We expect a return to profitability for the Bank in the current year, with the pace and the scale of recovery depending on the economic conditions.

Asia

We completed the sale for £8.2 billion of our businesses in Thailand and Malaysia in December. This has unlocked significant value from these high-quality businesses. We subsequently returned £5 billion of the proceeds to shareholders through a special dividend in February this year and in addition, we made a £2.5 billion one-off pension contribution to the pension scheme. This contribution has eliminated the funding deficit, significantly reduces the prospect of having to make contributions to the deficit in future, and frees up around £260 million per annum of future annual cash flows.

I would like to thank our colleagues in Thailand and Malaysia who've served customers brilliantly well for 20 years and more, and built two strong businesses. I've no doubt that they will continue to prosper under their new ownership.

Sources and Uses of Cash

If we now move to the sources and uses of cash, this is the waterfall I've shown many times before representing how we think about the sources and uses in the business. The most material item, starting with £3.2 million cash generated from retail operations. We saw a net inflow from working capital of £450 million. The majority of this was driven by higher trade balances and higher colleague payables. It also includes around a £200 million drag from lower fuel sales, although this was fully offset by planned changes to our fuel supplier payment terms. Exceptional cash items were £41 million in the year, with the largest components being costs associated with legal claims, partially offset by the refund of historical ATM business rates payments.

Cash CAPEX was just over £900 million – we've provided the usual breakdowns by region and type in the appendixes – and net interest paid of £670 million was broadly in line with last year. Cash tax paid in the year was £161 million. This was around £60 million lower year-on-year due to lower profits and a tax deduction relating to the one-off pension contribution we made.

We had a net cash outflow of £110 million in the year, relating to the buyback of 19 stand-alone stores and two distribution centres. This included the cost of buying back our partner stake in the Tesco Property No 2 Limited Partnership. Overall, this resulted in a retail free cash flow of £1.2 billion.

Retail Free Cash Flow Year-on-Year

This next slide is an additional one that I've added to describe the moving parts in our retail free cash flow performance year-on-year. At a headline level, free cash flow was around £500 million lower, with last year including £277 million of proceeds from the sale of our Gain Land associate in China, as I mentioned earlier. If we look through this one-off impact, free cash flow was down around £220 million year-on-year as lower cash profits and a higher level of store buybacks were only partially offset by the strong working capital performance and the lower exceptional cash items.

Total Indebtedness

Total indebtedness was £13 billion, down £1.9 billion year-on-year, primarily driven by the one-off pension contribution. The total indebtedness ratio was 3.6x at the year end, compared to 3.1x last year. This increase was driven entirely by the impact of COVID-19 on retail EBITDA and the rise in the underlying IAS pension deficit. As a reminder, the IAS19 deficit is independent from our actuarial pension deficit and does not drive contributions to the pension scheme. The Asia transaction had a net neutral impact. We remain committed to a strong balance sheet.

Liquidity and Debt Profile

We have proven access to the funding markets and we continue to take actions in the year to manage our debt portfolio. We have access to £2.5 billion of committed facilities which are undrawn, and we have significant cash liquidity of £2.1 billion. As you can see from the chart at the bottom of the table, we have a smooth repayment profile in the coming years, with annual maturities of well under £1 billion.

Integrating Sustainability

Tesco is a leader in our commitment to sustainability and we see our financing as part of those commitments. In October, we renewed our committed revolving credit facilities, linking the rate of interest payable to the delivery of three of the Group's ESG targets: on emissions, renewable energy and food waste. This was the first RCF in the UK with science-based targets. In addition, in January this year we were the first retailer to issue a sustainability-linked bond, achieving a coupon of 0.375% on a €750 million issue with an 8.5 year maturity. The risks associated with a changing climate pose a serious threat to how we operate as a business and form an important part of our strategic decision-making processes. You'll see a more comprehensive disclosure from us as we report TCFD in our annual report this year, and we will continue to enhance government and – governance and disclosure in future years.

Summary

In summary, we're well set to build on the strong momentum into the current year and beyond. We expect a strong recovery in profitability and in cash in the year. Our best estimate is for retail profit to recover to a similar level as in 2019/20 and for Tesco Bank to return to profitability, while, having said this, significant economic and consumer uncertainties remain. We remain a highly cash generative business and we are committed to retaining a strong balance sheet.

Before I hand back to Ken, as he said, with my imminent retirement at the end of the month and with Imran joining in a couple of weeks, I wanted to close by saying that it's been an honour and a privilege to be part of Tesco for the last six and a half years. I'd like to thank all of you on the call for your support and, sometimes, challenge over the years, and to all of my colleagues who I've enjoyed working with enormously. The business is in great shape.

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

My Perspective

Ken Murphy

Chief Executive Officer, Tesco Plc

Thank you, Alan, and thank you sincerely for all the amazing service you've given the business over the last six years. It really has been a privilege to work with you and I think I can safely say you've left the business in a lot better shape than you found it, as evidenced by the strength of our balance sheet. I also have to say that this year, even though it was Alan's final year in the business, he was instrumental in completing the deal in Asia, which I think everyone will agree was a fantastic deal from a shareholder perspective and generated a lot of value, so thank you for that also. And we're all a little bit jealous, we wish you the best of luck for the future in your retirement.

The First Six Months

So, moving on to my perspective, I plan to do this in two parts: talk a little bit about the last six months and what we've done, in concrete terms, in terms of building our platform; and then talk to you a bit about what that means for the future and where we see value and opportunities.

So, as I said at the introduction, I believe genuinely I've joined a great business and a team full of everyday heroes who really do simple things brilliantly for customers, and despite the conditions, despite personal risks, continue to do so day-in, day-out for customers. I've already mentioned some of the statistics around what we've done for colleagues and what we have done for customers. And by focusing on doing the right thing for customers we've really moved the business forward very materially, and I'll show you evidence of that in just a moment. But it's just a clear demonstration of the old adage: if you look after your people, they look after your customers; the business inevitably wins.

So, what's the practical demonstration, from an investor perspective, of all the things we have done during the year for customers? And for communities, by the way, because, of course, we doubled our donations to the food banks over the year; almost £60 million worth of food donated to feed local communities who were suffering food poverty of one sort or another. Well, the good news is it's really shown up in business results and the fundamentals that are very important for this business. We've gained share over the period, we've strengthened the brand, we've improved customer satisfaction, we've improved value perception and, of course, as mentioned earlier, doubled the size of the online business. Let me address each one of these in turn.

Market Outperformance

So, really, you can see, over the past 12 months, not only have we outperformed but we've built momentum as we've gone, and actually our final quarter was our strongest in terms of switching gains. And we've gained from all our key competitors, as you can see from the slide.

Brand

And the brand is in great shape, it's in the best shape it's been for ten years, with the overall brand health index moving forward by over 400 basis points year-on-year. And what's particularly pleasing for me is that it hasn't improved just on one dimension, it's been an improvement on every dimension: on impression; quality; value, of course, which is critical; reputation; customer satisfaction; and, of course, the acid test, would you recommend Tesco as a place to shop to friends and family? And you can see that the improvement has been material across every one of these axes, which shows real quality and underlying strength in the brand.

Customer Satisfaction

And customers have demonstrated that also in terms of how they feel about the shopping trip and the quality of that experience. And it's really indicative to me that in a year of a pandemic, where we had to limit the number of people in store at any one time – we had queuing systems outside the door, we had social distancing inside the door – every one of our customer satisfaction metrics moved forward during the year, with over 4% improvement in 'ease of shop,' 4.5% in 'clean and tidy,' 2% improvement in 'I can get what I want,' despite, for the first three weeks of last year, we had a Christmas every day that was unplanned for in terms of demand planning. 'Prices are good' moving forward by nearly 5% – real validation of our pricing strategy – and a 5.8% improvement in 'I don't queue,' which is really a testimony to the commitment of our colleagues, but also how we're building out our platform beyond the store environment into the online world as well. And, really, particularly pleasing to see that colleagues are helpful, so despite the pressure that colleagues were under, despite the huge increase in demand, despite the stress of making sure everyone was wearing a mask, etc., etc., our colleagues found time to be even more helpful to customers during the past year.

Value Perception

And we're seeing it, of course, in our value perception. Our value perception's been the best it's been for ten years; you can see there's a growing white space between us and the market in terms of that perception. It's momentum we plan to build on. We're very committed to our value positioning.

Online Growth

And then online growth. And I'd come back to that to leave it to last for a very specific reason. We have almost doubled the size of our online business. It's now a £6.3 billion business. We have had by far the largest quantum growth in the market and, of course, enjoy a market share of 35% online versus about 27% in the store estate.

My Guiding Principles

1. Customer satisfaction

So let me talk a bit now about the looking forward and how I see the future, and start with the guiding principles really that are going to really shape how I think about Tesco and the future. I think the first, and hopefully you've gotten a good sense of this over the last six months, is that customer satisfaction is where I always begin and end. It's the most important thing in my view, for any retail business, any service business, is that your customers are happy and feel that you're looking after them.

2. Market share

The second is market share. This is a brutally tough market, the grocery market in the UK. It's full of very strong competitors. And, in fact, some of our most dangerous competitors are international brands with huge, huge resources. We have competitors now with market cap of over $1 trillion and other competitors across their group have turnover in excess of €100 billion. So, we really have to re-establish what made Tesco famous, which is the challenger brand mind-set. And that's something that I'm really keen that we inject in everything we do.

3. Cost & capital discipline

The third is that we maintain throughout our, kind of, plans rigorously focused on cash efficiency, and making sure that we maintain capital discipline throughout. As a low margin retailer, we cannot afford to be profligate with money. We need to be really tight. We need to be able to spend money in places that only really matters to customers.

We believe, by the way, that we can achieve our plans and ambitions by maintaining broadly the capital spend targets that we have outlined previously.

4. Shareholder returns

And then finally, but definitely not – last but not least, we are firmly committed to returning excess cash. We are deeply committed to our shareholders. They own our business. We think they are incredibly important to the health and the future our business. I hope that you will see a demonstration of that commitment through our decision to maintain the final year dividend in line with last year despite the falling profit numbers.

It's also, I believe, a demonstration of our confidence in the future of the business and our ability to generate sustainable cash flows over the long-term.

Sustainability

And then finally, I'd like to speak about our commitment to sustainability. Our sustainability and our ESG agenda is no longer aside and as part of the Little Helps Plan. It has been truly integrated into everything we do as a business. And it will show up in everything from our product innovation through to how we think about our operating model. And you will see it show up in our commitments to net zero, which I'll speak about a bit later.

The Tesco Group

Let me start by just reiterating our commitment to the Group that we have and the businesses within it. There's a couple of important points to make here. The first is that I believe that there is a lot of value inherent in the different components of the Group. And I see a lot of opportunity and potential in those. But I see even more opportunity by harnessing some of the strengths of each members of the Group to benefit the whole Group and leveraging those strengths across the Group. And over the next six months or so, you'll start to see examples of that show up in the initiatives that we land on the ground.

I don't believe that our strategy will consist of any form of geographic expansion or large-scale acquisition, but really getting the most out of the business we have will be absolutely critical to that.

Reiterating Our Commitment to Value

I'm starting to look forward with a reiteration around commitment to value, because I think that underpins everything we do. I think it's directly correlated with our ability to maintain market share. And that is absolutely essential to anything we want to do on the growth side. So, the first thing to say is that you can expect us to maintain our investment, maintain our commitment to great value. And clearly, the current mechanic is the Aldi Price Match. It's working very well for us. We don't know what it will be in the future, but for the moment we're very happy with this and it's really doing the job it's designed to do.

The second thing is that it's not good enough just to reduce prices. You also have to make it obvious to customers and you have to make it easier for customers to find. So, we've reduced the number of promotions from 36% to 21%, so less of a high-low strategy, much more of an everyday low price strategy, so customers can rely on the value from us and don't have to wait for when things are in and out of promotion.

The second thing is that we have removed a reasonably significant number of SKUs to simplify our range, improve our availability. But in that range review process, we've added 32% more space for the products that are matched against Aldi. So, this is not something you will find at the bottom right-hand corner of the shopping aisle. These are things that are really easy to find. They are obvious to customers. They're products we want customers to buy. So, this is a real clear demonstration that we are properly committed to value.

And as you can see from the middle chart, we have consistently held that right through the second half of this financial year just gone.

Clubcard Prices – Rewarding Loyalty

The second value initiative, although it's much more than a value initiative, of course, is our Clubcard Prices. This really has two main strategic objectives. The first is to re-inject a sense of excitement and value into the Clubcard itself. You may remember a few years ago, we reduced the number of points available for customers through the Clubcard and we felt it was really important that they reappraise the Clubcard as something that really rewards them for shopping with Tesco. We're really pleased to say that we've seen a 12% increase in Clubcard penetration in our larger stores since we launched Clubcard Prices, so really a significant move up to almost 80% of transactions.

But the second purpose, which has really got much more long-term strategic value is the migration of Clubcard from being a physical card proposition to a digital one. And over the same period, we have more than doubled the number of active users on the Clubcard app to over five million. And that really is the thing that excites me the most, it is that thing that I think gives us the greatest potential for the future.

And as you can see, I've just jumped ahead one of my slides. But it is the – these charts are just simply illustrating what I have just said.

Clubcard Prices – Building a Digital Platform

The last thing of course to note is how customers feel about what we've done. So, as you see, there's been a 12% improvement in Clubcard perception in terms of, 'The offers are personalised to me, so I feel like you're speaking to me directly in a way that's relevant,' and a 7% increase in the perception that, 'You're rewarding me for shopping with you.'

Increasingly Digitally Focussed

So as I mentioned, we are increasingly becoming a digitally focused business. Clearly, the last year has given our digital ambitions a massive stimulus and created an inflection point, where we now have £6.3 billion of profitable online grocery sales. We have unrivalled reach in the business, greater than 99% coverage, practically everybody in the country. And we have a really flexible model.

We have really worked on our Click & Collect model and that now accounts for almost 25% of our online sales. We, of course, continue with our CFCs and they continue to do a very important job for us. And of course, laterally, we are trialling the urban fulfilment centre, which is about six months into its trial now and is hitting its productivity targets. And of course we land a second, even larger UFC in Lakeside next month, where we will be pushing the kind of capabilities of the UFC even further.

We generate about 16 million visits to our website every week. And we have 20 million Clubcard households, which gives us an incredibly rich seam of data and insight into our customers' needs. And as I mentioned earlier, we now have five million active users. So, this is a platform that many pure-play digital businesses would kill for. When you combine this with our incredible store infrastructure, where we service an extensive convenience network, where we have supermarkets and metros in town centres, and then when, of course, we have the large out-of-town hypermarkets, plus this digital platform, you can see that we can create a network and an ecosystem that can provide the ultimate convenience to customers.

Add that to what we can do with Booker through our wholesale capability and the way we serve local retailers and what we can deliver by way of financial services through our bank, and you're starting to get a sense of what's possible through the Tesco environment.

Digital Platform Opportunity

Customer proposition

The way I like to think of it, and the digital platform opportunity that I've just articulated, is in three distinct but interrelated ways. The first and foremost, of course, is the customer proposition. I've already talked about more ways to shop. We really believe that over time we will be in a position for shoppers to be able to shop us when they want, wherever they want, however they want, and at short notice as short as they like. And we believe that that will be truly transformational.

The second thing is that through our insight and our digital Clubcard platform, we'll be able to increasingly personalise the experience. We'll be able to make sure that the products that they're most interested show up on their landing page. We'll be able to make sure that only the kind of inspiration around recipes, nutrition, offers that really matter to them will be what they receive. We'll be able to make sure that the value they seek on the products that they are focused on will be what they get. So, we see a much more relevant proposition in a very time constrained world showing up.

And of course, we're going to make it more efficient for them, because the ease of shopping with us will be seamless and completely versatile to suit and work around their agenda, and as I said, more immediate. We're working hard to make sure that we'll be available on an on-demand basis. The UFCs already can process an order from receiving that order within eight minutes, which truly transforms our capability to respond.

Supplier proposition

The second bucket is the supplier proposition. And so just as for customers, we'll be able to offer a more tailored and personalised experience. We believe we'll be able to offer our suppliers also a much more agile relationship than they've had in the past. We believe that if they behave and work as partners to Tesco, they will be able to access a platform that will give them much more insight into how customers perceive their products, what customers want from their products, which will inform their innovation agenda, inform their pricing agenda and their value agenda, and also give them great flexibility about what shows up in a physical environment versus the digital environment.

We will allow them to innovate and to trial directly with customers, and also to establish potentially premium products through a digital platform that you would never stock in a shop. So, we really see a huge opportunity through this digital platform with suppliers, and we're only in the infancy of exploiting that.

Operating model

The last one is the operating model. And ironically, through the conversations we've had over the last six months, this is the one that seems to have got all the focus, particularly through the conversations around the UFC. But as you've seen, it's really only one dimension of a multi-dimension opportunity and strategy. But clearly, the operating model is the underpinning for what will allow us to fulfil the first two bubbles. And so we're very focused on that model being much more flexible, being faster, being simpler, very obviously cheaper and more profitable to serve, and then ultimately better. And who knows what's possible if we develop a really compelling operating model that's seen as best-in-class in the world.

All of that really can be encapsulated through our desire to create a network effect and a flywheel that accelerates customer's perception of their relationship with Tesco through a simple strap line that says, 'The more I use Tesco, the more use Tesco is to me.' And it really is in that spirit of service of the customer that we have developed our strategic thinking.

Sustainability – Integral to Commercial Strategy

But of course, as I said earlier, that is also only possible if we maintain a really, really strong focus on our sustainability agenda, and as I said earlier, that agenda is now completely woven through our strategy and our strategic intent. Everything we do, from product innovation, to some of our broader commitments, has our sustainability agenda woven into it. I think as we mentioned earlier this morning, we now have over 350 plant-based meat alternatives, and we have a commitment to increase sales by 300% by 2025. As you know, we announced that we have removed almost 50 billion calories since 2018 by Christmas 2020, and we've just established a new commitment to increase our proportion of sales of healthy products to 65% by 2025.

We also believe, by the way, that our digital platform will really help us unlock this with customers by being able to provide them with inspiration around healthier diets; offer them nutritional values on the products they buy today; and of course, give them recipes and inspiration for how they can eat even better than they do today.

And, of course, we're working very, very closely with the World Wildlife Fund with the long-term goal of having environmental impact on the shopping basket. And we're already 11% away towards that target.

Sustainability – Net Zero

And of course, I'd be remiss if I didn't talk about our commitment to net zero. We've already accelerated our commitment to net zero from 2050 originally, now to 2035. And there's a number of factors that will contribute to this. First and foremost, we have been taking a leading position and planning to continue that position on the reduction of food waste. This is something very close to my heart. It's something we're deeply committed to as a business. And I think we've demonstrated real progress on over the last couple of years. And clearly, we're also demonstrating that through our partnership and commitment to 10-20-30.

Secondly, of course, there are the four Rs, which is how do we remove unnecessary packaging; reduce the amount of it that we use in our processes; recycle what we do use; and reuse whatever we can. They are fundamental to us making any progress on our packaging waste reduction.

We're also participating in a government-sponsored initiative to electrify Britain. Our personal part of that commitment is to make sure that our home delivery fleet is fully electrified by 2028. And of course, our commitment to energy efficiency is continuous. We are constantly upgrading the technology in our stores to optimise our energy efficiency through our chillers, through our light and heat, and of course, the use of sustainable energy sources such as solar power.

A Workforce Representing Our Community

I started this presentation by talking about our colleagues and I want to end on that note as well. One of the other clear commitments that we want to lead on going forward is that we have a workforce that represents the communities we serve. We don't attach any labels, we don't attach any badges, we don't look for quotas or any other kind of, what I would describe as 'metrics.' This, for me, is a simple principle of, that when your customer walks through the door, regardless of where they come from, or their background, etc., that they see a colleague workforce that represents them. And we want that to be at every level of the organisation over time. We're not there yet but we are deeply committed to it and we have concrete plans to get there.

Summary

So, by way of conclusion, I think it's fair to say that this has been a truly remarkable year for the business in every respect, one in which Tesco has really shown its colours but one which we have emerged from an even stronger business. We've outperformed the market, as you saw; we have built brand momentum; we have greater customer satisfaction and our value is at the best it has been for ten years. As we move forward, having created this fantastic platform, our focus will be on maintaining our eye on the basics; making sure we're great value, that we can hold share, but really building out on our strengths, which is our online and digital platform, our incredible loyalty platform and creating a huge amount of opportunities for customers, suppliers and partners to build a really powerful ecosystem that will drive growth and generate sustained and strong cash flows for customers – for shareholders. All the time, done by integrating our approach to sustainability and our ESG agenda into everything we do.

So, thank you for taking the time to join us this morning and to listen to our presentation and I believe we'll be opening up now, shortly, for questions.

Thank you.

Q&A

Operator: Thank you. If you wish to ask a question, please dial star 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 answered before it's your turn to speak, you can dial # to cancel. So, once again, that's star one to ask a question, or # to cancel. If you're asking a question, please remember to mute your online webcast to avoid any feedback. There will now be a brief pause while we register your questions.

And the first question comes from the line of Andrew Gwynn at Exane BNP Paribas.

Andrew Gwynn (Exane BNP Paribas): Good morning Alan, good morning Ken. Well, first off, Alan, best wishes for the future. I'm sure you're looking forward to a life without IFRS 16, or IFRS 9. Though, as Ken mentioned, obviously it was a pretty trying period to be CFO, so I think clearly a job well done, so best wishes for the future.

Alan Stewart: Thanks, Andrew.

Andrew Gwynn: Three questions, if I can, hopefully quite quick. But first, just thinking, let's say, in five years' time and reflecting back on what the business looks like today, what are those opportunities, do you think, that COVID has presented for Tesco? Obviously, online is an obvious area but perhaps thinking about the market share opportunities versus, perhaps, the discounters?

The second one comes back to online groceries, which I'm sure will be a bit theme. Every day we seem to read more and more about immediacy coming more and more into customers' lives, almost. Is that an area where you think there's a significant opportunity, or actually are you generally quite happy with the consumer offer from the online grocery business?

And then the third question, you talk about returning excess cash. I suppose a very simple and very blunt question is, how much excess cash can Tesco generate in a given year? Thank you very much.

Ken Murphy: Thank you, Andrew. So, I'll take the first two and then I'll ask Alan to comment on the third. So, first off, in five years' time I think what COVID will have done is really compressed five years of online growth into one year and I think that's probably the biggest opportunity.

The second thing, I think it has allowed Tesco's underlying values to shine through. So, we had an opportunity to put our money where our mouth is, in terms of how we looked after colleagues, how we looked after the safety of our customers and how we behaved as a responsible citizen in regards to the rates repayment. And all of these factors, I think, have contributed to a reappraisal of Tesco from a brand perspective.

I think our mission is to make sure that, in five years' time, customers still feel the same way about Tesco as a brand and that they see that we've lived our values through thick and thin. But I think COVID has been a good test and I think we've passed that test.

The second thing is that – and a little bit linked to your second question around immediacy, is that, for sure, this is a more digital environment, from a grocery perspective, than it was 12 months ago. Customers are increasingly seeing the value and the convenience of online shopping for grocery and they're seeing, actually, that it's reliable and effective. Our customer satisfaction scores, as it pertains to – specifically to online are also at the best they've ever been, despite the surge in demand. So, we believe that that's a very powerful platform to build on.

You're absolutely right, though, that this sense of on-demand and immediacy is a growing trend amongst customers. We're watching it very closely and we are looking to learn and adapt our model appropriately to that mission. We already have an on-demand trial up and running with our One Stop business and it's running successfully and preferably. And we're always looking at whether or not we should do it alone, whether we should do it through partnerships.

For now, we're watching and learning because the economics of it are quite challenged. They're not that obvious. But we do believe it's a trend that's here to stay and our view, always, is that we'll keep learning until we've got something that we think really works.

Alan, do you want to talk about excess capital?

Alan Stewart: Yes, in terms of excess capital, I think what I would say is that our capital allocation framework is out there and that remains the basis through which we look at things. First and foremost, we have to generate the cash from our retail operations and we've done a good job of that. We've focused on working capital as part of it. That will continue to be our focus and we've spoken about the opportunity and what we see for the year ahead in terms of the improvement in our operating cash flow, particularly from our retail business.

We have a CAPEX allocation. As Ken said, we're pretty clear that the framework we've given is the right boundaries of our CAPEX; £0.9-1.2 billion per annum feels appropriate for our business and that remains the case. We do choose, sometimes, to spend some of our capital on property. We look at that through a very economic lens and we always have. We try, also, to look at where there's value we can realise from property and sometimes those balance each other in a year. The year just happened, actually, we spent more on property than we generated. Looking ahead, we expect to get some property realisations, particularly in Central Europe, from our Polish business, where we kept some of the properties and we will sell them during the course of this year.

And then all of those leave the excess cash. We have a dividend which we pay to shareholders. At a pay-out ratio, everything else being equal, we are paying out half of that excess capital every year and we're committed to returning the excess to shareholders in a way which is, again, economically sensible.

So, it all starts with how much can we generate from the business. In a good year, growing the business, we are cash flow positive through working capital as well, so I think there's a lot of opportunity in the excess cash generation. Admittedly, the year we've just finished isn't a year that we can be talking about specific excess cash now. But, as I've said before, I absolutely believe that what we are is in a strong position to be a business which becomes a cash compounder.

Andrew Gwynn: Would you be prepared to give a figure perhaps on the free cash flow the business could generate? A figure around about £1.5 billion, would that seem reasonable?

Alan Stewart: It certainly – that's – Andrew, it depends really what your models are and what your projections are but certainly we're generating a lot of cash every year and it will be dependent on the underlying profitability. But we're a business which tends to think in billions more than in hundreds of millions.

Andrew Gwynn: Okay, thank you Alan and all the best, again. Thanks.

Alan Stewart: Thanks.

Operator: Our next question comes from the line of Andrew Porteous at HSBC.

Andrew Porteous (HSBC): Hi team and obviously, first off, congratulations Alan on a successful tenure as CFO and all the best for your retirement. I hope you enjoy your time.

Alan Stewart: Thanks Andrew.

Andrew Porteous: Three questions from me. The first of those is you've talked about market share. Do you expect Tesco to gain market share going forward and would you see market share losses as a failure of the strategy?

Second, you talked about – a lot about digitalisation, personalisation. That's clearly going to be a big focus of the business. Do you have any evidence on what that could bring to the business? What's the opportunity to grow sales through that, or the share of wallet, for example?

And then, a last question, hopefully a quick one: does online growth in the future mean margin dilution?

Ken Murphy: Thanks Andrew. So, I do believe market share is important because I think it's the basis on which you can build out your platform and your ecosystem and it's a demonstration of customer satisfaction with your proposition. So, I think that's important to say.

I think it's equally important to recognise that, as some of the tailwinds that we've had in the last financial year reverse, we may see some temporary dips in market share over the 12 – next 12 months. But sustainably, over the long term, my belief is that, as a minimum, we need to be holding share. And that's something that we will be heavily committed to. I think that also underpins confidence over the long term that we can sustainably generate cash. I think that's an important component of it.

In terms of personalisation, I don't want to get into specifics around the profits it may generate for obvious competitive reasons but what I can tell you is that if you look at examples of how this is done well around the world, they are material and considerable in terms of the impact it can have on the P&L of a retail business. And there is significant growth in them, because you're tapping into revenue streams that are not accessed today through a normal relationship with suppliers. And so, done well, they provide a fantastic opportunity to grow your revenue base without any cannibalisation effect. So, I'm pretty excited about the possibilities in this space.

And then the third really is – it's an interesting question, Andrew. All things being equal, you would expect a partial reversal of online growth this year, as more people choose – as much out of – for novelty as for anything else, to shop instore rather than online. But, as we've seen in other markets and other categories, the rise of online is inexorable because it is highly convenient. And as the quality of the interface between customers improves, as it becomes easier and more flexible and more intuitive to use and then also as the economics improve, as we make it more and more efficient, I believe that the online channel will continue to grow in importance for us as a business and will be a material contributor to profits over time.

But I want to finish by saying the beauty of the Tesco model is actually because it has such a comprehensive store estate across the convenience format and the large store format and online, it actually doesn't matter to Tesco. We will be able to service the market whatever way it turns.

Andrew Porteous: Thanks. They were very helpful answers.

Ken Murphy: Thank you, Andrew.

Operator: Our next question comes from the line of Sreedhar Mahamkali at UBS.

Sreedhar Mahamkali (UBS): Yes, good morning. Thanks for taking my questions. Alan, as with others, congratulations and all the best for your retirement.

Alan Stewart: Thanks Sreedhar.

Sreedhar Mahamkali: So, the three questions are, I guess, Ken, I think you talked about returning to a challenger mind-set. I guess what's in my mind is, from that perspective, do you think the cost structure and hence the industry-leading margins that Tesco targets and achieved, stripping out and adjusting for the COVID impacts as we see them now, are they in the right place? Or do you see the need to add more cost to the business? Or is it actually the opposite, do you see potential to simplify further and improving the margin as you take it to a three year view? So, that's the first one, just reconcile those two for us. Maybe there are – they don't need reconciling.

A second one is, I guess you pointed to quite a lot of interesting stats, building on Andrew's point there, on digital assets, in terms of 16 million visitors and 20 million Clubcard holders, etc. And we actually now see some of your global peers generating significant media revenue and profit streams, and they're certainly a lot more vocal about opportunity. And some of your peers in the UK, at least one, seems to be making good progress there, too. Do you have any more visibility? Can you talk us through what your plans are in terms of monetising what you talk about as a very strong platform?

And maybe third one, just in terms of the capital allocation, I guess it's a really important one for a lot of investors. Alan, you've talked about a highly cash generative business, and I think Ken, you also referenced a very strong balance sheet. You clearly have enough visibility on the profit side as you look forward, even with your guidance, to bridge to a significantly lower total indebtedness ratio over the next year. So, from a shareholder perspective, can you discuss why you couldn't look through what is an exceptionally and unusually high gearing ratio this year and return cash? And that would help us form our views over the next 6 months or 12 months what you might do or what you mightn't do. So, those three would be very helpful, thank you.

Ken Murphy: Thank you very much, Sreedhar. Actually, I will ask Alan to comment on the last one first, and then I'll add my comments to it, and then I'll talk to you a little bit about our view on margin costs and media income.

Alan Stewart: Certainly, Sreedhar, and you're right, you do talk about the indebtedness ratio and the elevated nature at which we're looking at it now. And that's certainly a factor that we took into account in thinking about returns about our overall balance sheet position and about where we are.

I think we considered very clearly whether the – policy is important in all of this, because policy gives some element of consistency and predictability. So, we thought long and hard as to whether the dividend that we should pay should be a policy dividend. But in the event, and because of the exceptional year, we felt that we should make an exception to our policy, and we should pay out a dividend to shareholders, level on the year before. That cost us around £300 million of extra cash, just to put it in pence per share terms. A policy dividend pay-out would have been 5.97 pence for the full year compared with 9.15 pence, so around two-thirds of what we're paying out.

The important thing I think is that we are committed, and remain committed, and we very clearly stated today that we will return excess capital to shareholders. The year ahead is one where there are uncertainties. I don't think any of us, on this call today, certainly, not any of us around the room really know exactly how the UK and our other market environments are going to play out over the course of this year. And I think it's important that we continue to focus on customers, continue being able to react to them off the basis of a strong and stable foundation. But I've got no doubt that capital returns will remain high on the agenda. And the speed and rate at which we are able to translate that intent into reality is something which I certainly will be looking at very, very closely from my retirement cocktail on the beach in Lyme Regis, I guess.

Ken Murphy: Thanks, Alan. So, on your other two questions, Sreedhar, first on margins and cost. I think that the important thing, as I said at the outset, is that we maintain a very competitive position from a value point of view against the market. And that means that per se, we will not be held to a margin target at all costs. I think that what's more important is the cash profit we can generate as a business. So, allied with that, and clearly, one doesn't go without the other, we will have a relentless focus on costs. And I can tell you that as a retailer and as a business, we're already very focussed on costs and we have a number of cost reduction plans in the pipeline over the next three years, ones that we plan to supplement and augment over the next 12 months.

So, if you like, it is definitely a case of we will be relentlessly focussed on cost reduction and efficiency, but that it will be also really important that we stay competitive on prices, that we stay close to customers and really focus on generating that bottom-line cash return rather than being held hostage to a single ratio within the P&L.

Sreedhar Mahamkali: So, can – does that – you basically are still suggesting there is still a significant cost savings potential in the business and it's not been all taken out effectively.

Ken Murphy: Well, I think that it's an ongoing process. I think what I can tell you is that there's been a lot of cost taken up. And as I've come into the business, I have seen no let-up in that, and it's one that we constantly work on. So, I don't think you should expect any kind of grand announcement of a specific cost reduction programme, but you can rely on us to be relentlessly focussed on cost reduction as a consistent theme in our business.

If I come on to personalisation and media income and opportunity, etc., I think it's also fair to say that we also see significant value in this, but it's early days for us. I don't want to give a specific figure at this point, but I would also say to you that we see it as an even broader opportunity than simply media income. We see it transformative in the way our customers see us and the nature of our relationship with customers. But we also see a transformation in the nature of the relationship with our suppliers and the different services and capabilities that we can provide for suppliers on the back of this digital platform, which we believe will also create a lot of efficiency in their business models.

Sreedhar Mahamkali: Thank you.

Operator: Our next question comes from the line of Victoria Petrova at Credit Suisse.

Victoria Petrova (Credit Suisse): Good morning, and thank you for taking my questions, I will have three. First, is again on online. And actually, if you want to stop us asking those questions around profitability, when are you going to start reporting it? It's a £6.3 billion business. You report Central Europe, which is less than £4 billion. I think it would be very helpful. Do you have any plans to do so? And then depending on that, could you maybe elaborate a little bit on various profitability per online channel, like Click & Collect versus regular versus potential immediate propositions you are considering. And also maybe additional economics or any disclosure on your urban fulfilment centres, except for the [inaudible] fulfilment of online order, would be extremely helpful.

My second question would be around one-offs of 2020 – calendar year 2020. Do you expect discounters to ramp up? Have you been seeing any extra activity in lower COVID restriction quarters within the market share? Do you think you benefited from discounters losing market share, having lower SKUs in sub-prime locations or do you think your market share gain which you showed in your presentation versus the discounters is sustainable and driven solely by your online proposition and your Aldi Price Match strategy? If you could elaborate on that it would be extremely helpful? Thank you very much. And all the best to you, Alan.

Ken Murphy: Thank you, Victoria, always very insightful questions. So, on online profitability, we have done the modelling both on a fully allocated basis and also on an EBITDA basis, and the business is profitable on both measures. We don't disclose online profitability for the same reason we don't disclose the profitability of our convenience formats or any other subset of our business in the UK. So, it's not a question of scale, it's just a question of the fact that it's a part of our business model rather than a business unit in its own right.

I think that brings me on to the second point, which I think is really the important one when you think about online profitability. And the first thing is that it shares assets, it shares stock files and product, it shares colleagues with our larger stores. So, it really is an integrated part of our total proposition as well as a channel.

The second thing to say is that as we talked about in terms of the opportunity that this channel will give us in terms of the nature of our relationship with customers, the opportunities to build out that business model through other categories, through other platforms, and the ability to change the nature of our relationship with suppliers through this platform, I would really ask you to look through the online business as it is today and see the much greater potential that it provides the total business as a platform, rather than just as a trading channel in its own right. I know that doesn't make your modelling any easier. But actually, it is actually a reflection of the real value of this platform rather than just the delivery model in its own right.

If I move on to the kind of – and the second and third questions are a little bit linked in terms of the eat-in[?] versus other missions that we're seeing through the online channel. And by that, I'm assuming you're talking about the rise in the on-demand model and the takeaway model. Look, we are watching this with great interest. We have established a couple of small partnerships and trials that we're just running; they're not really worthy of mentioning until we have concrete facts and evidence. It's something that we respond to as we see the demand grow. I'm curious about it, because I think the economics are quite challenged when you look at the premium pricing that's applied to these on-demand missions plus the delivery charge. I think that what people are willing to pay in a lockdown may not be the same that people are willing to pay in a world post-lockdown. So, I think it's a space worth watching and keeping an eye on, but I don't think it's a given that the model will grow at the rate that we've seen over the last 12 months.

The final question, which I think is a really interesting one, is, look, we're highly respectful of the discounter model. It's obviously had exponential growth over the last ten years. It's done so through an incredibly disciplined ones-size-fits-all box with a very low number of SKUs, highly efficient, highly cost-effective, and they've used disintermediation in terms of dropping those boxes between customers in our larger stores, so it's very smart.

It would be interesting to see what happens in the future, where a lot of people will have written off our largest hypermarkets as a mission of the past, which have now come back into their own with the explosion of the online grocery business and the efficiency that we've been able to generate through that combination of store and online fulfilment, of which of course the UFC is a component.

So, I can't tell you for sure how the discounters are going to respond. We haven't seen any evidence of it yet. All I can tell you is that we are deeply committed to our strategy, deeply committed to maintaining very strong value in the market, making it unnecessary for customers to go looking for value elsewhere, and making sure that the ease, convenience, the versatility and the breadth of our offer attracts and keeps the customers we've won over the last 12 months.

Victoria Petrova: Thank you very much.

Ken Murphy: Thank you, Victoria.

Operator: Our next question comes from the line of Clive Black at Shore Capital Market.

Clive Black (Shore Capital Market): Good morning, gentlemen. Thank you for your time, and very best wishes again and thanks to Alan. You will be pleased to know, Ken, that I have supported the White Lion pub in West Covey and have a chill for my persistence.

Ken Murphy: Good man, Clive, I wouldn't doubt you.

Clive Black: I just have the one question, which given the length of the Q&A here, it probably might be a good model for analysts going forward, but I want to concentrate on the capital allocation framework again, if I may, and direct my question really to you, Ken. Just, first of all, in this respect, how do you see the mechanism working for the capital allocation framework? Up to now, you – the previous management, Dave and co talked about share buyback being the preferred route to distribute surplus cash. And maybe also, what sort of timescale you are most comfortable with to actually commence the distribution of surplus cash. And in that respect, what sort of conditions do you feel would be most comfortable for you to commence those? Thank you.

Ken Murphy: Thank you very much for the question, Clive. And of course, for me what's important is that our shareholders see a sustained cash flow and dividend return from their investment. And that can happen, as you know, in a number of different ways. And this year, obviously, because of the exceptional size of the proceeds from the sale of Asia, we chose to give back by way of a special dividend and a share consolidation. And then for me what's most important next in line is to make sure that we are delivering some consistency in our dividends and the cash returns to shareholders.

As you know, Tesco was able to restore the dividend over the last couple of years. And I felt it really important that we were able to sustain that this year; despite the fall in profits, that we maintain the dividend.

So, I hope that that's taken of an indication – as an indication of my serious intent to maintain some sort of consistency of returns to shareholders.

We have a capital allocation framework published that I think everybody is aware of. And unfortunately, largely because of conditions outside our control – the pandemic and the pension deficit – we're not in a position to announce buybacks at this stage. It's something that, clearly, we know there's a strong desire for. We are very keen to start returning cash as and when it makes sense from that capital allocation model. I can't give you a precise timing at this stage, Clive, because it's contingent really on the environment and the economic conditions over the next 12 months, which from my view point remain highly uncertain. But that it is very, very close to the top of our agenda, I can promise you that.

Alan Stewart: Clive, if I can just build on it, we spoke in the past about the basis on which and how we look at share buyback versus special dividend. And certainly, Ken and I have spoken about that as well, and I think we're absolutely aligned in terms of the theory, if you like, behind, when does a share buyback make sense compared and when a special dividend makes sense. And I've been clear my personal preference generally tends towards share buybacks rather than special dividends, unless, of course, there is something inherent in the share price, and there are number of reasons which we're very happy to discuss separately and remind people as to why I think that. But I think that remains the way in which we will think about excess capital beyond the dividend.

Clive Black: And just by way of supplementary, do you expect that Imran Nawaz will be aligned to your thoughts, Alan and Ken?

Alan Stewart: I'll let Ken answer that. I can't answer for Imran, but I'll let Ken answer.

Ken Murphy: No, I think, Clive, that clearly Imran is a very seasoned professional and will join us in a matter of a couple of weeks, on the 1 May. My instinct would be to ask our investors and analysts to give him a few months to get his feet under the table, and then I'm sure he will tell you for himself.

Alan Stewart: I think it's always unfair to play somebody offside though, when they're barely on the pitch.

Ken Murphy: Well, they're not even on the pitch.

Clive Black: That's why I asked you the question, Ken. Thank you very much for your answers. All the very best.

Ken Murphy: Thanks, Clive.

Operator: Our next question comes from the line of James Umstead at Barclays.

James Anstead (Barclays): Good morning, everyone. I'll start by doing all the tributes to Alan, and I suppose the key one here is that when you started as CFO, the market was very focussed on the risk of Tesco asking for money from its shareholders. And now the debate is all about how much and how quickly you'll give it back. So, I think that's a very nice way to finish.

And on that topic, I think probably the very last angle on the capital return to explore, is you've clearly reiterated the commitment to return the excess cash. Apologies if I missed it, but are you still confident that 2.5x leverage yardstick you mentioned when you announced the Asia sale is still the right number to be thinking about? And I think there was some debate about whether, now you've essentially dealt for the time being with the pension situation, whether the pension deficit should still be included within that leverage calculation? So that's one question.

And the other one was around the pandemic costs. I think you talked about a quarter perhaps of last year's costs remaining sticky in the year ahead. Should we assume most of that in the first half? And to what extent would you be confident you can ever eliminate all those costs, or is a chunk of this likely to remain on an ongoing basis?

Alan Stewart: Ken, you're happy if I…?

Ken Murphy: Yeah, sure.

Alan Stewart: In terms of the leverage, the leverage target that we've put out is a function and a reflection of the fact that what we're trying to show is that what we want is a stable and strong balance sheet. And it's against that that we put out the leverage target. I've also been clear that we didn't see the achievement of that specific numerical number – which, remember, is a range as well – as being a necessary condition either to be before or after excess capital. But it's a factor that we take into account in terms of our overall thinking about the strength of that balance sheet and returns of excess capital to shareholders.

And then I guess, linked to that, is also the fact that the – within the target, we do have an anomaly in that our total indebtedness does include the IAS 19 Pension Scheme, which there's no expectation from us, or the trustees, that that will turn into a cash requirement of the business. But because of the transparency we wanted from our published numbers through to the – through to that leverage calculation, we've always included IAS 19. It's something we give a lot of thought to, will continue to give thought to, but it doesn't translate into cash. And in that sense, it's slightly anomalous in terms of a specific trace-through, if you like, from one to the other. So, James those are all the factors, but the essence behind it is the strong balance sheet and if you think about the slide I showed in terms of our bond repayment profile…really comfortable with the annual renewals and repayments that are required under that. And as we've seen this year, as we issue, we fill in going forward. So the 8.5 year bond we issued in January puts us again in a profile which is steady and predictable and manageable within any one year.

Ken Murphy: And then James, regarding your costs on the – question on the pandemic costs, you're correct in the sense that there will be a weighting towards the first half, for sure, but we do expect some of the cost to persist. We don't know precisely how much yet because it will largely depend on legislation, on whether there are any lingering risk of the pandemic re-emerging. So, we are reasonably conscious of that, and we're just being cautious about it.

James Anstead: That's helpful, thank you.

Ken Murphy: Thanks, James.

Operator: Our next question comes from the line of Nick Coulter at Citi.

Nick Coulter (Citi): Hi, good morning, likewise, all the best to Alan. Two quick ones, if I may, please. Firstly, on growth, would you be able to give a sense of the level of sustainable long-term, multi-year cash EBIT or profit growth that you think the business can deliver once we're through COVID into normal running?

And then, secondly, sorry to flog the capital allocation horse, but could I ask around store buybacks and how we should think about those in the future? Do those buybacks continue? Because obviously, that is something that has also pushed up the leverage ratio. Thank you.

Ken Murphy: Thank you, Nick. So, look, starting with the store buybacks, yes, you can expect us to continue with that policy. It's one we apply judiciously, so, where we believe that the asset is an asset for the long-term. I, personally, am a strong believer in owning your own estate, I think it's an important sense of security for any retailer and it gives you a lot more flexibility. And particularly, in an environment, if we see a return to inflation, then owning a reasonably significant proportion of your estate will become really important. So that, I think you can expect to see persisting.

I think on the EBIT growth question, even if I wanted, I don't think I'm allowed to answer that question, so.

Nick Coulter: Do you think that you can deliver – I mean, is measured growth your target? Or, I'm just trying to obviously look beyond the part that –

Ken Murphy: Yeah, I think that's –

Nick Coulter: – a second year flat growth of –

Ken Murphy: I think that's right, Nick. I think that's exactly what you should be thinking, is that it's a measured growth profile, simply because of course we've been – a) we're in a very mature market, in all our markets so that's a reasonable assumption to make. The second thing is that of course we've indicated capital discipline. And so, we are not going to be trying to spend an awful lot of cash to try and accelerate our way up the growth curve.

That said, we are excited about the growth opportunities. We are very conscious of the fact that the UK food and other grocery markets around our portfolio are brutally competitive, and so we definitely have to think laterally about the opportunities within our portfolio to make sure that we can sustainably grow revenues and grow profits. But measured growth is probably the right phrase to use.

Nick Coulter: That's helpful, thank you.

Ken Murphy: Thank you.

Operator: Our next question comes from the line of Xavier Le Mene at Bank of America.

Xavier Le Mene (Bank of America): Yes, thank you, gentlemen, for taking my question. And Alan, congratulations for the retirement. Two questions actually, if I may. Just back to competitive landscapes. You touch a bit about the hard discounters but I just want to understand how you see the Aldi price match going forward, because in a way, you could say you're more advertising Aldi than Tesco by doing it and you've also seen of your competitors copying you. So, how do you see it going forward? Is it something – a sustainable strategy for the long term or just a tactic for now? So what's your view on that?

And linked to that, too, is the level of promotion you have, which is around 20%, do you think it's a sustainable level or do you potentially expect the market to get back to a higher level? Maybe not to where it was, but to higher level of promotion going forward.

So, first question about that. And the second one is more for you as the new CEO, so, you've been six months into the role. So, any change from your initial view or thoughts before you joined Tesco? What do you see differently today from six months ago? Where do you want to accelerate, especially?

Ken Murphy: Okay, thank you Xavier. So, I think the first thing to say around the Aldi price match is that I think the fact that our competitors have chosen to follow us is a sign that it's effective and it's a form of flattery.

The second thing to say is that any initiative on pricing that lasts more than six months goes from the tactical to the strategic. As you know, we're in a very reactive market, a very dynamic market, and therefore anything that you can sustain as long as this and shows demonstrable and sustained improvement in perceptions, is an effective strategy as opposed to a tactic. And it's one that we will sustain for as long as we absolutely see it working and when it stops working, then we have to shift gear.

The important thing to say about the Aldi price match is it has a very specific role to play, which I've alluded to before, which is that we use it to anchor our value perception and eliminate it as a negative reason why you wouldn't shop Tesco. And then we rely on all the other positive aspects of our proposition to win with customers and get them to come back.

So, it's never the strategy we lead on, it's never the thing that we think makes us famous, but we do think it's a really good anchor for our strategy. And we may have to change it and adapt it over time and absolutely I reserve the right to do that, but for now we think it's very effective. And whatever about the mechanics, we're committed to the investment from a financial perspective.

The second point is that the promotional participation of 20% is historically low. And for sure, an element of that is related to Covid. So, invariably, as the lockdown eases, as volume migrates back to eat-out away from eat-at-home, you're definitely going to see a reaction in the market to that and you're going to see higher promotional participation. That's almost an inevitability. But our commitment to everyday low prices through Aldi price match, means that we actually have to do less promoting because our value credentials are more firmly established. And because it's simpler, it's more visible in the store, and it's more reliable because it doesn't change with offers, we think it's a more powerful mechanic for establishing value. And then of course we have the Clubcard prices mechanic, which offers us the ability to be much more tailored in terms of what we promote to customers and make sure that our most loyal customers benefit from those promotional prices.

And then the third thing is the question around have my views changed in the last six months. Well, I think the fundamental views in terms of the inherent strength of the business, the quality of the organisation, the cultures and the values haven't changed. And if anything they've got stronger. The one or two things that have changed is definitely I've moved from seeing the online business as a channel to being a platform. And particularly when I combine what we're doing on Clubcard prices and the digitisation of our Clubcard scheme, then I see a huge opportunity that feels a bit different from the way I saw the business – well, dramatically different from the way I saw the business when I joined.

The last thing to say is that the economies of scale and the opportunities to work across the different businesses in the Group, to leverage the power of the Group, is also something that I believe we can do a lot more of. So, they're probably the biggest things that have shifted in my mind over the last six months.

Xavier Le Mene: Thank you.

Ken Murphy: Thank you Xavier.

Operator: Our next question comes from the line of Maria-Laura Adurno at Morgan Stanley.

Maria-Laura Adurno (Morgan Stanley): Thank you very much for taking my question. All the best to you, Alan. So, I only have two quick questions. The first one is, if you could perhaps give us some comments with respect to Booker for the type of underlying momentum that you started to see. And I fully appreciate this is a year of uncertainty but any comments that can provide us into the rest of the year would be helpful.

And the second question that I wanted to ask, given all the optionality around the Clubcard, is you now have 3,000 products, so I'm just wondering how you plan – if you have any targets in terms of expansion at the year-end and also in terms of the tailoring that you're providing to customers. That would be extremely helpful. Thank you.

Ken Murphy: Thank you, Maria-Laura. So, first of all, Booker. Booker, even though suffered a really challenging year in terms of the market, the wholesale market, because of obviously the huge contraction in the catering and the eat-out market which is an important part of its business, actually it was one of the star performers in the Group. So Booker grew its sales by 18% in its retail business, supporting all the community retail customers around the country. And although its catering business fell by 40%, it actually grew market share within the market. So it outperformed the market significantly and, of course, has maintained its real focus on customer service and looking after its colleagues. So, it didn't take a penny of government money, did a great job of looking after colleagues and improved customer satisfaction through the year. So, Booker, we think, is in great shape to have a good year this year as markets, and particularly the eat-out market starts to open back up over the next coming weeks and months. And we also increasingly see Booker playing an important part in helping the Tesco Group create a really strong network of convenience stores and learning from each other as we go.

In terms of the rest of the year, it's difficult and we describe it as an uncertain time ahead because that's what it is. We find it, at the moment, difficult to forecast at what rate customers will start to go back to eat out. Whether that will be sustained for a long period or whether actually there will be a burst of enthusiasm and they'll go back to eating more at home, we don't know. We also don't know how the return-to-work profile is going to look. We don't know to what extent people will seek to go back to the office, work from home. We think it will be a hybrid and that will impact demand, both in terms of our urban formats and our community formats, our online formats. And of course we don't know what, if any, travel will be permitted. So, we don't know what the holiday shape looks like this year and whether customers will be able to travel abroad to holiday or not. And my assumption is if they are allowed to travel, they will do so in large numbers.

So, we think there's a lot of uncertainty in the market that makes it really hard for us to give you a more accurate prediction. We have made lots of contingent plans. We're working very hard to make sure that we're as well prepared as possible, but it is probably as uncertain an outlook as I have seen in the short term. My long-term optimism is very strong for the business.

Speaking in terms of the 3,000 products we have Clubcard prices, what I've just mentioned is, we are in the process of rolling Clubcard Prices out to the rest of our general merchandising categories, and then finally we'll be rolling it into our F+F clothing range. So that will increase the number of categories and products included in the Clubcard Prices programme significantly during the year.

James Grzinic (Jefferies): – Good morning both and congratulations Alan on your retirement. Just quickly Ken, does the Path to Parity thinking still apply? I understand you are migrating towards more thinking holistically about margins, but there's a big delta between online and offline. Can you perhaps say whether the scale of the improvements open to the online business means a shift to online sales won't be dilutive from a mix perspective anymore, just simply because that base profitability can really improve meaningfully from here.

Ken Murphy: My optimism around the digital platform that has been created through the doubling of the online business and the Clubcard migration relates to the total income potential and not only the inherent profitability of the online delivery model. There are a number of factors that are kind of underpinning that optimism. I think the first is that we continue to improve the efficiency of the manual pick we have today. The second is clearly we have the UFC trials up and running and hitting some interesting metrics, albeit that clearly getting to scale is going to take a couple of years on those. And then thirdly, we have achieved about a 25% share of Click and Collect in our online business, and we're improving the customer experience in Click and Collect all the time.

But really, the substantial upside in the P&L as it relates to the online proposition and digital comes from all the other income streams that you can generate as a consequence of that platform. So, the way I would describe it to you, James, really, is that we believe from a holistic perspective, the online channel will be accretive rather than dilutive to the profit and loss over time. And that rather than look at one single component, which is the cost to fulfil, we should be looking across the broader spectrum of all the opportunities that it generates.

James: Great, thank you.

Ken Murphy: Thank you.

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

Ken Murphy: Okay. Thank you very much. Thank you again, everyone, for all of your excellent questions and for taking the time to join us this morning. I'd just like to, first of all, reiterate my thanks to Alan for again doing a sterling job for getting us ready for today, but not only that but the incredible job he's done for the business over the last number of years.

I want to close really by just restating what I think makes Tesco attractive as a business to invest in. The first is that I believe this business has really demonstrated its commitment to its values over the last 12 months. Through really challenging conditions, it has looked after its customers and its colleagues incredibly well, and we've seen the results of that in terms of our brand health, our market share and our top-line performance. And while we've seen a short-term drop in profits related to the exceptional cost that we've incurred during this pandemic, I believe the underlying strength of this business is even better.

We've really talked about the future in two parts. The first is really staying true to the basics and doing them brilliantly, relentlessly focussing on value and quality in the customer experience. But really the second, which we believe is super exciting, is creating this network effect through the combination of a really strong store network and a very exciting digital platform that we've been building for a number of years, but we've really seen accelerate massively over the last 12 months through the doubling of our online business and through the doubling of the number of customers we have using our digital app.

I think this is a very exciting time for Tesco, one of great opportunity, and although the short-term outlook remains uncertain and challenging, I'm hugely confident that the future of the business is very bright for the medium to long term.

So, thank you again for your time. Have a great day and I'm sure we'll see you all in person at some point in the future. Thank you.

[END OF TRANSCRIPT]