Tesco

Interim Results 2021/22 Presentation

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Transcript

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Ken Murphy: Good morning, everyone. And welcome to our interim results presentation. I'm joined today by our CFO Imran Nawaz. Good morning, Imran. This morning, I'll give some brief reflections on our first half. Imran will then talk you through the financial performance. And after that, I'm going to speak about our strategic priorities and performance framework going forward. Of course, we'll make sure there's plenty of time for Q&A at the end. Now it's just over a year since I joined the team at Tesco, and before we talk about the half, I wanted to reflect on the progress we've made over the last 12 months. First of all, in an extremely competitive UK market, I'm delighted that we've grown market share. This is the result of our absolute focus on customer satisfaction, which has stepped forward across all areas. In particular, we have delivered a consistently strong price proposition and maintained great availability, despite some significant industry challenges.

Ken Murphy: Secondly, we've strengthened our digital platform. Combining our digital assets with our unrivalled store network enables us to create even more value for customers, our suppliers, and in our own operations. We've retained a significant proportion of the customers we gained online through the pandemic, and with more than 20 million club card households and nearly 7 million regular app users, we are better placed than anyone to benefit from the profound shifts underway in retail. And lastly, all of this is underpinned by our commitment to sustainability, which we know is increasingly important to all our stakeholders. We have put sustainability at the heart of our business and made it a core consideration in all of our decisions. As I said in April, customer satisfaction is always first and foremost. We've made great progress, seeing movements across every metric.

Ken Murphy: I'm particularly pleased that our consistently strong value proposition is being recognised and that we've been able to maintain a great shopping trip despite the supply chain challenges in the industry. This shows that we're getting the basics of retailing right, and is a huge testament to our colleagues who continue to work day in day out to give customers a fantastic experience. You can also see the impact of this great work in the year on year improvement we are making in our brand net promoter score. I'd like to take this opportunity to thank the whole Tesco team sincerely for the fantastic work they do. When we get it right for customers, we see the results in our performance against the market. From a very strong base last year, we've seen market share gains month on month throughout the first half. We're also winning more of our customer shopping missions.

Ken Murphy: As you can see here, we're gaining against all the key competitors. Customers are recognising the tangible improvements we're making in our offer, which is driving outperformance against the market. I believe that Tesco is an outstanding business and one that can create significant value for shareholders. With the executive team and senior leaders in the business, we've been working over the last 12 months to refine the strategic priorities that will enable our success over the coming years. And I'll come back to these shortly. We are also sharing the framework we will use to guide our actions and track our progress. We are aiming to grow both top and bottom line, maintaining sector leading margins, and in doing so, we will generate retail free cash flow of between £1.4bn and £1.8bn per year.

Ken Murphy: How we use that cash is incredibly important, and we have taken great care to test every element of our capital allocation framework. As a result, we have made a number of changes which Imran will take you through once he's presented his review of the first half. Driven by our strong performance and consistent with the framework, I'm really pleased to confirm the launch of our first share buyback. We see this as an ongoing multi-year program, with the first tranche of £500 million being completed within the next 12 months. We'll provide an update on our progress when we see you in April. Over to you, Imran.

Imran Nawaz: Thank you Ken. Good morning everyone and thank you for joining us. I'm now five months into the new role here at Tesco, and I want to thank everyone for the fantastic welcome I've received. Tesco is a brilliant business, and I've been really impressed by the amazing people here. In my first few months, as I've been getting to know the business, I have visited many of our stores and distribution centres, as well as Booker and the bank. As Ken mentioned, I've also taken the opportunity to refresh our capital allocation framework, and consistent with that we have today announced an ongoing share buyback program.

Imran Nawaz: I am very committed to being open about what's driving our results. Therefore, you'll see as we go through the presentation, we have made a few small changes to the way we talk about performance, with a focus on driving transparency and simplicity in all we do. I will call these out where relevant. Throughout my presentation, percentage growth rates are expressed in constant currency unless stated otherwise. Looking first at performance across the group, we have made good progress in all our key metrics with a really strong start to the year. Group sales grew by 3% on a one year basis, and by 10% on a two year basis, with a strong performance across all regions, as we continue to benefit from elevated sales as a result of the pandemic. Group profit increased by 41% to £1.5bn. This reflects sustained strong sales, a reduction in COVID costs, and a return to profitability in the bank, partially upset by the effect of £249m of business rates relief in the prior year.

Imran Nawaz: As you will remember, we went on to repay this in the second half. One of the changes we have made is to introduce a simpler retail free cash flow measure to provide a more consistent and predictable way of operational cash performance. We have removed some of our more volatile cash flows relating to acquisitions and disposals, property transactions, and exceptional cash items. Based on this simplified measure, retail free cash flow was £1.5bn and a half, up £746m driven by our profit recovery, the elimination of the UK pension contribution, and a strong contribution from working capital. Around £400m of this is expected to unwind in the second half. In line with our policy, we will pay an interim dividend of 3.2 pence per ordinary share, which is in line with last year. As a reminder, our interim dividends are set at 35% of the prior year full amount.

Imran Nawaz: Our headline earnings per share of 11.22 pence represents an improvement of 54%, driven by the growth in profit. Net debt at the end of the half was £1.7bn lower than at the year end, including the strong retail free cash flow generation in the half. This slide shows a summary of our key sale and profit numbers by segment. Total retail sales were £26.9bn, with profit of £1.4bn. As you can see, both sales and profit grew across all segments. Tesco Bank returned to profitability, generating £72m of profit in the first half compared to a loss of £155m in the prior year. And I will come back to this later on. Over the next few slides, I will cover the performance of each of these segments in more detail, starting with sales before moving on to profit. Sales have shown good momentum in each of the UK, Ireland, and Booker businesses.

Imran Nawaz: In the UK, like for like sales grew by 1.2% ahead of our expectations. We grew market share and retained a higher proportion of last year's elevated sales volumes than we originally anticipated. Growth stepped up from 0.5% in the first quarter to 2% in the second quarter, including a contribution from events such as the Euro 2020, and the benefit from staycations. In Ireland, whilst our one year like for like sales declined, as we traded over a particularly high impact of stockpiling in a prior year, our two year like for like sales remained strong, up to 12.2%. in Booker, one year like for like sales grew by 11%. we saw a sharp recovery in catering sales as the hospitality industry reopened and a resilient performance in retail against a very tough base.

Imran Nawaz: Now focusing on the UK. We have seen very different drivers of performance in each quarter. So, I'll briefly break it down by channel and then category. As you can see from the chart on the left, in large stores, like for like sales growth in the first quarter included the impact of stockpiling in the prior year. Like for like sales in the second quarter improved to 6.9% as we retained a higher proportion of sales than anticipated, as I had mentioned earlier, and we maintained very good levels of availability, even as industry supply chains came under strong pressure.

Imran Nawaz: In online, like for like sales growth was strongest in the first quarter, where we had not yet reached the full ramp up of capacity in the prior year. We then saw sales decline in the second quarter versus last year's exceptional demand. We are pleased that we have maintained the majority of the new customers we gained with over 700,000 more of them shopping with us than pre the pandemic. In convenience, like for like sales declined, as we traded over particularly strong performance in neighbourhood locations last year. However, our performance did strengthen throughout the half, reflecting a significant recovery in footfall to our city centre express stores.

Imran Nawaz: Now looking at sales by category. On a one year basis, the impact of customer stockpiling resulted in a decline in food sales in quarter one, recovering to growth in quarter two. Compared to pre-pandemic levels, food sales are of course up very strongly as customers continue to consume more meals at home. Overall, we are very pleased with our non-food performance as well. Customers have started to reappraise our non-food offer and are buying these categories with us more often. In the first quarter, we saw strong demand in general merchandise compared to the prior year when customers were prioritising spend on essential categories. The decline in the second quarter reflects a stronger base along with the reopening of non-essential retail in the current year.

Imran Nawaz: Clothing has performed exceptionally well throughout the half, as we lack the impact of the prior year lockdown and attracted over a million more customers to shop our offer. In the Republic of Ireland, sales were 12.2% higher than pre-pandemic sales with a strong performance across all categories and channels. On a one year basis, our sales declined by 2.6%, as we traded over a strong performance in the prior year, reflecting the particularly marked impact of stockpiling in Ireland.

Imran Nawaz: We continue to see strong growth in our market-leading online business, where we have grown market share, increased geographic coverage, and expanded click and collect locations from 28 to 36 stores.

Imran Nawaz: Moving now to Booker, Booker is an important business for us, and I have made sure to spend plenty of time with the team and get to know the operations over the last few months. Booker sales have grown strongly on both a one-year and two-year basis.

Imran Nawaz: Performance versus last year was driven by the sharp recovery of catering sales, which grew by 54.4% as the hospitality sector reopened for outdoor dining in April and indoor dining from mid-May.

Imran Nawaz: This included a strong performance from best foods logistics, where most of our customers were closed for much of the first half last year. Given the level of COVID distortion, I have included some monthly charts here on a two-year basis.

Imran Nawaz: We are really encouraged by the pace of recovery in our catering business. And as you can see on the chart on the bottom right, sales started to exceed pre-pandemic levels from June onwards. This was supported by great prices on key volume lines.

Imran Nawaz: We worked hard to mitigate the impact of significant supply-chain challenges, including a high number of colleagues required to isolate due to COVID-19, as well as the shortage of HGV drivers.

Imran Nawaz: The strong recovery from the catering business, more than offset a decline in sales to our retail customers due to significant demand in the base as customers shopped close to home during the initial stages of the pandemic.

Imran Nawaz: I am pleased that retail sales were almost 20% higher, compared to pre-pandemic levels. We have invested in price on key customer lines and expanded our range in response to increased demand.

Imran Nawaz: In central Europe, like-for-like sales were up 1.4% on a one-year basis and 0.3% on a two year basis. In the first quarter, trading conditions remained variable with a particular impact in the Czech Republic due to restrictions on non-food.

Imran Nawaz: All three markets delivered sales growth in the second quarter as customers returned to our large stores following the easing of COVID-19 restrictions, which previously encouraged shopping locally. Online sales continue to do very well, and we're up 24.7% on last year.

Imran Nawaz: We hold market-leading online positions in two out of our three markets. Moving onto profit. As you can see on this graph, retail operating profit improved by £194m year on year to 1.4 billion driven by our UK and ROI segment.

Imran Nawaz: I'll break the movement in each segment down in more detail on the next few slides. In the UK and ROI, profit growth of 16.5% was driven by sustained sales growth and lower COVID costs, which reduced from £533m last year to £122m this year.

Imran Nawaz: This year's costs relate primarily to colleague absence, maintaining a safe environment in stores and some additional costs in relation to elevated online sales. In addition, we saw a significant recovery in fuel sales and a greater participation of higher-margin non-food sales.

Imran Nawaz: Our operating efficiencies allowed us to offset inflationary headwinds. Growth was held back by the benefit of business rates relief in the prior year of £249m, which was repaid in the second half last year.

Imran Nawaz: In central Europe, profit was up 18.6%, reflecting strong sales performance, lower COVID costs, and higher-model income. These benefits were partially offset by the retail sales tax in Hungary being in place now for the full period this year, compared to just four months in the prior year.

Imran Nawaz: In Tesco Bank, we saw a return to profitability in the half. You'll remember that last year's performance was significantly impacted by the provision we took for potential bad debts, reflecting the macroeconomic environment in light of COVID-19.

Imran Nawaz: This year's profit also includes a 12-million contribution from Tesco underwriting, which is now fully consolidated, following the acquisition that we completed in May. As you can see from the ratios on the slide, the balance sheet remains strong.

Imran Nawaz: This slide gives you more detail on the components of our statutory profit performance, which increased by 109% as higher exceptional items and tax charges were more than offset by reduction in finance costs.

Imran Nawaz: We incurred exceptional charges totalling £154m in the half. This was driven by £193m settlement relating to historic shareholder litigation claims. I am pleased to say that we can now draw a line under this issue.

Imran Nawaz: Net finance costs in the half were £158m, including a fair value re-measurement credit of £180m. Primarily relating to the mark to market movement on inflation-linked swaps, this was a significant change to the prior year.

Imran Nawaz: Before fair value re-measurements, net finance costs were £23m lower than last year at £338m, as we continue to actively manage our debt portfolio, achieving lower rates of interest.

Imran Nawaz: Our tax charge in the half was £313m up from £154m in the prior year, which reflects the growth in operating profit with both years at similar effective tax rates. In the half, we also incurred a one-off charge due to a re-evaluation of our deferred tax liability. That was following the increase to the UK corporation tax rate from 19% to 25%.

Imran Nawaz: Let's move now to the cash performance in the first half. Based on our simplified definition, we generated £1.5b of retail-free cash, and I'll now talk you through some of the major components.

Imran Nawaz: Our total working capital inflow was £556m driven mainly by a significant recovery in fuel sales and the recovery of Booker's catering business on top of the usual Booker seasonal sales peak.

Imran Nawaz: We expect a total working capital unwind of around £400m in the second half, as the seasonal benefit reverses and based on our expectations that some of the elevated sales we have seen in the first half in the UK will fall away.

Imran Nawaz: CapEx in the half was £495m. And we have provided the usual breakdowns by region and type in the appendices. We paid £314m of interest costs of which £207m related to the finance charges on lease liabilities and £107m to interest paid on bank debt.

Imran Nawaz: The cash tax paid in the half was £49m. This is after a £60m benefit from the one-off pension contribution following the disposal of our Asia business last year. It also reflects a benefit from the new super deduction on certain capital investments, which was introduced in March '21.

Imran Nawaz: In addition, we purchased 55 million of shares in the market to offset dilution from our share schemes. Finally, capital repayments of leases in the half were £286m.

Imran Nawaz: Looking now at the movement in retail-free cash flow year on year, we generated an additional £346m of cash compared to last year, excluding the circa £400m working capital benefit, which we expect to unwind.

Imran Nawaz: The additional cash was mainly driven by higher profits and the elimination of UK pension contributions following the £2.5bn one-off contribution made last year. For transparency, I've included this next slide to describe the performance of items now outside our simplified definition of retail-free cash flow.

Imran Nawaz: The net business acquisitions, and disposals line shown here, includes the proceeds from the sale of our business in Poland to selling group, which completed in March. We generated £72m of net proceeds from property transactions.

Imran Nawaz: This includes gross proceeds from property of £109m, primarily from the sale of properties in Poland, which were not sold as part of the corporate transaction in March. This was partly offset by the buyback of one large store in Barry for a cash consideration of £37m pounds.

Imran Nawaz: Exceptional items principally covered the amounts paid to date from the £193m settlement of historic shareholder litigation claims that I mentioned earlier. The remaining £88m has already been paid in the second half.

Imran Nawaz: Whilst we are not planning on incurring any exceptional costs going forward, if any do arise, for example, as we accelerate our cost savings plan, we will of course continue to highlight these to you.

Imran Nawaz: On the previous definition therefore, we generated £1.6bn of retail-free cash flow compared to £0.6bn in the prior year. I'm now pleased to share our refreshed capital allocation framework.

Imran Nawaz: We've conducted a detailed review, focusing particularly on the appropriateness of our leverage target, the application of our dividend policy and our ability to return excess cash to shareholders. The first element, re-investing in our business and our customer offer is unchanged. And CapEx will remain in the range of £0.9bn to £1.2bn per year.

Imran Nawaz: For the second element, we are introducing a new headline leverage metric of net debt to EBITDA. We will target this to be between 2.8 and 2.3 times, consistent with a solid investment grade balance sheet.

Imran Nawaz: Whilst we continue to place great importance on the obligation we have to the members of our pension scheme, we are removing the IAS 19 pension deficit from the leverage calculation used for the purposes of capital allocation.

Imran Nawaz: This deficit creates material volatility, which could not be accurately predicted and had no bearing on our near-term cash obligations or our long-term unwavering commitment to our pension scheme members.

Imran Nawaz: Third, we can confirm it is our intention to be a progressive dividend, meaning we aim to grow or at least maintain the dividend each year. We will broadly target our dividend payout ratio at around 50% of earnings. The fourth and the fifth elements are unchanged.

Imran Nawaz: We will continue to consider inorganic growth opportunities, including property buybacks, where economically viable. And we will return surplus cash to shareholders as we have shown this morning with the announcement of our first £500m buyback of shares.

Imran Nawaz: Now let's turn to the balance sheet. Total indebtedness was £10.7bn down £2.3bn pounds since the year-end. This was primarily driven by a reduction in underlying net debt due to our strong cash generation.

Imran Nawaz: We also saw a reduction in the ISE 19 pension deficit due to the impact of market movements on our pension assets. Finally, lease liabilities reduced to £8.2bn, reflecting the sale of our Polish business.

Imran Nawaz: Our total indebtedness ratio was 2.8 times compared to 3.6 times at the year-end, reflecting this reduction in indebtedness and the increase in retail EBITDA.

Imran Nawaz: Our new leverage ratio, net debt to EBITDA was 2.7 times compared to 3.3 times at the year-end. And fixed charge cover was 3.1 times at the end of the first half up from 2.9 times at the year-end. Net finance costs, lease interest payments and lease capital repayments all declined in the first half.

Imran Nawaz: Finally, this is a comprehensive slide covering all of our guidance, and I just want to touch on the key updates. As you have seen today, we have reported a strong performance in the half, and as a result, we are upgrading our profit guidance for the full year.

Imran Nawaz: We now expect to deliver retail profit off between £2.5bn and £2.6bn. This is based on an assumption that some of the elevated sales that we have seen in the first half fall away and that we do continue to invest in our customer offer. We now expect to deliver profits in Tesco Bank of at least £120m pounds.

Imran Nawaz: The precise amount clearly remains highly dependent on the economic outlook. This slide also reflects the updates to the capital allocation framework that I have outlined, including the updated leverage ratio, the intention to pay a progressive dividend and the announcement of our share buyback program. Thank you very much for your time. I'll now hand back to Ken.

Ken Murphy: Thank you Imran. I'm going to spend the second part of my presentation, looking to the future. Specifically, I want to help investors understand how we are thinking about the business going forward and the principles guiding our decisions. I'm not going to set out all of our detailed plans nor the specific actions we will take. I want our customers to see the changes we make before our competitors and believe that this is the best way to protect value for all other stakeholders in the business.

Ken Murphy: What I do want to do is give you a sense of the huge opportunity we have to capitalise on some of the profound shifts underway in the sector. So, to the priorities. Magnetic value for customers, I love my Tesco Clubcard. Easily, the most convenient and safe to invest. Taken together these will enable us to redefine value, increase loyalty and access both new income streams and capital-like growth while ensuring we maintain cost efficiency in everything we do. For me, these priorities are about maintaining focus on doing the basics brilliantly and then overlaying that with new opportunities to accelerate growth.

Ken Murphy: I'll now talk about each priority in turn, outlining our overarching thinking and then sharing some of the key themes within each one. These priorities are rightly focused on our UK retail business today, given its impact on our total results, but I can assure you, they are equally relevant for other parts of the group. And indeed, we will increasingly need the capabilities of our other businesses to deliver on our ambitions. Starting with magnetic value, we all know that value is a combination of price, quality, including sustainability. And of course, the customer experience.

Ken Murphy: This strategic driver is all about doing the basics brilliantly, providing reliable value that removes customers' needs to shop elsewhere, combined with positive reasons to shop more with us. Great quality product and great innovation. Looking to solve their everyday problems and make life just a little easier. On price, I said back in April, that we would double down on our commitment to low prices. And I absolutely meant it.

Ken Murphy: We have continued to invest in the three key elements of the value proposition, Aldi price match, Low Everyday Prices and Clubcard prices. 80% of our customers shopped all three of these during the first half. Together, they give our customers confidence that the core lines they buy are competitively priced and provide unbeatable value to Clubcard members while maintaining promotional participation at a level that works well for both us and our suppliers.

Ken Murphy: The quality of fresh food remains absolutely critical to customers. And we start from a great place. We know, however that we can't standstill. We're working with our supplier partners to bring new innovations to market and to ensure that the quality of everything we sell is protected all the way from farm to fork. You've heard from me previously that supporting customers with healthy, sustainable diets is a real driver for me personally. I genuinely believe that Tesco can play a role in democratising nutrition and benefit from doing so.

Ken Murphy: At the start of the year, we launched ambitious commitments on health, across all of our markets. For example, in the UK and the Republic of Ireland, we are aiming to increase the proportion of healthy products we sell from 58% to 65% by 2025. And we're aiming to drive a 300% increase in the sales of plant-based meat alternatives. We continue to develop new products that deliver on both health and convenience, such as our new beautifully balanced range of prepared foods. We've also invested to make sure our Plant Chef range of family favourites are price matched to the equivalent meat-based products.

Ken Murphy: On sustainability just over a week ago, we announced ambitious new climate commitments. We've brought forward our own operations net-zero group target to 2035 to be in line with the UK. And we've launched a new goal to be net-zero across our entire value chain by 2050, aligned to a one-and-a-half degree pathway. Customers see packaging as the number one issue for us to address and we'll continue to take a leadership position. We've now launched soft plastic recycling in all our UK large stores, and we've delivered a market first in central Europe with recyclable packaging across the whole of our household category.

Ken Murphy: We've also recently announced a new service in 10 stores with loop to test consumer appetite for reusable packaging on over 80 high-volume products. We can make a very tangible difference in the way we distribute and deliver our products. We use a higher proportion of rail to distribute our products than any other food retailer in the UK, including a dedicated train service bringing fresh food to our distribution network from Spain. We transport 65,000 containers by rail each year saving over 22 million road miles with plans to increase this to 90,000 containers in the near future. We are also aiming to have a fully electric home-delivery fleet in the UK by 2028.

Ken Murphy: Turning to our second strategic priority, I love my Tesco Clubcard, more than 20 million households have a Clubcard, and that's an amazing base. Going forward we'll be making even greater use of the insight this gives us to personalise the shopping experience with our most frequent Clubcard customers that will have access to enhanced rewards. Combining Clubcard with our online grocery business, our nearly 7 million regular app users and the capability offered by dunnhumby, we've created an unrivalled digital platform. We can use that to create additional value and increase loyalty, making sure that the more customers use Tesco, the more useful Tesco is to them.

Ken Murphy: We can also use that same digital platform to access new sources of revenue reinventing the way we work with our supplier partners. This last year has given our digital ambitions a massive boost. I shared some of this data with you in April, and I'm delighted to say we've made even more progress. Clubcard prices has been instrumental in driving an enhanced customer perception of the Clubcard's value plus an increase in penetration. With Clubcard now being used in over 80% of large store transactions. We have also launched Clubcard prices in our express format, which has been really well received by customers. And we've seen an increase in the number of active app users from two and a half million last year to over 6.6 million this year.

Ken Murphy: With an ever-stronger platform, we have new opportunities to personalise the offer for customers and make the Clubcard work harder for them. The insight we have from our customer data enabled us to send over four and a half million uniquely personalised offers and coupons in the half. And this will be something we look to take even further. We have strengthened and simplified the range of exclusive deals customers can access with our reward partners. All deals are now three times the value of Clubcard points across the full range of partners.

Ken Murphy: We've also made some exciting new additions to our offering such as Disney+. For me, one of the most compelling and unique opportunities for Tesco is to bring together the various different elements of the group to provide an unrivalled offer for customers. I'm therefore particularly pleased that we've launched Clubcard prices for Tesco Mobile in September, and they'll soon be coming to Tesco Bank.

Ken Murphy: We also launched a trial of Clubcard Pay+ in March, which we are now making available to more customers. I see dunnhumby as a real opportunity for Tesco. In a world where data analytics, customer insight and personalisation are ever more critical we have an amazing capability sat right here as part of the Tesco family. Working with insight gained from over 700 million customers worldwide, dunnhumby has an incredible data set of over 18 billion records per week. It partners with over 70 retailers in 29 markets and drives growth for well over a thousand consumer goods companies.

Ken Murphy: Through dunnhumby we give suppliers access to a platform enabling them to receive unrivalled insight into how customers perceive their products. I believe that we are at the foothills of what dunnhumby can do for Tesco, its supplier partners and its many retail and consumer goods clients around the world.

Ken Murphy: You'll remember I spoke in April about the digital platform we've created, as I've already mentioned, that platform has been further strengthened by our progress over the last six months. While many of the opportunities I have touched on so far are about maintaining and building on existing strengths, the digital platform presents an important new opportunity to access incremental income streams. These will support our economics as we navigate some of the shifts underway in retail more broadly.

Ken Murphy: Our digital platform will be at the heart of a reinvention of our supplier strategy. For example, providing suppliers with the opportunity to market their products on our website in a highly targeted way, giving customers an increasingly relevant offer. We also see the potential for suppliers to provide access online, to a tailored range of additional products direct to specific customers. We will focus on improving supplier returns on their marketing investment and improving the hit rate of their innovation pipeline.

Ken Murphy: The third priority is easily the most convenient, accessing incremental capital light growth through our online and convenience businesses. We already have a very strong position in both channels and see further opportunity for growth meeting customers' shopping needs, whatever, whenever, and however they want to be served.

Ken Murphy: As you know, our online sales already exceed £6bn. Even following the exceptional performance last year, we still saw growth in the first half, retaining the majority of the customers we serve during the pandemic.

Ken Murphy: Our extensive store network and flexible model means we have fantastic position in the market, with online market share-maintained year on year and exceeding that of our store footprint. Our scaling online also supports the efficiency of our model, with more than a 10% increase in the number of our picking locations in the half, or even closer to the customers we serve, helping to optimise deliveries.

Ken Murphy: We have really worked on our click and collect model, which is more profitable for us than home deliveries. This now accounts for around 20% of our online sales. We also opened our second urban fulfillment centre in Lakeside in May, which is delivering productivity benefits in line with our expectations.

Ken Murphy: I firmly believe that we can continue to grow from this exceptionally strong base. I see future acceleration in online as a way to sweat our existing infrastructure and asset base, as well as providing our customers whatever more convenient ways to access our offer and, as I mentioned before, provide us with a source of incremental profit.

Ken Murphy: In a crowded market, on-demand is an area of test and learn for us. Our focus is on developing the right offer for Tesco customers in a way that complements our existing online business.

Ken Murphy: We piloted Tesco Whoosh in a small number of Express stores earlier this year. Local customers can order via the Tesco app or tesco.com for a 60-minute grocery delivery service. Products are delivered via bike, moped, or car for a fixed fee, which customers can still earn Clubcard points, use their coupons, and take advantage of in-store offers.

Ken Murphy: Most importantly, Tesco retains the direct relationship with the customer. We have just expanded Whoosh to around 50 Express stores, with more opening every week. If successful, we see this as a platform we can also offer to Booker retail and catering customers. We are also testing and learning other propositions. One Stop is expanding its partnership with Deliveroo to cover about 450 stores and Booker's retail partners are working with a variety of delivery providers.

Ken Murphy: To be clear, we are not in a race towards on-demand and we're absolutely not about winning the most customers at the expense of margin. This is an area we'll continue to challenge ourselves to look at in a range of different ways, focusing on learning at pace rather than rolling out aggressively.

Ken Murphy: Now coming to our convenience stores. After online, convenience is the fastest growing food retail channel, and we have a very strong platform. Our current offer is made up of 2,600 Express and One Stop convenience stores and our wholesale relationship with 90,000 Booker franchise stores. We have converted 89 metros to better reflect how our customers shop and we are delighted with the early results of rolling out Clubcard prices into express.

Ken Murphy: During the pandemic, we saw fewer customers in our city centre stores. But our local neighbourhood stores really came into their own as we strengthen the ties between Tesco and the local community. We believe there remain many capital light opportunities to open new stores where Tesco is underrepresented. We've set out here our store opening program for this year across Express, One Stop franchises, and Booker partners.

Ken Murphy: Finally, save to invest. We only want to spend money where it adds value for customers and where we'll make a real difference. We've already identified a number of material savings. As a minimum, we want to offset the impact of cost inflation on our business each year and ideally create additional headroom that will allow us to invest in competitiveness and growth.

Ken Murphy: Having conducted a detailed review, we have identified significant opportunities to simplify, be more productive, and reduce costs. In total, we can already see around £1bn of savings across goods not for resale, productivity improvements, delivery network optimisation, and central overheads.

Ken Murphy: We see Tesco business services, our shared services centre in Bengaluru, as playing an increasingly important role going forward. We are also looking at opportunities to automate standard processes and routines so that we can invest our efforts where they can add the most incremental value to customers and to the business.

Ken Murphy: In sharing these priorities, I hope I have given you a sense of what we are going to focus on going forward. Tesco has many unique advantages, such as the scale and reach of our store estate, our ability to reward loyalty through Clubcard, and our world-class food expertise. Together, these mean we can anticipate and respond to changes in the market, meeting customer needs better than anyone.

Ken Murphy: Our strategic priorities enable us to build on this already strong base. Magnetic value for customers and save to invest will ensure that we do the basics brilliantly and operate as efficiently as possible. I love my Tesco Clubcard and easy to most convenient are all about growing our business by unbeatable digital convenience and loyalty platforms.

Ken Murphy: We want to make it easier for you to understand how this all comes together in terms of performance. And so, we are sharing the framework that we will use to guide our actions and track our progress over the coming years.

Ken Murphy: As you can see from the slide, it is about a combination of growth and cash. We are seeking to grow the top line underpinned by increasing customer satisfaction and adding those capital light opportunities in convenience and online.

Ken Murphy: As I said in April, market share matters in food retail, and we are aiming to grow or at least maintain market share in our core UK market. We are also seeking to grow absolute profits in quantum terms. We will use our assets across all channels in the most efficient way possible and add in new revenue streams generated from our digital platform.

Ken Murphy: As I mentioned just now, we will target productivity savings to at least offset inflation and ideally create headroom to invest in our other strategic priorities. By doing this, we are clear that we can generate between £1.4bn and £1.8bn of retail-free cash flow each year.

Ken Murphy: We will flex our approach to reflect the changing market, and our progress on each element is very unlikely to be linear. But we want to give shareholders the reassurance that the generation and use of cash is something we take very seriously.

Ken Murphy: Before I close, I want to share our refresh purpose. Our purpose of serving shoppers a little better every day has been a guiding force for our business. It has enabled us to stay focused on doing the right things for our customers.

Ken Murphy: As I hope is clear from today's presentation, our customer focus is unchanging. We are now bringing this together with a more explicit recognition of our broader commitments to the communities we serve and our planet.

Ken Murphy: Our priorities in these areas already guide the actions that we take day in, day out. And so, it's only right that these should equally be reflected in our new purpose: serving our customers, communities, and planet a little better every day.

Ken Murphy: We've had an incredible response from colleagues to this new purpose. I'm sure that will be a motivating force for the entire Tesco team as we move towards creating value for our stakeholders in our business.

Ken Murphy: In summary, I'm delighted with the performance over the last six months, not just the sales and profit growth but the underlying improvements we have made to further strengthen our business. This strong performance has enabled us to increase our guidance for the full year. It also gives us a fantastic platform to launch our strategic priorities, to enhance our competitiveness, accelerate our growth, and generate cash.

Ken Murphy: Imran and I have set out what we hope is a clear investment proposition for you, underpinned by ongoing capital returns. We are aiming to create sustainable long term value for every Tesco stakeholder, consistent with our new purpose of serving our customers, communities, and planet a little better every day. Thank you.

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'd like to cancel your place in the queue, you can do so by pressing star two. So once again, that's star one to ask a question. If you're asking a question, please remember to mute your online webcast to avoid any feedback. Our first question comes from Andrew Porteous of HSBC. Please go ahead, your line is open.

Andrew Porteous: Yeah. Hi guys, and congratulations on a great set of numbers. A couple from me, interested in progress on the digital platform firstly. Can you just talk about what you're seeing? How important are app users versus non app users? Is there there anything you're seeing there? And how can we think about the next steps of building that online platform? And then secondly, a question around margin, I guess. I appreciate the strategic framework and subject to you guys meeting your ambitions on market share and customer satisfaction, do you think there are still opportunities to expand the margin? I know that the UK margin is probably still in the mid threes, pre-IFRS 16.

Ken Murphy: Thank you, Andrew. I'll deal with the digital platform first. So we've seen great progress this year on building out our digital platform. If you think back to pre pandemic levels, we were serving just under 1.2 million customers online on a weekly basis. Now, we've got an active user base of almost two million, about 1.9 million customers, and they've really stuck with us post pandemic and we continue to see really high demand for our online proposition. And that's quite a sticky proposition and has really been embedded into their behaviour, so that's the first thing to say is that we're really pleased with the continuing relationship we've built with customers through the pandemic and beyond.

Ken Murphy: The second thing is that using Clubcard prices, we've really started this digital transformation of the Clubcard experience. And so if you cast your mind back 12 months, we had about two and a half million app users that were active on Clubcard. Today, we stand just shy of 7 million active app users, so this is really tremendous progress, but really, we're in the foothills of exploiting that in terms of making sure that customers can be much more dynamic in the way they interact with the Clubcard, that we can increasingly personalise their experience, make the card work harder for them and their individual needs and that's really how we are planning to evolve the card over the next two to three years.

Ken Murphy: In terms of margins, I think that for us, given our ambitions around growth, given our ambitions to be really strong on value for customers, we're not focused on margin expansion but we're focused on maintaining what are already market leading operating margins for the business. Imran, is there anything you'd like to add on the margin point?

Imran Nawaz: Yeah, look, I think that's right. I'm happy with where the margins are. You've seen the performance framework we laid out and what we are really focusing on that is driving absolute profit growth, because ultimately, that's what turns into cash. And I think that's the algorithm we want to run, and I think it's the right way to make sure we maximise value.

Andrew Porteous: Thanks a lot guys. Good to hear.

Operator: We'll take our next question from Andrew Gwynn of Exane BNP Paribas. Please go ahead, your line is open.

Andrew Gwynn: Hi. Morning, Ken. Morning, everyone. Yeah, two questions if I can. So firstly, just coming back to the cash point, if I heard right, excluding exceptionals but you weren't really expecting any exceptionals coming up, so just to clarify on that point. And then maybe just some of the other non EBITDA movements in there, is there a big opportunity in working capital for instance? And then the second question I think is more for Ken, but it doesn't take much effort to see plenty of disruption in the market, but clearly, what the press reports and the reality could differ quite significantly so just wondering what your take is on where we are at present. Thank you very much.

Imran Nawaz: Yeah. Thanks Andrew. I'll take the cashflow question. Look, we've simplified the definition. What we're trying to do is just to be very clear with the market on what does the underlying business generate in terms of cash? So, for that reason, from the definition of cash flow, we've taken out any sort of property buybacks, any disposals that we would get benefit from, but at the same time, also any exceptionals. The concept of exceptionals is not something I love. I mean, we'd like to minimise them, they do occur from time to time as they did this half, but we'll continue to isolate those for you. In the performance framework, to that point, that excludes anything in terms of exceptionals or anything in terms of income that we get from any property disposals that we may have.

Imran Nawaz: In terms of your second question, how to think about working capital over the framework, the way I like to think about it is as you grow the top line, you should see some sort of working capital benefit as well, simply by being more efficient. Growth helps that way, and that's what we've built into our assumption. Some sort of, if I was to put a number on it, maybe 100 million a year of a working capital inflow is the central case assumption.

Ken Murphy: Thanks Imran. Andrew, on your second question around disruption, I think that the sales performance speaks for itself. So, as you can see, we are in growth across all our businesses with the exception of the Republic of Ireland. But even within that business, we've got a two year like for like of over 12%. And the two year like for like in the UK retail business is 10% with a one year like for like, a booker of 11%. So, by any standards, this is exceptional performance and our supply chain has held up fantastically well under the pressure of those additional sales. So that I think speaks volumes for the resilience of our supply chain and the capability and the relationships we've built with our supplier base.

Ken Murphy: The media of course have published a number of articles around various elements of disruption. We are obviously seeing challenges on a daily basis but we're coping amazingly well with those challenges, and we absolutely will continue to do so into the foreseeable future.

Andrew Porteous: Okay, thanks very much.

Ken Murphy: Thanks Andrew.

Imran Nawaz: Thank you.

Operator: We'll take our next question from Sreedhar Mahamkali of UBS. Please go ahead, your line is open.

Sreedhar Mahamkali: Hi, good morning. Thanks for taking my questions. I've got two questions and a very short follow up on the free cashflow please. So first one, on the capital allocation framework, you've talked about the inorganic growth opportunities that you mentioned. Can you perhaps talk through your thoughts there, which sectors and markets should we be expecting you to spend time on? And equally on the other hand, I'm just wondering how central is the role of rest of Eastern Europe and also perhaps banked or the free cashflow lead investment pieces of Tesco. And again, just to supplement there, do you really need to own 100% of dunnhumby to benefit from the insight of the business? That's first one.

Sreedhar Mahamkali: Secondly, can you talk about new nonretail revenue streams as a way of leveraging the vast digital platform that you referenced a few times now? I wonder if you could talk specifically about retail media, advertising revenue streams potentially. Are there any numbers that you've see that you can share with us at this stage? Those are the two questions. Just a quick follow up on free cashflow. If the range is 1.4 to 1.8, I just wonder, what is the flex here? What are the drivers to get from 1.4, to 1.8? What are the moving parts? If you could just talk us through to the extent you can, that'll be greatly appreciated. Thank you.

Ken Murphy: Well, Sridhar, you've managed to slip at least three questions into that one, but what I'll do is I'll ask Imran to answer the last question first, and then I'll come back to the first two.

Imran Nawaz: Right. Okay. So, the modelling we have is clearly one of the things that you've seen us in the first half, is we have a big working capital swing. In the first half you saw, we have around 400 million so that there is a bit of tolerance for that built into our range. The way I think about that 1.4 to 1.8 is you start with a solid profit growth that we see year on year. I mentioned before, the working capital inflow of probably around 100 million or so, I'm thinking the CapEx of 0.9 to 1.2, potentially closer to the 1.2 range given the strategies we have, interest costs between 200 and 250, and then the rent that we pay around a billion or so, and then obviously the tax at 26% in the outer years.

Imran Nawaz: That's sort of, if you wish, the mechanical approach that we have. Stepping back from it, this year is demonstrating that a disciplined approach to cash and cash flow can deliver results, and that's what we've been doing. And I've had a terrific reception from the team around that in the company and I feel that just by focusing on cash and making a number out there that we want to hit, we'll deliver that disciplined approach as well. So I feel that's the mechanical add up, if that helps you, Sridhar.

Ken Murphy: Thanks, Imran. So Sreedhar, on your first two questions, I think that in terms of inorganic growth, we're really thinking about bolt on acquisitions, so acquisitions that either enhance our core proposition, build out market share where we have gaps, and in the areas of digital marketing and insight, et cetera, where we think that there's a lot of value that can be added. So we have no specific targets in mind at this moment, but we will update you as and when we do.

Ken Murphy: In terms of the role of the businesses within our portfolio, we're very happy that these businesses are complimentary to what we want to achieve. The strategy and the new purpose I hope you will see really focuses on leveraging the capabilities across the group to maximise and optimise the group effect and the benefit of being part of that group, and we're starting to see that in a number of areas, so that's how we see it. Next question?

Operator: We'll take our next question from Clive Black of Shore Capital, please go ahead.

Clive Black: Good morning, gentlemen, and again, well done. Two for me. I wouldn't normally ask this question but the chairman of Tesco went on British television and said that he was expecting four to 5% inflation. And so I just wondered if you could clarify his meaning in terms of what Tesco expects to absorb and what shoppers should be anticipating from an inflationary perspective, given there are clear pressures there. And then secondly, Ken, you spent a lot of time on this digital platform today. I just wondered, could you give some indication of what that can mean in terms of materiality of earnings in due course, please?

Ken Murphy: Thanks, Clive. So, on the first one, my understanding is that our chairman really responded to what could inflation be in the UK in general, and it was a hypothetical possibility, not a sense of expectation. In the first half of this year, Tesco customers actually saw deflation because we extended Aldi price match from 250 lines this time last year to 650 lines. We have a platform of everyday low prices of an additional 1,600 lines, and of course we extended Clubcard prices into our convenience format. So, all in all, customers are actually seeing better prices from Tesco in the first half of the year. Obviously, there are lots of different challenges coming down the pipe, whether it be commodity inflation, energy costs, transport costs, and we work really hand in glove with our suppliers to manage and mitigate this to make sure that we deliver the best possible value to our customers.

Ken Murphy: In terms of your second question around the digital platform, so this for me is really around resetting the relationship with customers and indeed with suppliers. It's a very broad strategy in terms of what we're trying to achieve. I think what's been demonstrated by the behaviour of customers since the pandemic through our dotcom platform is that if you build a strong relationship online with customers, it's very sticky and this has been born out. The Clubcard element of the digital strategy is really trying to move from a physical, either paper-based coupon, card-based push relationship to a much more interactive conversation-almost-based relationship with the customer, through a digital platform where we can be much more tailored in our approach and much more responsive in our approach to customer needs.

Ken Murphy: Now, this isn't something that we have up and running today, this is a three-to-five-year ambition that we're building towards and adding functionality and features to every quarter. And as we do so we'll update you; I really don't want to go into the details because there is a philosophy in Tesco that we like our customers to see these before our competitors do. So, as and when we launch them, I'll be very happy to give you more detail, Clive.

Clive Black: Okay. Ken, can I just come back on the first question, please? And thank you for the answer. A number of industry participants have said that they anticipate that food inflation will feature in the UK in the forthcoming quarters. Is that a message that Tesco would concur with though?

Ken Murphy: Our job, I think Clive, is to manage circumstances and situations as they arise and to work really closely with all our partner suppliers to make sure that we continue to give great value to customers. And that's something we continue to do day in day out. And I think that the last six months of illustrated, if you stay focused on those basics, you really get rewarded by the customers through the performance. And that's what we'll continue to do.

Clive Black: Okay. I tried my best. Well done. Thank you.

Ken Murphy: Thanks, Clive.

Operator: We'll take our next question from Xavier Le Mene of Bank of America. Please go ahead.

Xavier Le Mene: Yes. Thank you for taking two questions, if I may. The first one, I just look at your revised full-year guidance and it seems that actually it's only driven by the strong growth and expected the H1 sales and profit, so implying potentially no revision for H2. So why are you so cautious in a way, given the strong H1 you had? The reason behind your cautiousness, that would be interesting to know. And the second question will be on the asset that you've got, and it's more for Imran; so you joined the company six months ago. Taking your financial hat, how do you see the current portfolio of countries and assets? Do you think that all the assets are relevant today for Tesco?

Imran Nawaz: Okay.

Ken Murphy: Okay. So, I'll take the first question and then I'll pass on to Imran. We're really pleased with the first half performance. It has definitely exceeded our expectations and it's a combination of a number of factors. Some of them have been market tailwinds, and some of them have been through the excellent performance of the Tesco team as a whole in terms of its focus on value, its focus on great service and great availability. So, while we feel really confident going into the second half of the year in terms of Tesco's relative position, we do see some of the tailwinds we experienced in the first half falling away. And if you overlay that on top of the fact that the second half was exceptionally strong last year because we were in a full COVID lockdown for much of the second half of last year, we are expecting a modest decline in like-for-like sales in the second half. But we remain incredibly confident of Tesco's relative performance in the market. That said I'll pass on to Imran to answer the second question.

Imran Nawaz: Sure. And just on the guidance portion of it, just to build on that, the central case as Ken mentioned, is a COVID unwind. We need to understand the customer behaviour, and that's really the main reason why you see the first half/second half from a financial perspective, so fully in line. In terms of the broader question you asked, I'm here five months now. I spent a lot of it going to stores, visiting the bank, spending time at Booker, Central Europe. It's been a big learning exercise. I am very impressed by the power of the group when it comes to procurement, when it comes to copying fast from each other great ideas, and ultimately the strategies we outlined, in my view, apply to all of them.

Imran Nawaz: So, I'll give you a finance example since you asked me on, save to invest is something that I expect everyone to do. The bank, Central Europe, Booker, and obviously core UK and core Ireland. And to me, that's sort of a benefit that you get because you can leverage services to provide it to a bigger population, if you focus. The biggest job that we have to do is make sure we make the right capital allocation decisions as to who has the best ideas, who has the best return, and what's best for Group. And that to me, at this point in time, is the job ahead. It's why we laid out a framework to say, "Look, we can live with the capital guidance that we have to generate a perfect return for the company and create value for our stakeholders." That's sort of my first five months in perspective.

Ken Murphy: Thanks, Imran.

Operator: We'll take our next question from James Grzinic of Jefferies. Please go ahead, your line is open.

James Grzinic: Thank you. Good morning, Ken & Imran. I just had one, it's really for you, Ken. I guess, one of the big achievements of Tesco in recent years has been driving more discipline in how the industry prices the delivery offer to customers. Do you think there's a lot more you can do in leading the industry to a more rational place on that front? Is that something you spent a lot of time on?

Ken Murphy: You're speaking particularly about online delivery, home delivery?

James Grzinic: Yeah. I mean, digital services in general, but yeah I mean, the greatest proportion of that being home delivery.

Ken Murphy: Yeah. That's something we continue to evolve. I think that clearly the pandemic changed customer behaviour fairly substantially, and we obviously suspended certain elements of that for a period because we felt it was appropriate in the circumstances. And of course, we've moved recently back to more of a dynamic model to make sure that we optimise slot utilisation. And we've also seen really strong growth in our Delivery Saver option, which of course means that customers for our subscription will get free delivery. And I think that those models are working well in the marketplace now.

Ken Murphy: The other thing of course, is that we want to optimise Click+Collect. This is something again, which experienced enormous growth during the pandemic. It's settled down now at about 20% of our online sales. We'd like to grow that over the coming years, but we're very conscious that we have work to do to make the customer experience an even better one end-to-end for the Click+Collect experience. So that's something that we think is an important part of the total distribution model for .com.

James Grzinic: Understood. I guess, just to follow-up on that, Ken, so the increment revenue base that you're getting through Dunnhumby, a greater utilisation there, will that be the only main major driver to the online economics, or do you think pricing of the service can still play a part in terms of a more rational pricing? Even more rational than we're seeing right now.

Ken Murphy: So, we think there are a number of different ways that we can build out the economics of the digital platform. But I think we should start from the perspective that actually our digital fulfillment today is built on, for the most art, our existing infrastructure insofar as we service the majority of our .com business from existing large stores that use existing resources and team capabilities, existing stock. And so, it is really all about optimising the asset utilisation of Tesco as a whole, that's the starting position.

Ken Murphy: The second thing is we see a number of different opportunities to optimise profitability digitally. I think, one for sure, is the Dunnhumby platform and the ability to demonstrate to suppliers the value that can be created through a much more targeted approach to their marketing, building a much more strong relationship with customers that are actually engaged and interested in their categories. And getting involved with them at a much earlier stage in their innovation cycle, so that we can input prove the hit rate of their innovation, reduce their go-to-market costs, drive better sales, better conversion for their marketing activities.

Ken Murphy: And I think that's quite a powerful opportunity for suppliers, and for Tesco it unlocks a budget that today we get nothing of as such because most of our conversation with suppliers are trade marketing, and really this is all about unlocking the above the line marketing and innovation budgets of our suppliers by demonstrating superior value. The third area of course, is efficiency. I've already mentioned Click+Collect, which is a great efficiency opportunity, but we think also the UFCs in time would provide an opportunity.

Ken Murphy: Not only to optimise the cost of fulfillment, but to reduce the time from order to fulfillment, significantly. Increase capacity of stores. And we're already at 90% in many of our stores in terms of utilisation, so we have a lot of headroom for further growth in those stores. And UFC's will deliver that possibility.

Ken Murphy: So, I think there are a number of fronts that I feel excited about, the opportunity on the digital platform. And media is just one.

James Grzinic: Thank you.

Ken Murphy: Thank you.

Operator: Our next question comes from Robert Joyce of Goldman Sachs. Please go ahead.

Robert Joyce: Hi, good morning. Thanks for taking the question. So yeah, two from me as well. Just to follow up on an earlier point, in terms of focusing on absolute profit growth. Should we take that to mean that the midpoint of guidance this year, the 2.67, if we take that midpoint. Is a number you'd look to build from next year and beyond? And then, the second one, just to understand, to follow-up on what you just said there Ken. I understand that you said you really aren't getting much of this retail media, said nothing at the moment, in terms of retail media income from suppliers. And just looking to size that, I mean, Kroger have talked this year about that being an incremental hundred to 150 million. And this year alone. Is this an opportunity which is in the hundreds of millions? Thank you.

Ken Murphy: Rob. I'll take care of second question first, and then I'll hand over to Imran, for the first question. We'd prefer not to speculate about the value at this stage, but what I can tell you, is we're in the footers of it. And I believe that there is a significant price to go after. We'll update you, as and when we start delivering.

Imran Nawaz: And maybe I'll take the second question then, on profit guidance. Again, as Ken mentioned, we had a great first half, ahead of our expectations. Staycations Euro, doing a fantastic job on availability frankly, as well. Which, kudos to our team, has really been a big driver of that. Second half, we now need to figure out what do customers do? What is the benefit, or the impact of COVID unwind? Is there going to be one? And the central case assumption we have, is there will be some of that, in that portion of the year. Key question, of course then, is what does that do to the profitability of the business? And that's why we've given you a fairly tight range of 2.5 to 2.6,. I mean, mathematically, you can go to the mid point, I'm looking at the range as a range and saying it could be 2.5, or it could be 2.6. That's roughly how I internally, think about it.

Robert Joyce: And then, Imran, how I understood on this year. But I'm just thinking about beyond, as you're looking at, you've got a multi-year plan. Do we think growing profits from here is a good aspiration?

Imran Nawaz: Look, I think I want to get through the second half, understand truly what customers are going to do? How the world evolves? It is rather uncertain out there. What I would draw your eyes, or your attention to, is the fact that we've laid out a midterm framework, on how we want to judge our performance and how we see it. And that clearly does call for, we want to grow the top line, we want to grow profits and we want to be able to generate that cash. And that to me, is the important piece, is that there is an underpin that we want to hit and clearly, next year we'll have to see that. And that's very much predicated on the second half of this year. And we'll talk to you in April when we meet again.

Robert Joyce: Okay, thank you.

Ken Murphy: Thanks Rob.

Operator: Our next question is from James Anstead of Barclays. Please go ahead. Your line is open.

James Anstead: Good morning, Ken and Imran. Two questions, please. Firstly, you're announcing now that you're targeting a billion of gross cost savings for the next three years, I wonder if you can reassure us that is a faster run rate, than you've been achieving in recent years, even though I guess, it must've been quite difficult to measure cost savings during the pandemic, but I presume that is a step, versus what you've been doing recently. And secondly, you're relatively unusually not working with Deliveroo, or Uber Eats in your main chains. I looked at most of your big payers out there doing that. So, I wonder if that's a decision based on you thinking, the economics sounds attractive, or is it a reflection of you really putting a lot of value on this direct relationship with your customers? Thanks.

Ken Murphy: Thank you, James. I'll take the second question, then pass to Imran, to answer the first. So, the first thing to say, is that we're very interested and curious about the on-demand mission. We watch it very closely and of course, through our Whoosh platform, we're actively working the model. And having started with a one-store trial in Wolverhampton, we then expanded to 19 stores and we're now at 50, with an ambition to be at 100 by Christmas and in most of the major conurbations. And we've been really pleased with the results of it, but it's very early days. And so, we still very much consider it a trial. We don't think that the customer themselves has made up their minds yet, about what proposition they really value and they're willing to pay for and which ones they don't. So, we're adopting a curious, but active mindset to this mission.

Ken Murphy: The second thing to say, is that we are actually working with partners largely again to learn. So, we have an active partnership with Deliveroo through our one-stop chain of convenience stores. Very importantly, for us though, our relationship with our customers is key and maintaining that relationship directly, is really crucial, whatever solution we end up coming to and whatever partners we end up working with. So, really that's all I would say on demand for now, I'll pass over to Imran to talk about our cost savings.

Imran Nawaz: Yeah. So, the question is on the 1 billion and how does that compare to what Tesco normally generates? I mean, I've obviously looked at that, and because I think, it's a good question on that front. And the way I got to the 1 billion, as to why does that number makes sense? Is we work with the team to figure out, "Well, there's going to be an inflation on our operating costs and we want to have some fuel to reinvest into the priorities that we laid out." And the good thing is, being efficient and driving cost savings is actually in the DNA of this company. We're really good at it. And it roughly equates to that 250 to 300 million a year that the business has been generating pre-COVID already. And so, this is a question of calling out what we do well and making sure we don't stop. And we continue to do that. That gives me the confidence that it's achievable.

James Anstead: That's helpful, thank you.

Ken Murphy: Thanks James.

Operator: We'll take the next question from Victoria Petrova of Credit Suisse, please go ahead.

Victoria Petrova: Thank you very much. Congratulations with great results, and I promise I will be short. I have two super short questions. First, is on cost inflation. We're obviously getting multiple, press releases around all costs. Could you please let us know what, out of your coastline items, was subject to the highest inflation? And also, maybe you could provide any short comment around personnel expenses and how you addressed cost inflation there? Obviously, you mentioned the automation, but maybe something else around it. And my second super short question is on cannibalisation of offline, versus online post-COVID lock downs. Have you seen any massive change? Your last comment was that cannibalisation stood at around 30%? Is that the same? Is it different? How should we look at it? Thank you.

Ken Murphy: Thanks Victoria. Let me start with the last question first. So, actually our cannibalisation rates in the first half of this year were de minimis. So, last year, our online sales peaked at just over 15% of sales, they've settled down now just under 14% around 13.9. So, still incredibly strong on a two-year basis. The real star performer, particularly in the second quarter actually, has been our large store format, where we've seen very strong growth. So, we don't believe there's a whole lot of cannibalisation going on between our channels at this stage. I will pass over to Imran to talk a little about the cost inflation lines.

Imran Nawaz: Sure. So, I mean, it's the stuff that you read about every day, right? We're seeing inflation in certain commodity type items. We have it on the distribution side, the HGV shortage driver, you've seen publicly, we're paying a bonus to bring people in. I look at all of that as inflationary pressure, and that's what we're working very hard with our suppliers to manage and mitigate as much as we can. And that's the work we've done. We've done very well in the first half. And we aim to continue into the second half. That's how I see it. I think the second question was on personnel expenses. I mean, reality is as you know, we're ramping up for Christmas. And we're actually hiring, I think, was it 30,000?

Ken Murphy: 30,000 of which half are already.

Imran Nawaz: 15,000 are already in place. So, it's actually more, that we're needing to bring people in, because ultimately servicing Christmas in the right way, is the most important thing right now in this business.

Ken Murphy: And just to finish on that last point. We're really proud of the fact that we are a very competitive payer in the market. And we look to look after our colleagues incredibly well. So, since 2014, we've increased wages by over 30%. Just this Summer, we've agreed with our colleagues and their unions, a pay rise of 2.7%. So, we feel we're in a sensible place with our colleagues on pay and we continue to monitor and review it on an ongoing basis.

Operator: Our next question is from Nick Coulter at Citi. Please go ahead, your line is open.

Nick Coulter: Morning, two questions, if I may please. Actually, with apologies, it's a bit of a crystal ball question, but when you talk to the sales drivers in the midterm, is the key driver, or drivers, is he taking core share in store? Is it channel shares? Is it convenience in sale? Look, I'm just trying to get a sense for the pool of materiality, the drivers of growth in the midterm, please. And secondly, just to clarify a previous question, would you bolstering M&A, to enhance, or leapfrog your capability in some of the new areas of digital? Or, I guess conversely, which areas do you think you need to build capability, and from an organic perspective? Thank you

Ken Murphy: Thanks very much, Nick. So, I think that one of the beauties of the Tesco platform, is its ubiquity. And in so far as, we are really strongly represented in every channel the customer would wish to shop. And therefore, we're actually agnostic about where the growth comes from.

Ken Murphy: Our ambition is to build a kind of a master relationship with the customer through the digital platform and through the Clubcard and let them decide how they want to shop. Let them decide which products and which offers are most valuable to them, let them decide which channels are most convenient to them, and then reward them for progressive shopping behaviour. So, we can't predict, as you rightly say, my crystal ball has been on the blink for a while now, with any confidence what will happen from a channel perspective. All we know is that no matter what they do, we're well-positioned to respond.

Ken Murphy: In terms of M&A activity and our desire to make sure that we're right there when those demand missions crystallise, we obviously are very confident in our own technical capabilities, and as I said earlier, that customer relationship is really critical for us. So, our Whoosh platform operates really well for customers. We've had some great feedback from it, and importantly, it's technically designed to integrate seamlessly with our supply chain platforms, our store platforms, our billing platforms, our dot-com platform, and crucially, our Clubcard platform. And it's very hard to acquire that so that's why we chose to build it ourselves and we're very pleased so far with the results. That said, we would never rule out future M&A, we will continue to monitor it very, very closely, and respond as and when it makes sense.

Nick Coulter: I was more thinking in terms of ad-tech or marketplace or some of those newer areas that the legacy Dunnhumby expertise might not have the capability in.

Ken Murphy: Yeah. I think in Dunnhumby specifically, for sure, as and when the opportunities present themselves on digital capabilities that we don't have today, we would be definitely open to that. We have a new CEO joining us in January, and of course, once he's had a chance to get himself bedded in, we'll be happy to give you an update the next time we speak probably at the preliminaries next year.

Nick Coulter: Thank you.

Ken Murphy: Thank you.

Operator: Our next question is from Fabienne Caron of Kepler Cheuvreux. Please go ahead. Your line is open.

Fabienne Caron: Good morning everyone. Two questions from me. The first one regarding online sales and your share that you gave up 13.9%. So is it fair to say that the online sales on an absolute level was flat on H1 over H1 at over 2.8 billion would be my first question? And the second question, you said so you had no price inflation at Tesco, more price deflation given of ID price match and the Clubcard, but you had some operating cost inflation. So, can you share with us the operating cost inflation that you had in H1 and how much you expect to be in H2 please?

Ken Murphy: Hi Fabienne. Thank you. So, we experienced actually pretty strong growth in the first quarter online because we still had some residual lockdown impacts, and then we went into a modest decline in the second quarter, in quarter two. So, from memory, we had a very, very modest decline in sales in the half online.

Imran Nawaz: Yeah, it was the second quarter where we declined and on the whole for the first half, we were actually flat to slightly ahead in totality once we added up all the numbers. In terms of your second question, Fabienne, so look, in the first half when you look at the profit bridge that we had in the presentation, we had strong sustained sales, we had significant recovery in fuel sales, which was not unhelpful from a profit perspective, we had greater sales from a higher margin non-foods, whether it was GM or clothing, and that helped us offset, together with the cost efficiencies that we started, to mitigate most of the inflationary impact.

Imran Nawaz: I don't want to give all the numbers because then it becomes a bit of a laundry list of items, but on the whole, we delivered our profit growth that way. As I think about the second half, clearly the cost inflationary pressures will continue, they're not going away, and we're going to try and figure out how do we navigate that as successfully in the second half as we did in the first half, albeit that the second half in absolute at the current guidance is lower in absolute.

Fabienne Caron: Okay. But can you help us regarding the range of cost inflation? Are we talking about five, 6% in H1 and more in H2?

Imran Nawaz: Yeah, well, I mean, clearly, the reason why I'm not giving the step up in inflation, because the reality is it's a very moving picture right now. As you can imagine, the CO_2 situation or whether it's the freight and the distribution and the volume needs that we have, it's still working itself through so rather than give you here's a definitive number, my angle is much more, there is a challenge that the industry is facing, we're one of them, inflation, and we're needing to manage that together with our suppliers as well. And that's the approach we're taking.

Fabienne Caron: Okay. Thank you.

Operator: Our next question is from Tom Davies at Berenberg. Please go ahead, your line is open.

Tom Davies: Morning guys, two questions from me. Firstly, following up from Andrew's earlier question, with the 1 billion gross savings outlined, what cash cost do you expect to extract there? And I guess depending on the answer to that, if you require a cash cost to release continuous cost savings, aren't those exceptional costs then inherently recurring and should be included in the free cash flow target? And then second question, what elements in the supply chain do you think are exhibiting hits to recess and what elements do you think are just temporary pressures?

Imran Nawaz: Okay. So let me take the first question.

Ken Murphy: First two, yeah.

Imran Nawaz: Look, on cash costs to incur the savings, as we indicated in the earnings release, the ultimate aim is to do it through business as usual activities and avoid incurring exceptionals, but I'm not going to stand here and tell you we won't incur any. I'd first want to execute the program and you have my commitment that we will continue to report those very black and white so you will understand what they are and why we incurred them, and that's pretty much what Tesco has been doing.

Imran Nawaz: As it comes to the definition of free cash flow or adjusted free cash flow, I think the feedback I got in the rounds talking to yourselves and talking to investors is it gets a little bit muddled if you add property decisions, proceeds from selling a store or buying another one or having exceptional costs. And we decided, well, why don't we remove the noise and give people clarity? What is the underlying cashflow generation of the business that you're running? Everything else after that is a choice and I think that's why we've done what we've done. If I'm very honest with you, it makes life a little bit harder because in more recent years, it's actually been a net positive, ie, we've actually sold more stuff than we incurred in exceptionals so this makes life a little bit harder for us if I'm honest, but it's the right approach and I think it's a much more clean base for investors to understand and for yourselves to understand our true performance.

Ken Murphy: Thanks, Imran. In terms of your supply chain question, Tom, we see the majority of the supply chain issues as temporary. Now, how long is temporary? That is something we don't know. I think what's really important though is that we are maintaining a fantastic level of variability despite all the challenges we've seen over the summer, and we have very strong plans in place to continue doing so right the way through Christmas and beyond. So, the short answer is that I think these are for the most part temporary. I think markets and businesses and even countries adjust to conditions and respond accordingly. I think that will happen in this case too but the timeframe is the difficult thing to judge.

Tom Davies: Good. Cheers, guys.

Ken Murphy: Thanks, Tom.

Operator: Thank you. Once again, if there are any further questions, please dial star one on your telephone keypad now. Our next question is from William Woods at Bernstein. Please go ahead.

William Woods: Hi, there. Thanks very much for taking my questions. The first one is could you just comment on the performance of the economy or value private label ranges? From the data we're seeing, it appears to have underperformed in the recent months and just wondering what's happening there? And then secondly, in terms of the supply chain questions that have already been asked, just building up in terms of Christmas preparations versus a typical year, how far are you progressed with your stock buildup in your stores and your warehouses? And can you say that consumers won't see any shortages over the Christmas period? Thanks.

Ken Murphy: Thanks very much. So, look, the first thing to say is that the performance in total speaks for itself. So, we have outperformed the market in both volume and value terms, so that for me suggest that the portfolio of products and the value, particularly the value propositions, are actually performing very well in the market. What might be distorting the read somewhat is that demand for premium products is elevated. As people stay home more, eat out a bit less, you are seeing elevated demand for our Finest range, and Finest is performing incredibly strongly this year and is outperforming the average for sure. So, it could be a mix effect but I don't see any under-performance in our value range. That would be the first thing to say.

Ken Murphy: The second is that the distribution shape of getting stock into our stores this Christmas is a little different from last year. It's spread a bit more evenly. We front-loaded it last year and this year we're spreading it a little bit more evenly. We have absolutely concrete plans in place to make sure that that happens on time and we have no plans to disappoint customers this Christmas. We are planning on it being a great Christmas.

William Woods: Thank you.

Operator: There seem to be no further questions at this point, so I'll hand back to Ken Murphy for closing remarks.

Ken Murphy: Thank you very much. On behalf of Imran and myself, I'd just like to say a huge thank you for taking the time this morning to listen to our presentation, for all the great questions that you asked for us, and we're looking forward to speaking to when we give our Christmas update and then again when we present our final results next year. So, in the meantime, take care and good luck, and hope you have a wonderful Christmas.