Tesco

Preliminary Results 2021/22

Analyst event

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Transcript

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Ken Murphy:

Ken Murphy:

Good morning, everyone, and welcome to our preliminary results presentation. I'm joined by our CFO Imran Nawaz, and in a few moments, I'll give a brief introduction. Imran will then talk you through the full year results, and after that, I'll update you on the progress we've made against our strategic priorities, as well as talking to you about the current market environment and our outlook for the year. We've then allowed plenty time for Q&A at the end.

Ken Murphy:

We all know that it has been an extraordinary year. I'm really proud that throughout all of the challenges and changes, we have stayed resolutely focused on our customers. Our commitment to value has been unwavering, and we have delivered market leading availability. All of these efforts have resulted in continued strong growth, building on our momentum and helping us to emerge from the pandemic as a stronger business. This has only been possible thanks to the brilliant work of the entire Tesco team. And I want to thank every one of them for going the extra mile for our customers. It has been fantastic being able to get around and meet many more colleagues over the last year, and I feel very privileged to work alongside them.

Ken Murphy:

I'm delighted that in agreement with USDAW in the UK, we've been able to agree a substantial new pay deal for our UK store colleagues, as well as a further thank you payment in recognition of colleagues' amazing contribution last year. Our future success depends on our colleagues and our commitment to them has never been stronger. Before I reflect on business performance, I wanted to take a moment to speak about the war in Ukraine. All of those affected are in our thoughts. We were really quick to respond, together with our colleagues and customers, doing whatever we could to help. Our teams in central Europe started to transport donations of food and other essential items to the border within hours of the conflict starting, as well as supporting with logistics and supply chain capability at the border.

Ken Murphy:

To date we have supplied nearly 1,000 pallets of food for humanitarian organisations and are helping in other ways, too, such as making it easier for refugees to access job opportunities and removing all charges from calls and money transfers to Ukraine. As always the generosity of TESCO colleagues and customers is incredible. Together we have raised almost £4 million to support the vital work of the Red Cross, as well as more than £500,000 for humanitarian organisations in central Europe.

Ken Murphy:

Since I presented our results to you 12 months ago, our business has dealt with a remarkable amount of external change. We have continued to support customers and colleagues through the pandemic, navigated significant industry disruption, and further improved our competitive position despite inflation starting to bite. You can see on the slide the contribution we have been able to make on so many different levels, helped by the efforts of our colleagues, the capability of our supply chain, and the strength and depth of our relationship with our supplier partners.

Ken Murphy:

Turning to our business performance. As I set out in October, customer satisfaction is critical to our success. It is the best measure of whether the efforts we are taking are being recognised by customers and underpins our ability to grow in the medium term. Over the past year, we have made conscious investments to strengthen the shopping trip for customers, such as expanding Aldi Price Match, and ensuring we had sufficient resource to keep products on the shelf throughout the industry supply chain challenges. I'm really pleased to say that these efforts have been recognised. Our level of outperformance for our customers recommending Tesco versus other supermarkets has further improved over the course of the year.

Ken Murphy:

As you'll see here, our brand net promoter score has also continued to strengthen. As you know, holding or growing market share in our core UK market is really important to us. It provides us with the scale and reach to serve more customers, however, wherever, and whenever they choose to shop. This year, we gained market share in every single month. Importantly, our outperformance was even stronger in the volume terms than in value, as we held back inflation. You can see that this is set against a market share decline for the rest of the big four, which is even more marked in volume terms. We had our longest unbroken run of switching gains, too, with 23 consecutive periods where we picked up trade from our competitors. Progress against this measure isn't linear, and you should expect it to move around quite a bit, particularly as we see some normalisation in the market.

Ken Murphy:

We are pleased with our market share performance across our other markets too. Ireland has driven an improvement of 11 basis points, as we have strengthened our value offering and focused on making shopping easier for customers. In Booker, while there isn't a defined market share metric for the wholesale market, we're really pleased with both our customer retention and our rate of new customer acquisition. We also saw an improvement in market share in Central Europe. As you can see, we've delivered improvements in quality, customer satisfaction, and brand perception too, with all three businesses benefiting from leveraging the group scale and capabilities. Over to you, Imran.

Imran Nawaz:

Thank you, Ken. Good morning everyone, and thank you for joining us. I'll start with an overview of performance followed by some more colour on trends and drivers. Throughout my review percentage growth rates will be expressed in constant currency unless stated otherwise. In the year we have delivered a very strong performance in all of our key metrics across the group. Group sales grew by 3% on a one year basis, and by 10.2% on a two year basis, with a strong performance across all regions on top of exceptional sales last year. Group profit increased by 58.9% to £2.8 billion. This reflects the strong sales performance across the retail businesses, a reduction in COVID 19 costs, and a return to profitability in the bank, partially offset by inflationary pressures in the cost base and ongoing investment in the customer proposition.

Imran Nawaz:

You'll remember that at the half, we introduced a simpler retail free cashflow measure, and on this basis, retail free cashflow was £2.3 billion, up £0.9 billion on last year. This was driven by higher retail operating profits, the elimination of the UK pension contribution following our one-off contribution last year, and a working capital benefit from higher sales, partly offset by an increase in capital expenditure. Net debt at the end of the year was £10.5 billion, £1.4 billion pounds lower than last year, primarily driven by the strong free cashflow generation. In line with our targeted payout ratio of circa 50% of earnings, we have proposed a final dividend of 7.7 pence per ordinary share, taking the full year dividend to 10.9 pence per ordinary share an increase of 19.1%.

Imran Nawaz:

Our headline earnings per share of 21.86p represents an improvement of 88.8%, with the recovery in retail and bank profits more than offsetting the higher tax charge. Total retail sales for the year were £53.8 billion, with profit of £2.6 billion. Both our UK and Ireland and central Europe segments delivered a strong profit recovery, with quantum profits exceeding 19/20 levels for each segment. Tesco Bank generated £176 million of profit compared to a loss of £175 million in the prior year. Over the next few slides, I will cover the performance of each of our segments in more detail, starting with sales before moving on to profit.

Imran Nawaz:

Sales have shown good momentum in each of the UK, Ireland, and Booker businesses. You'll see the exceptional growth on a two year basis, with substantially higher sales than before the pandemic. More specifically, in the UK, sales grew ahead of our expectations with like for like growth of 0.4%. Our relentless focus on value and service drove consistent outperformance against the market throughout the year. While we saw deflation over the year as a whole, our numbers do include some benefit from inflation in the second half. In Ireland, while we delivered double digit like for like growth on a two year basis, our one year like for like declined. We traded over an exceptionally strong comparative with restrictions on hospitality in place last year for longer than in the UK. In Booker, one year like for like sales grew by 15.3%, driven by a sharp recovery in catering sales as the hospitality industry reopened. Retail was also resilient against a very tough base.

Imran Nawaz:

I'll now break down sales by quarter and then give some colour by channel and then by category. In terms of like for like growth through the year, you'll see that our UK and Ireland businesses followed a relatively similar shape. Q1 growth was impacted by the lapping of stockpiling in the first lockdown last year. This was followed by stronger growth in Q2, as we lapped a period of lower restrictions and with warmer weather, staycations, and events such as the delayed Euro 2020 this year. Q3 and Q4, then lapped further lockdowns. By contrast, for Booker, while sales quantum followed the typical seasonal shape with a summer peak, you'll see that growth rates built quarter by quarter throughout the year, following the phased reopening of hospitality from period two.

Imran Nawaz:

Focusing on our UK business, you'll see that we delivered a strong performance in our large stores throughout the year, with some normalisation in customer shopping behaviour resulting in higher levels of store footfall and discretionary spend. We have consistently focused on delivering a great customer shopping trip, investing to protect availability in light of the strong pressure on our supply

chains. As anticipated, with some of our customers choosing to return to shopping in our stores, we did see a decline in online sales, especially as we lapped last year's peak demand in the second half. Our online business remained significantly larger than before the pandemic, with two year like for like of 66%, which equates to £2.3 billion of additional online sales.

Imran Nawaz:

We were pleased that our convenience stores returned to growth in the second half, with a particularly strong growth in our on-the-go stores, as city centre footfall started recovering from Q2 onwards. Turning to performance by category. Food obviously reflects the majority of our business, and for the year as a whole delivered sales that were slightly down, reflecting elevated levels of in-home consumption in our base. Looking across the year, we saw food sales decline in Q1 as we lapped the start of the first lockdown and a period of stockpiling, followed by growth across both Q2 and Q3. In Q4 food sales did decline year on year, reflecting very strong comparators.

Imran Nawaz:

We saw strong growth in both GM and clothing in the first half of the year, which reflects lower discretionary spend in the first lockdown last year, and a benefit this year from the continued closure of non-essential retail. Growth in clothing was particularly strong, especially in kids and leisure wear, as we continue to evolve our ranges to reflect changing customer demand. As a result, we are able to achieve a higher proportion of full price sales, supporting our profitability. Our non-food performance also benefited from rebalancing our space in 116 stores over the last couple of years, making our clothing more of a destination, and our GM ranges simpler and easier to shop. On a two year basis, we delivered growth across all three categories. 8.1% like for like in food. 1.6% in GM and 15.1% in clothing.

Imran Nawaz:

Turning to Ireland where sales were 10.6% higher than pre-pandemic with a strong performance across all categories and all channels. On a one year basis our sales declined by 2.9%, as we traded over a strong performance in the prior year, reflecting the market impact of stockpiling in Ireland and the longer period of restrictions on hospitality.

Imran Nawaz:

We continue to see strong growth in our online business, where we have increased geographic coverage and expanded click and collect locations from 28 to 65 stores. Online now represents 8% of our sales in Ireland. We've announced our intention to acquire 10 Joyce's stores in Galway, providing us with a platform to reach more customers and to bring online to more locations in the west of Ireland. Subject to regulatory approval, we expect to complete this transaction this year.

Imran Nawaz:

In Booker sales have grown strongly on both a one year and two year basis. Performance versus last year was driven by the sharp recovery of catering sales, which grew by 56.1%, as the hospitality sector reopened for outdoor dining in April and indoor from mid-May onwards. Given the level of COVID-19 distortion, I have included some quarterly charts here on a two year basis. You will see that our retail business has delivered very consistent growth on a two year basis, maintaining the increased sales from last year, we are really encouraged by our strong customer retention supported by maintaining our keen focus on pricing.

Imran Nawaz:

Our catering business recovered strongly from Q2 onwards and we worked hard to mitigate the impact of significant supply chain challenges. Growth in Q4 was lower than in Q3 due to the emergence of the Omicron variant and its impact on the restaurant industry. In central Europe, like for like sales were up 2.9% on a one year basis and 2.5% on a two year basis, with growth across all channels and categories.

Imran Nawaz:

In addition to some benefit from inflation, we saw a strong one year performance from non-food. We were able to offer our full range following non-food sales restrictions last year and saw customers returning to our large stores. In addition, we've doubled the size of our online business over the last two years, albeit from a relatively small base.

Imran Nawaz:

Moving on to profit, as you can see on this graph, retail operating profit improved by £686 million year on year to reach £2.6 billion, driven by our UK and Ireland segment. In the UK and Ireland, profit growth of 35.4% was driven by a number of factors. In the UK COVID-19 costs reduced from £892 million last year to £220 million. With this year's cost primarily relating to absence for those colleagues who were sick or self-isolating. We benefited from a sales recovery in categories that were particularly impacted by COVID-19 last year, including margin accretive categories, such as clothing. We invested in customer shopping trip in price and service.

Imran Nawaz:

Our efficiencies across the year mitigated the cost inflation that we saw coming through, especially towards the end of the year. In central Europe, profit was up 41.1%. Again, reflecting lower COVID-19 costs. Non-food sales grew strongly following the restrictions last year. And we benefited from higher mall income. As in the UK, we continued to invest in our customer offer, and our operating efficiencies, largely mitigated cost inflation.

Imran Nawaz:

Turning to Tesco Bank, we have seen some recovery in volumes this year, driven by an increase in new business, although lending balances still remain below 19/20 levels. The bank’s return to profitability was predominantly driven by the year on year movements in bad debts. The profit also included a £13 million contribution from Tesco underwriting, which is now fully consolidated following the acquisition that we completed back in May.

Imran Nawaz:

As you can see from the ratios on the slide, the balance sheet remained strong. As a result of the stronger performance this year, the bank paid an £87 million pound dividend to Tesco Group, consisting of the usual £50 million plus a catchup of £37 million in relation to the dividend paid last year. This slide gives you more detail on the components of our statutory profit performance, which increased by 186% as higher adjusting items and tax charges were offset by a reduction in finance costs. Formally known as exceptional items, and now as adjusting items, we incurred £265 million of adjusting charges in the year.

Imran Nawaz:

As mentioned at the half, this was driven by £193 million settlement relating to historic shareholder litigation claims, which was paid in full in the year. Net finance costs were £542 million, including a fair value re-measurement credit of £123 million, primarily relating to the mark to market movement on inflation link swaps, which was a significant change to the prior year. Before fair value re-measurements, net finance costs were £58 million pounds lower than last year at £665 million, driven by lower net pension finance costs and a lower interest charge on lease liabilities. Our tax charge was £510 million, up from £104 million in the prior year. This reflects the growth in operating profit, both in our retail business and in Tesco Bank. We also incurred a one-off charge due to revaluation of our deferred tax liability, following the increase to the UK corporation tax rate from 19% to 25%.

Imran Nawaz:

Moving now to our cash performance. Based on the simplified definition that we introduced at the half year, we generated £2.3 billion of retail free cash. And I'll talk you through the major components and year on year movements. Before working capital, you'll see that we generated £4.3 billion of retail free cash from operations. An increase of just over a billion. This reflects higher sales and lower COVID-19 costs, as well as the benefit this year from no longer making contributions to the pension scheme, following our one-off contribution last year from the Asia disposal proceeds. Our total working capital inflow was £501 million, mainly driven by a sharp recovery in fuel volumes and the recovery of Booker's catering business in the first half. Working capital in the second half was then broadly neutral with the typical seasonal unwind after the summer peak being offset by strong sales in the UK and higher fuel payables, reflecting both volume and cost price inflation. Capital expenditure was £1.1 billion in line with our guidance range, and we have provided the usual breakdowns by region and type in the appendices.

Imran Nawaz:

This was £148 million pounds higher than last year's CapEx, reflecting more store openings across the UK and the continued expansion of our online proposition in both the UK and in Ireland. We paid £641 million of interest costs of which £402 related to finance charges on lease liabilities and £239 to interest paid on bank debt. Cash tax paid was £195 million benefiting from three factors. First, a benefit of £120 million from the one-off pension contribution last year, following the disposal of our Asia business. Second, a benefit of around £80 million from the new super deduction for certain capital investments, which was introduced in March 2021. And third, a benefit from the utilisation of prior year losses. We expect the first two of these factors to recur in the coming year. We received £109 million in dividends from Tesco Bank and property joint ventures and purchased £144 million of shares in the market to offset dilution from share schemes. Finally, capital repayments of leases was £571 million.

Imran Nawaz:

I've included this next slide to describe the performance of items now outside our simplified definition of retail free cash flow. The net business acquisitions and disposals line includes £122 million of proceeds from the sale of our business in Poland to the Salling Group, which completed in March. Net property proceeds and purchases of £228 million relate to £308 million from the sale of properties, partially offset by an £80 million outflow related to property buybacks. The property sales included a disposal of our Fenny Lock distribution centre, along with the sale of properties in Poland that were not part of the corporate transaction with the Salling Group. Partly offsetting this,

we bought back one extra store in Bury and a full stake in the Tesco Sarum limited partnership, bringing 11 stores into full ownership. Adjusting items, principally covered the historic shareholder litigation claims that I mentioned earlier, which were fully settled in the year.

Imran Nawaz:

On the previous definition, therefore we generated £2.3 billion of retail free flow compared to £1.2 billion in the prior year. In the coming year subject to regulatory approval, we expect our other cash items to include the cash consideration for Joyce's as well as a circa £200 million proceeds from the sale of 17 malls and one retail park in Central Europe that we agreed this month. We also exercised the option in February to buy back our partner's equity in the Tesco Dorney property joint venture, which we expect to complete in the fourth quarter of this coming year.

Imran Nawaz:

Turning to the balance sheet. Total indebtedness was £10.8 billion, down £2.2 billion with all three components of indebtedness reducing year on year. Due to the impact of market movements on our pension assets, we carried a £2.1 billion IAS 19 pension surplus at the end of the year, in comparison to a £1 billion pound deficit last year. In line with our definition, this surplus is not included in indebtedness. So the £0.2 billion deficit that you see on the slide reflects only the pension schemes that are in a net deficit position. We also saw a £0.9 billion reduction in net debt before lease liabilities driven by our strong cash generation.

Imran Nawaz:

Finally, lease liabilities themselves reduced to £7.9 billion following the purchase of our partner stake in the Tesco Sarum limited partnership that I mentioned earlier, as well as the sale of our Polish business. Our total indebtedness ratio was 2.5 times compared to 3.6 times last year. Our new leverage ratio - net debt to EBITDA - was 2.5 times compared to 3.3 times last year and is midway in our target leverage range of 2.3 to 2.8 times. Our fixed charge cover was 3.5 times, up from 2.9 times. Along with higher retail EBITDA, the reduction in lease interest payments and lease capital prepayments more than offset a small increase in net finance costs.

Imran Nawaz:

I wanted to close by talking about shareholder returns. We've delivered a strong performance this year across sales, profit, and cash generation. This does, of course, flow into shareholder returns. First, in line with our targeted payout ratio of circa 50% of earnings, I'm pleased that the proposed full year dividend is an increase of 19.1% at 10.9 pence per ordinary share. This increase reflects the growth in retail and bank operating profits, partly offset by the impact from last year's dividend policy exception. As I mentioned in October, we intend to pay a progressive dividend going forward. Second, having launched our ongoing buyback program in October, we have already purchased £300 million pounds worth of Tesco shares today. I'm pleased to be able to confirm today a commitment to buyback a total of £750 million worth of shares over the next 12 months.

Imran Nawaz:

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

Ken Murphy:

Thank you, Imran. Now to our strategic priorities. As a reminder, these are the four priorities we shared with you in October. 'Magnetic value for customers', 'I love my Tesco Clubcard', 'Easily the most convenient', and 'Save to invest'. I strongly believe in letting our customers see any new initiatives ahead of our competitors. So we won't be sharing any specific details of our future plans, but I will give you a sense of the progress we have made under each priority.

Ken Murphy:

Price is a critical component of magnetic value, and we have been unwavering in our commitment to keep prices as low as possible for our customers. Although we could not have foreseen all of the increasing pressures that consumers are starting to face, our efforts over the last 18 months or so have put us in a really strong position to help. You can see from the chart that we have strengthened our competitiveness throughout this year, reaching our strongest relative price position for many years. As a result, we are much better placed than we were the last time the market experienced significant levels of inflation. Importantly, customers are recognising this too. Our value perception has gone from strength to strength. Over the last couple of years, you can see a meaningful gap opening up between ourselves and the rest of the big four supermarkets over five full percentage points.

Ken Murphy:

So how have we achieved this? As you know, our value proposition is made of three key elements, which together form a powerful combination. Aldi Price Match clearly plays an important role. It is serving its purpose really well, removing price as a reason to shop anywhere other than Tesco. The rigour with which we have made sure that our customers never lose out and the expansion of the basket to 650 lines in October have made it a really powerful part of the proposition. To give you a sense of just how important it is, Aldi Price Match items feature in 99% of weekly shops in our large stores, providing savings for millions of customers week in week out.

Ken Murphy:

Clubcard prices have also landed really well with customers. From the initial trials back in September 2020, we have now moved all of our promotions onto the scheme. As well as providing customers with a really clear sense of how much they are saving it also enables us to negotiate the very best discounts for them with our suppliers. The most recent addition to Clubcard prices was our iconic lunchtime meal deal. This allowed us to keep the price at an inflation busting £3 for anyone using their Clubcard, at least 50p cheaper than most of our competitors and at the same price as it was 10 years ago.

Ken Murphy:

Finally, the relaunch of Low Everyday Prices, which benchmarks around 1,600 products to the cheapest available alternative base price. With a particular emphasis on household and health and beauty, this removes the need for customers to shop around on an even wider range of everyday products.

Ken Murphy:

Magnetic value is also about ensuring that we are offering our customers fantastic quality. I'm delighted that we've been able to step forward on this front too, particularly in a year with so many supply chain challenges. On the product development side, we launched over 300 new products in the year, including adding a significant number of new seasonal lines to our Christmas range. We have also continued to work on reformulation, improving the quality of over 500 lines. Finest is a key focus for us as it offers customers the chance to trade into more premium products without needing to shop elsewhere. At a time when customers are recalibrating their choices as to whether to eat in or out, it's really important to have a great offer to suit every meal occasion.

Ken Murphy:

The finest range includes around 2,000 products and grew by 9.3% this year. It generated sales of £1.7 billion pounds making it the UK's largest premium food own brand. As a result of our efforts so far, you can see from the chart that we delivered an improvement in quality perception this year against the market trend.

Ken Murphy:

You may remember that we launched ambitious new health commitments across all of our markets a year ago. Over the course of the year, we have continued our reformulation program, looking at ways to improve the nutritional characteristics each time we touch a product, either reducing the fat, sugar and salt content or increasing dietary fibre. In total, we have removed a further 7.7 billion calories from our own brand ranges this year. Demand for plant-based products has remained high. Since our 2018 baseline, we have now grown sales of plant-based meat alternatives by 130% in the UK. In December, we launched a range of Wicked Kitchen vegan products through our Booker Retail Partners, and we have introduced Plant Chef to all of our three central European markets.

Ken Murphy:

Although we clearly made good progress on each of these initiatives, our overall percentage of healthy food has held flat for two key reasons. First, with more customers eating at home, we have seen some of their less healthy choices transfer from restaurants into retailers. Second, the temporary consolidation of ranges to support availability throughout the industry supply chain issues has had an effect. We remain committed to moving the percentage up in the coming year and are progressing well with our trials ahead of the forthcoming HFSS legislation.

Ken Murphy:

The final component of magnetic value is sustainability. Increasingly customers see this as a given for whomever they choose to shop with. We launched our ambitious new climate commitments in September, bringing forward our net zero commitments for our own operations across the group to 2035 and launching a new scope three target of 2050. We were proud to launch the UK's first electric HGVs in January, and to be the first to pilot them in Hungary and the Czech Republic. We're also making good progress on electric dotcom vans. For customers, our network of EV charging points is now in 500 stores, providing over 2 million free charging sessions to date. On plastic, we have now removed over 1.6 billion pieces of plastic from our operations, and we are the first retailer to roll out a nationwide soft plastic recycling program in the UK.

Ken Murphy:

We're also supporting innovations such as our trial with Apeel on citrus fruit, which aims to minimise both plastic and food waste. Our community efforts always get great support. Under our 'Buy One To Help A Child' campaign, we made a donation for every piece of fruit and veg that customers bought over a period of three weeks. This enabled us to donate the equivalent of 3 million extra meals on top of the 53 million donated through our usual food redistribution programs.

Ken Murphy:

Moving now to the second of our strategic priorities, 'I love my Tesco Clubcard'. This priority is about combining the power of the Clubcard, our online grocery business, and our increasing digital relationships with customers, to create a powerful digital platform. In doing so we can unlock new value for our customers, for our suppliers and for Tesco, in the form of new incremental income streams. Clubcard prices has been a key enabler of this, encouraging more and more customers to use an app to interact with Clubcard. This drives greater frequency of interaction, enables a much more immediate relationship between earning, checking, and spending Clubcard points.

Ken Murphy:

You can see on this chart, how the number of regular app users has increased more than fourfold over the last two years to 9 million. It is also worth noting that we have been leveraging the same capabilities across the group, with Clubcard prices launching in our other markets, in Tesco mobile, and in Tesco bank. As a result, Clubcard penetration has continued to increase. Customers are swiping, tapping, or scanning their Clubcards on three quarters of all UK Tesco transactions, and we expect this to further increase over the coming months. This greater level of engagement is allowing us to improve the customer experience of Clubcard too with personalised coupons and increasingly relevant rewards.

Ken Murphy:

Our third priority is 'Easily the most convenient', serving our customers wherever, whenever, and however they want. It's about keeping our existing estate relevant for customers while seeking out capital light growth in convenience and online.

Ken Murphy:

Tesco has emerged from the pandemic a much stronger business, and nowhere is this more true than online. As expected, we have seen some normalisation, but we are still seeing around 1.2 million orders each week. Over 60% higher than pre-pandemic. Basket sizes are up too, and online grocery still represent nearly 14% of the total UK sales, about 5% more than two years ago.

Ken Murphy:

This is testament to the brilliant work the team did to open up our capacity when customers needed us most in the first few months of the pandemic, and their continued efforts to maintain an outstanding service to our customers over the last two years. As a result, we gained a million new customers to Tesco, and around 67% of those are continuing to shop with us, either online or in store.

Ken Murphy:

I should stress that the normalisation we are seeing is an industry feature, and in fact, we are retaining more of the uplift in trade than others. From an exceptionally strong base last year, we have further increased our online market share by over 140 basis points. We continue to lead the online market in the Republic of Ireland with a share of 59%, and our online business in central Europe has grown strongly.

Ken Murphy:

While we are expecting further normalisation in the current year, we see online as one of our key medium term growth opportunities. We now have four UFCs open and our fifth in Rutherglen open next month. We've seen the two most recent sites following a faster ramp up trajectory than either West Bromwich or Lakeside. In addition to providing extra capacity, to allow our grocery home shopping business to grow, UFCs also improve the economics. Our UFC pick rates are around four times the rate of manual picking. Another area we are focusing on from an economic point of view is click-and-collect. Having peaked at around 25% of orders during the pandemic, we are still seeing around double the proportion of click-and-collect than we had two years ago. This year, we have rolled out an additional 102 locations for customers to be able to pick up their groceries and are continuing to refine the customer experience.

Ken Murphy:

Our super fast home delivery service, Tesco Whoosh, is now in 200 stores. While we are still not certain of the scale of demand in this part of the market, our aim is to make sure that if customers do want the convenience of having their shopping delivered within a very short period of time, they can do so without leaving the Tesco ecosystem. We plan to roll this service out to 600 stores in this financial year with further refinements to the customer offer being trialled along the way.

Ken Murphy:

We have pushed on with our convenience opening program opening 40 new Express stores and 59 new One Stops. In the coming year, our opening program will take us to a total of over 2000 Express stores and over 1000 One Stops. In addition, we continue to seek opportunities to make our larger stores even more compelling for customers. With concession partners, including Decathlon, YO! Sushi and Homebase. Booker's catering business has coped brilliantly with the challenges of the pandemic and is emerging a stronger business. Over 37,000 new catering customers were added in the last year alone. It is also continuing to build on its partnership with Just Eat, and the retail business is performing well too.

Ken Murphy:

Although the majority of our growth in stores is in convenience, I would like to mention our planned acquisition of 10 Joyce's Supermarkets in the Republic of Ireland. These stores provide us with a unique opportunity to grow share in the Galway region, and we look forward to welcoming our new colleagues to the Tesco Ireland family subject to regulatory approval.

Ken Murphy:

Our final strategic priority is 'Save to invest'. You've already heard from Imran that cost efficiency is not new to Tesco. It's in our DNA to ensure that everything we are doing and every pound we are spending is in the service of our customers. That's more critical now than ever. We set ourselves the goal of being able 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. We identified £1 billion of savings over three years, broadly evenly phased with the key areas of opportunity being goods and services not for resale, property, improved operational efficiency and central overheads.

Ken Murphy:

Since we constructed the plan, the external environment has changed and cost inflation has rapidly accelerated. This is certainly spurring us on and we will do everything we can to increase the overall pace and scale of the forward program particularly in the first year. We have already delivered a number of changes that will result in lower costs in the coming year, as well as better reflecting how our customers shop with us. For example, we removed counters from a further 317 stores in February and have been introducing more card only tills and increasing the efficiency of checkouts. We also moved replenishment from nights to days in a number of stores, enabling more colleagues to be available on the shop floor, to help customers at peak times. Closing our Jack's format and unifying our leadership structure in clothing and general merchandise also help simplify our business.

Ken Murphy:

I wanted to close by talking about the current market environment. We know that this is a really challenging time for many of our customers, facing the biggest increase to the cost of living that we've seen in decades. Over 70% of customers say that inflation is a serious concern for them and real incomes are forecast to fall by almost 4% this year. As you would expect, this has impact shopper confidence, which has fallen sharply since the start of 2022, on top of any uncertainties around the emergence from the pandemic. You can see from this chart that many customers are already planning changes to the way they shop, and we will make sure that we are there to support them. Own brand will play an important role, and we continue to make sure that we have the strongest range and the best possible prices across every tier and every category. We need to stay close to our suppliers too, with the crisis in Ukraine, straining availability and adding to the cost of ingredients, particularly in commodities, such as wheat and sunflower oil.

Ken Murphy:

The strength of our supply chain and our strong supplier relationships put us in an excellent position relative to others. But we do need to recognise and respond to the challenges being faced by the industry. Against this backdrop, it's essential that we keep listening to our customers. Value is going to be critical. And I see three immediate priorities as we look to the year ahead. We will stay laser-focused on price. We will not allow price to become a reason for customers to shop anywhere else than Tesco. We will also make sure we have a compelling offer for those customers looking to save by eating in instead of eating out. Feeding the family out of home can be a big expense, and we will make sure that we can provide a brilliant alternative at great value.

Ken Murphy:

Finally, we recognise that customer needs will change. Despite having spent two years waiting to emerge from the pandemic, many customers are likely to want to economise on travel and the staycation may be with us for longer than we thought. Again, we will make sure our ranges are in tune and our offer strong throughout.

Ken Murphy:

So what does that mean for next year? Given the significant external uncertainties, we have given our profit guidance in the form of a wider than usual range. Our current best view is therefore that we will deliver between £2.4 and £2.6 billion of retail adjusted operating profit next year. We've highlighted in the release, the three main factors that are likely to influence our actual performance as we don't want to pretend we have any certainty over how they will plan out.

Ken Murphy:

Clearly there are levers we could pull to land on a certain level of profit, but that's not what we're about. We're running the business to generate sustained value for all stakeholders for the long term. If we can do better, we will, or if we think it needs to change, we'll let you know. What we can tell you with certainty is that we will stay focused on our customers throughout, as that's the best way to deliver the medium term growth and the strong, sustainable cash flows that we have set out. We are confident that we can keep this level of cash generation sustainable into the future and are therefore pleased to commit to a further £750 million capital return under our share buyback program to be completed by no later than April 2023.

Ken Murphy:

In summary, we are pleased with our strong performance in what has been an extraordinary year. We have really good momentum and start from a position of strength with our most competitive positioning for many, many years. We will maintain our unwavering commitment to value and continue to support our customers and colleagues when they need us most. In uncertain times, we will prioritise the right decisions to create long term value for all of our stakeholders. By doing the right things for our customers and colleagues, we will continue to drive value for our shareholders and remain firmly committed to returning cash through the buyback program. Thank you for your time so far, Imran and I are now really happy to take your questions.

Ken Murphy:

Can everybody limit their questions to one or two at the outset. If you have any further questions, please feel free to join the queue and then ask them once everybody has a chance to ask what's really on their mind. So, thank you.

Mark:

Thank you. Our first question comes from the line of Andrew Porteous at HSBC. Please go ahead, your line is open.

Andrew Porteous:

Yeah. Good morning, team. A couple from me. I guess, this morning the market's been spooked by the outlook statements a little bit. I just wondered if you could reflect on to what extent the outlook today reflects you to some of the industry headwinds you flag, and to what extent perhaps does it reflect you being able to continue to hold back inflation and go after the market share? And then the second is around Clubcard expand out for you over the coming year? To what extent is that a sustainable competitive advantage? I mean, does your scale really help you in that regard? And do you think it's something that competitors could look to replicate? Or would they find that difficult?

Ken Murphy:

Thank you very much, Andrew. Look, I want to start by saying that we start the year in a really strong position. We've got the best price in the sales we've had in many years versus our competitors. And our ambition is to make sure we maintain that leadership position and that we continue to be a very, very attractive place for customers to shop. And when they do shop with us, the combination of the Aldi price match, the lower everyday prices, and the Clubcard prices means that they don't feel disadvantage on price, whatever their needs. And that is the commitment that we're sticking to. And I think our guidance reflects that it's a wider than usual range because we are uncertain about what it's going to take, but we're really committed to maintaining that focus on our customer. And we think, by doing that, we deliver great results for customers, we look after our colleagues, and also that delivers the kind of meeting term sustainable growth as part of our multiyear framework that we set out last October that we think shareholders will really value.

Ken Murphy:

I mean, with regard to Clubcard prices, we think the Clubcard prices is part of a pyramid of value proposition that, together, are incredibly powerful. And therefore, you shouldn't look at Clubcard prices in isolation. We think that it's the combination of the three that set us apart. And as the year progresses, you will see that, through our Clubcard platform, we will get increasingly sophisticated at really identifying what customers' needs most and making sure we address that through the offers and the propositions we present to them.

Andrew Porteous:

Thank you.

Ken Murphy:

Thanks, Andrew.

Mark:

Thank you. And next question comes from the line of Andrew Gwynn at BNP Paribas. Please go ahead, your line is open.

Andrew Gwynn:

Yeah. Good morning, Ken. Morning, everyone. Just one question actually for me, which is where prices are needing to go up, where you've got sufficient level of cost inflation, are they going up in the market at present? And then kind of connected to that, I suppose the second question, unfortunately. But where the discounters….are they leading the market, or would you anticipate that Tesco would be leading the market in the coming year? Thank you very much.

Ken Murphy:

Thank you very much, Andrew. So, we are seeing some price inflation where the cost pressures are, such that they need to go up. So, we are seeing a rational market at this stage. We are seeing a mixed bag in terms of who's leading prices up. I think Aldi in particular have shown that over the last couple of weeks. Our ambition is to stay resolutely focused on offering the best value in the marketplace on a combined basis to our customers, and we are doing our very best to kind of hold back that tide. So, what we plan is a little bit less and a little bit later than the market, and that's really helping us maintain momentum in terms of both volume and value share in the market.

Andrew Gwynn:

Great. Thank you very much.

Ken Murphy:

Thank you.

Mark:

Thank you. And our next question comes from the line of James Anstead at Barclays. Please go ahead, your line is open.

James:

Thanks very much. My two questions. Firstly, you talked, Ken, a little bit about some of the trends you expect to see in the year ahead with, for example, own brand being an important area and making sure you have a great alternative to eating out. But could you just be clear? Are you starting to see already significant changes in customer behaviour in the early parts of the new financial year, or is this an understandable expectation given the disposable income pressure that we can see ahead? So, that's the first question. Second one would just be, I imagine a lot of people like me will be trying to do a back of the envelope profit bridge from the number you've just delivered at 2.65 to, say, the midpoint of the new guidance range of the year ahead at 2.5. I think you put in the statement, there's a benefit of COVID costs hopefully being £140 million less year on a year, which means that at least to the midpoint of the new guidance everything else that adds up to around about 300 million. I just wonder perhaps, Imran, whether you can give us any granularity on any of the individual elements in that movement you're expecting for the year ahead. Thank you.

Ken Murphy:

Thanks, James. Why don't I let Imran answer the question on the outlook first and then I'll come back on the own brand after that.

Imran Nawaz:

Okay. Let me try and avoid giving you a line by line bridge, but I'll give you assessment of how I'm thinking about the range. And as Ken said, the key term there is there are three uncertainties. The COVID normalisation, what do we think happens? The price level of investment that we need to have to continue to do what we've been doing the last 18 months, and where does inflation end up? And the way I'm thinking about it is, if you think on the top line we have at the moment, there will be some level of normalisation. So, I would expect volumes to go back two to three points. Let's see how that plays out as customers go back to work and rather than staying at home or do the traveling outside. Then clearly, there's going to be a bit of a mix down trade as well. I do see also some of the inflation will offset that.

Imran Nawaz:

On the cost line, I think you're aware we are facing significant cost inflationary pressures, right? So, you've seen our recent investment in colleagues, £200 million. Think about energy around that scale as well. And then clearly you have the same types of increases on property, on store, on distribution. But at the same time, we are doubling down on our save-to-invest program. Now clearly, within the year, I don't expect to be able to offset that. In terms of the COVID costs, as you well know, we spent around £200 million or so this past year. I think £80 million or so will stick because of the continued elevated demand for online, which was part of that stickiness. And that's actually a good investment. So, net, when I look at it and I think, okay, some lower volumes, a bit of mixed down trade, cost is clearly going to be the thing that we need to manage well. And therefore, you have the range and the 2.4 to 2.6 is, if you wish, the different realms of possibilities as we see it right now.

Ken Murphy:

And as regards the trends from a customer perspective, I think what we have seen over the past few months is clearly a reversal of some of the behaviours that we were seeing during the pandemic. So, we are seeing more people eat out, and that's reflected in the incredibly strong performance from Booker. We are seeing people travel more, and you'll see the well-publicised issues that have been shown on airports, etcetera. And we're also seeing people shop a little less frequently. What we're really trying to do is understand and anticipate how customers may choose to shop as we progress through the year, and make sure that we're ready with a really compelling proposition, whatever those trends may be. And they will include the staycation. Can we make sure that people can entertain at home really cost effectively with really great quality product? If they choose to shop on a tighter budget, can they do so effectively through Tesco, making sure that we have a really strong Aldi price-managed range together with our exclusive at Tesco proposition. So, we're really working on the premise that, whatever the customer chooses to do, we will be there for them.

James:

That's very helpful. Thank you.

Ken Murphy:

Thank you.

Mark:

And next question comes from the line of James Grzinic of Jefferies. Please go ahead, your line is open.

James:

Yes. Good morning, all. I took it once. I guess, first, a clarification. So, what you're saying is that there hasn't really been a change in behaviour as far as your behaviour within stores, mix dynamics, good, better, best growth is concerned, despite the fact that we had, by your own survey, four months of very elevated concerns on inflation. And we had essentially eight, nine months of very elevated levels of inflation that consumers have had to cope with. I think that's the first question in terms of a clarification. And the second one, I guess, for Imran specifically, so that 1.4 to 1.8 billion retail free cashflow guidance for the year ahead, Imran, that includes a full unwind of the half a billion benefit from working capital. So, you would see things like the Booker recovery that we saw last year, the fuel recovery that we saw last year, unwind to some extent? So, if you could help us on that free cashflow bridge, that would be very helpful as well. Thank you.

Ken Murphy:

So, James, in terms of the trends, and you're absolutely right. We see exactly the same thing. So, we see a dramatic increase in customers being concerned about the cost of living. There's no doubt about that. And we are seeing some behaviour shifts associated with that. It's hard to separate them from the kind of unwinding pandemic trends, which, if you like, go in the opposite direction. But we are really pleased with the fact that, because of our incredibly strong value positioning, because of the great experience availability that you get, and because of the flexibility of our proposition, i.e., you can order it online, you can click and collect it, you can go to a large store or small store, we have outperformed the market. And our ambition is to make sure that, no matter how those trends shift customer behaviour, we'll be able to anticipate and respond to those really, really quickly.

Imran Nawaz:

Let me take the cash question. To your point, we delivered a fantastic performance in cash. I think there's no doubt that 2.3 billion is even slightly ahead of our own expectations. And I actually think, if I could just add this, I think it's actually demonstrating when we get it right on pricing proposition, all the mechanics we have, it actually generates a lot of cash. And the thinking we have is, if we continue to do that, we will continue to generate that cash. Now, as we go into next year, clearly the key drivers that will drive the cash generation are going to be one, the level of profit, where do we land? The second big piece is on the working capital. Now, the view is, I think some of the working capital work that we've done will stick. Some will unwind. As you well know, it happens to be falling

at the half year and the year end as to what was the trend at that month before, so that you get a sense of the unwind.

Imran Nawaz:

My view is maybe I don't know, my current central plan is maybe £100 to £200 million unwinds, the rest will stick. But again, we have to wait and see how volumes trend throughout the year. And it's linked, again, to the top line assessment that we've made. What I would say to you is, in October, we laid out a range of £1.4 to £1.8 billion, and that did include, in our view and assumption, that the one thing that will swing around more than normal would be working capital. So, that's kind of why I feel comfortable with the range that we have.

James:

Thank you. I don't know if I still have the floor, but if I do, can I just ask you specifically what changes? Because what you've offered so far is a change in behaviour that is linked to a normalisation in a post COVID world rather than a significant change in a more defensively minded consumer. But you now referenced that you're seeing that as well. So, it would be very helpful to understand in what way you're seeing consumers behaving more defensively. Because presumably by definition, they're going out more, they're spending more per calorie consumed. That'd be very helpful as well.

Ken Murphy:

Yeah, I think, James, it's a little early to draw any concrete conclusions because April is the first month that the elevated energy bills will hit households. So, I think it's from here on in, you'll really start to see behaviour changes. I think that the hard thing to unpick will be to what extent will it slow down unwinding COVID behaviours versus change behaviours in their own right. I think the important point is that Tesco is incredibly well positioned to manage it, whatever it may be. And that we feel that we have all the right mechanics in place to be able to offer customers fabulous value with great quality, great convenience, and a great shopping experience. And I think that reliability will stand us in great stead, right the way through this year.

James:

Great. Thank you.

Ken Murphy:

Thank you.

Mark:

And our next question comes from the line of Rob Joyce at Goldman Sachs. Please go ahead, your online is open.

Rob Joyce:

Hi, good morning. Thanks for taking my questions. Just a couple of follow-ups and then one new one. In terms of the guidance, Imran, is it fair to say volumes back two to three ongoing out, a bit of down trading, but inflation running mid single digit, we should think of the broader top line, like-for-like you're expecting to be zero to plus two percent? And then on the operating cost side, I think back in January, you said they were running at around 5% inflation. Wondering if you could help us understand where that's got to and whether there's any help from those volumes declining within that. And then the final one, possibly one for Ken. I guess you said the strategy to price to be a little bit less and a little bit later than the market on pricing. Does this necessarily mean margin investment for you? Or does your scale advantage, particularly in the UK, allow you to do this without seeing any relative squeeze on margins? Thanks very much.

Ken Murphy:

Thank you. Why don't I take the last one and then I'll hand over to Imran.

Ken Murphy:

So, look, Rob. I think that it's a combination of factors. I believe that our supplier relationships, the strength and quality of our supply chain, our sourcing team capabilities, our incredible focus on cost efficiency, all help us to be price competitive without compromising our relationship with suppliers and making sure that we can look after customers and pay our colleagues well at the same time. And that's really where we derive our competitive advantage. I don't see it as a scale thing. I see it more as a quality of operation and efficiency and focus thing. And it's something Tesco has been historically good at throughout its history. And it's never been more important than it is now.

Imran Nawaz:

Okay. If I take your two questions in turn, so one top line growth. I mean the central case assumes between zero, to one to two percent top line growth. Essentially, the drivers I laid out. Volume going back, some inflation and some mixed down trade offsetting each other in that way. We have to see of course how it plays out. But that's what I think we're going for internally.

Imran Nawaz:

When I look at the operating costs, you'll have seen, especially now with the unfortunate situation in Russia, Ukraine, that's clearly exasperated a lot of the cost lines. The way I think about it is, the £200 million that we're seeing on the payroll investment we've made for our colleagues. You see similar increases on energy. We're seeing similar increases across a few of our key lines.

Imran Nawaz:

Now, the question that you would also ask me then is, so what are you going to do to offset that, right? We've got our 'Save to invest' program. We called out a billion over three years. The original plan was we were going to do it, call it, a third, a third, a third. Now clearly, we're going to try and do better. We have to, without impacting the shopper experience, which is also important. And I think we're trying to work that through still. My gut assessment at the moment is in this case as part of the guidance that we will not mitigate the full cost increases in year, but certainly over the horizon that the one billion applies.

Rob Joyce:

Okay. And very quickly, do you get any help as volumes are down a bit this year. Do you get any offset there? Does that naturally take some of the opex down?

Imran Nawaz:

Look, I think the way I think about it is, in a normal world where you maybe just had COGS inflation, maybe it would be helpful. But in a situation whereby your operating costs are going up as well, if you have a slight benefit from that, you're really going to eat it up very quickly in terms of the cost pressure increases that you're seeing. So, I'm not counting on a lot of benefit from that.

Rob Joyce:

Very clear. Thank you.

Mark:

Thank you. Our next question comes from the line of William Woods at Bernstein. Please go ahead. Your line is open.

William Woods:

Good morning, both. Two questions. The first one on the relationship with the suppliers. I suppose you mentioned keeping those supplier relationships strong. How much pressure are you seeing from them to pass on inflation and how well you able to push back? Do you think the relationship has changed there? And then the second one, you mentioned strained availability. And we've noticed some patchy availability online. How much are you being disrupted by some of the lumpiness in the supply chain and how much do think that'll affect the next year? Thanks.

Ken Murphy:

Thank you, Ali. So, our supplier relationships in my view have never been more important. They are what has carried us to through this pandemic? What has carried us through the pandemic last summer, all the supply chain disruption we saw in late summer and coming into Christmas and the latest challenges we have with the dreadful war in Ukraine and the latest issues in Dover, et cetera.

Ken Murphy:

We count on in those relationships. We're very pleased that for the sixth year running, we were voted by the independent advantaged survey as the number one supplier to deal with in the grocery industry. And that I think is placed to the fact that we are very long term in our thinking. We build long term relationships with suppliers. We're fair and reasonable to deal with, but clearly, we're also very, very objective about making sure that we work together to minimise the cost impact on our customers.

Ken Murphy:

And that's something they get. They're as committed to it as we are. It dials up the need for us to be more efficient in the way we think, to be really focused on simplification of range and of focusing on making sure we optimise every stage of the supply chain. We have a great sourcing team that know commodity prices inside out. And so, we know what's true inflation versus what's added on top. And that's really where we derive our strength. It's something suppliers get and understand, and they work with very effectively.

Ken Murphy:

I think that those relationships will get even stronger through this period. And also of course, we're offering them growth as we're winning in the market. We become the go-to place to offer them growth. And I think that is a further factor that's helped us with our suppliers.

Ken Murphy:

And of course, to your second question, it also is really helping on availability. We are not immune from the availability challenges that the market faces by any means. What we believe we can do slightly better than the market. And that's playing out in our availability numbers that I see day in, day out. And that's something that we look to maintain as we go into this year.

William Woods:

Great. Thank you.

Ken Murphy:

Thanks Ali.

Moderator:

Thank you. Our next question comes from the line of Clive Black at Shore Capital. Please go ahead to your line is open.

Clive Black:

Good morning, gentlemen. Well done on last year. Continuing the theme around inflation. Could you give us an indication of where you think food inflation in the UK may peak? And in that respect, does that change the way you think about your business, particularly around the involvement of automation and digitisation in the operating model, to the extent that you bring forward and make bigger decisions about the operating platform of the business and future, please. Thank you.

Ken Murphy:

Thank you, Clive. Great questions as always, which of course I'm not going to answer. We really aren't in the business of trying to forecast what food inflation is going to do over the next six to 12 months. What we are doing is working incredibly hard to minimise that impact on our customers, no matter what it is. And that's really the focus of the company. So, we're not really speculating on the

projected food inflation. We're really working on managing all of the inputs and optimising them so that we can be incredibly competitive for our customers. And that really is the job at hand.

Ken Murphy:

Rising costs by definition, make automation solutions more feasible. But actually, don't change fundamentally our trajectory because I think that we need them to work and work really well for the business before we invest in them. The good news is that things like urban fulfilment centres are working well.

Ken Murphy:

And we're seeing now productivity levels from our latest two investments. And we've gone from two to four in the last couple of weeks, and we'll add a fifth in the coming weeks that are hitting productivity levels that we forecasted in the business case and the latest ones accelerating towards that business case level of productivity on a much faster arc than the first two, which really gives me great confidence that we've learned the lessons and we've really refined the model and we're in good shape with it. And that really will help as much in terms of increasing our capacity online as it will in reducing the cost to fulfil. And of course, it also accelerates our ability to capture and process an order, which means we'll be able to fulfil a full grocery order much, much faster, particularly on a click and collect basis then we would've been able to do historically. And so that's really pleasing.

Clive Black:

Can I just ask a follow-up, please, just around the visibility of your costs? Maybe one for Imran. Can you characterise the nature of hedging within the business please?

Imran Nawaz:

Yeah, look, I mean, we follow our hedging policies. Last year, it really was very helpful because we were able to mitigate most of the increases we saw. Clearly, as you continue to hedge you end up hedging at the higher level. So, there's always going to be a year on year impact. I'm quite happy with the percentages. We follow our policy, which is a rolling mechanism. We're hedged to a large extent for the year ahead. There is some open exposures in the light of following, not closing, everything all the time because we want to make sure we follow the guidance that we've set out as a company. But again, even when you hedge, you end up hedging year on year, locking in some of the cost increases, which is why like energy is a good example. You do still see an increase year on year that you have to deal with.

Clive Black:

Thank you very much, guys. Well done.

Ken Murphy:

Thanks Clive.

Mark:

Thank you. Now next question comes from the line of Victoria Petrova of Credit Suisse. Please go ahead, your line is open.

Victoria Petrova:

Thank you very much. I'll be short and quick. First of all, have you seen any first signs of price elasticity of your customer first signs of price elasticity of your customers' demand in the current environment, and you've mentioned £200 million investment in your employees. Could you quantify the cost pressures on any lines? Obviously, cost of goods sold, energy, supply chain disruption, in the first quarter, or at least something you're seeing right now, just to give us some additional colour on current inflationary trends?

Victoria Petrova:

And the very last, do you expect the next wave of cost of goods sold price increases towards the end of second quarter, or is it happening already now? Thank you very much.

Ken Murphy:

So, Victoria, I'll answer the first one and then I'll pass over to Imran for the second. So, the short answer on price elasticity is no, not yet. So we are not seeing significant impact around price elasticity just yet, but we do anticipate some which is why we are maintaining such a strong focus on value, why we are so focused on making sure we've got a really great range of entry-level product that's priced super competitively against the market and particularly the discounters, and then why also we believe that our finest proposition is a really compelling, easy and alternative that we are going to continue to invest in. I'll pass over to Imran now just to address the two cost questions that you-

Imran Nawaz:

Sure, sure. So, look, I'll tell you one thing. I'll tell you what Tesco's really good at is driving our efficiencies, and you saw that last year and we're going to continue to do that. So, as we're seeing cost increases, and I call them actually on the payroll piece for our colleagues, I actually see that as an investment and I see that as the right type of investment given who we are and given the importance of the colleagues that we have. We do continue to see increases on energy of a similar nature. Distribution costs are going up similarly. You saw recently, we had announced a payroll agreement back over Christmas. When you add those up, they're significant, but at the same time, and that's, I think, the equally important question that we ask the team. What are you going to do to offset that? And I think I'll come back to save to invest, which is a key program for us to drive out those efficiencies, such that we minimise the impact.

Imran Nawaz:

So, the challenge of calling out a percentage cost increase that you're seeing on the operating costs is that it takes into account or it assumes that we're just going to be bystanders. But we're

actually going to be actively working that. And that's what we've been doing last year and we're definitely going to be doing that this year. So, the net of where that comes out, we'll keep you posted but that to me is the focus point of when I look at cost increases. As to the COGS question, look, you can imagine, and look, it's a fair question but you'd never expect me to talk on a call like this about our supplier commercial agreements and the conversations we're having and the negotiations. What I can say to you is for sure, there are live dialogues that are taking place over the last months and will continue.

Victoria Petrova:

Thank you very much.

Ken Murphy:

Thanks Victoria.

Mark:

Thank you. Our next question comes from the line of Sreedhar Mahamkali of UBS. Please go ahead, your line is open.

Sreedhar Mahamkali:

Yeah. Hi. Good morning, guys. Thanks for taking my questions. Two as well then, please. First one is to just follow up on James Anstead's question earlier on with the bridge, maybe slightly differently with the 2.4 to 2.6. I'm more interested in trying to understand the lower end and why it's there. Probably splitting hairs here, a little bit to be honest but is the driver to get to 2.4 a larger proactive investment absorbing more inflation relative to a 2.5 billion scenario or 2.6 billion scenario? Or are you assuming something different? So just trying to explore the lower end of the range there. That's the first one.

Sreedhar Mahamkali:

Secondly, I think you both talked about strategy on shareholder returns and I realise and appreciate that you are returning over a billion on a two year basis to shareholders, but in the context of, I don't know, 3.7 billion or 4 billion free cash flow on a two year background, why do you think that is at the right level? Could it be higher if you see the shares remaining as attractively valued as they are now? Could you step it up through the year? Those are the two questions. Thank you.

Ken Murphy:

Thanks very much, Sreedhar. I'll pass to Imran to address the range in a moment. Just specifically, the reason we have a larger range is because we are not certain about what it's going to take in terms of price competitiveness, but you should read it as more reactive than proactive. So, we believe that we need to stay focused on customers. We believe we needed to invest in our colleagues. We've done both of those things and we maintain that focus. We think it's the right thing for shareholder value and we think it's going to deliver a strong performance for Tesco in the context of the market. It's just hard for us to predict what that's going to take as we look into these

12 months, and therefore, we've given ourselves a wider than usual range as a consequence. Imran?

Imran Nawaz:

Yeah. I'll just build on that very quickly because I don't have that much to add to that point. Here's how I look at it. We are continuing to do what we said we would do, and it worked really well for us last year. Aldi Price Match, Clubcard pricing, low everyday pricing, continuing to put the customer first, it creates a virtuous cycle. You continue to win in the market, you outperform, and you drive cash, and bingo, you return it. There is no need to change that model, it's the core of the strategy we're trying to run. Now, the problem, Sreedhar, is we've got a lot of uncertainty out there at the moment in terms of how customers are reacting, how inflation is going to go, and frankly, what will happen from a competitive stand.

Imran Nawaz:

We're rational - is one thing that is maybe obvious to say, but this is not like trying to do something crazy out there. We're very rational in our thinking on delivering the profit levels that we've set out, and that's how we want to continue to run the business because we do believe that virtuous cycle and protecting the competitive price position that we have created is important, and that's why it's there and that's why you see a wider range. In terms of the way to think about the lower end, the reality is with the uncertainty, it could be the lower end, it could be the midpoint, we don't know yet. It really does depend on how customers react to the higher cost inflation environment that they're living in. What we are clear is we will not waiver away from it, that we will continue to leverage the strength we have today because we're convinced it will drive the cash that we need to generate.

Imran Nawaz:

As it comes to the buyback itself, your question, look, cash was really strong and the philosophy we laid out in October, and I think that we'll continue to demonstrate to you here today is that if we are within our range of 2.3 to 2.8, and if we are in the cash range that we want to generate, the £1.4 to the £1.8 billion, then we should have the rolling buyback program that we've announced and now, what we're doing is we're just building on that. Now, I think the right thing to do in an uncertain environment is to make sure we get that number right and 750 to us felt like the right step. It's a step up from where we were on the 500 but overall, as you point out, cumulatively, it'll be a billion and 50 by the time we get to April, which I think is a strong number.

Mark:

Thank you. And our next question comes from the line of Maria-Laura Adurno of Morgan Stanley. Please go ahead, your line is open.

Maria-Laura Adurno:

Thank you very much for taking my questions. So, the first one is with respect to your inventory, so the inventory of products that you are selling. When it comes to suppliers, are you already starting to see the impact in your negotiations of the potential cost increases that could come through related to Russia/Ukraine? Because I do know that in different categories, to a certain extent, food retail is a second derivative on whether it's the fertiliser that could increase and et cetera. So that's my first question.

Maria-Laura Adurno:

The second question that I have, so we have started to see cost inflation coming through last year already and labour was definitely one of the categories that was mentioned, but of course, there were some others. Just wondering, these 1 billion pounds over three years of cost savings that you have, how come at no point was it raised? Is there no more headroom from a cost saving standpoint to actually see further increases coming through? Just trying to understand here basically the execution on cost saving and the optionality. Thank you.

Ken Murphy:

Thanks, Maria-Laura. So, look, the first thing to say on inventory and cost of goods is yes, we are seeing some impact from the war in Ukraine, and as you say, it is the things that have been highlighted already in the press, fertiliser, things like tomato paste, sunflower oil, and clearly any wheat-based products. So those impacts are being felt. Clearly, we don't want to disclose any commercially sensitive information, but we are seeing some impacts. Positively though, we are working really hard to mitigate those wherever possible and we're working really close with suppliers to minimise the impact on customers. With regard to the cost savings program, I'll pass over to Imran to address that.

Imran Nawaz:

Yeah, you sound like me. You're pushing the right buttons in the sense of can you do more? We announced the 1 billion only in October and we're building the program and we feel really good about it. As I said, it's in the DNA, and as I also said, we need this fuel because the pressures that we have are significant. But right now, I want to get through the year. I want to continue to look for what else can we do in efficiency terms that doesn't impact the customer or the customer experience? That balancing act is important and that's what we're going after. Do I think we will need more than the 1 billion in the midterm? Yes. I think given the cost pressures we have, I'd be wrong to say no. So obviously, we'll continue to look but it's too early to officially come to you today and say, "And here's another chunk." We first need to do the work and find it, which we are working on as we speak.

Maria-Laura Adurno:

Thank you. That's very clear.

Ken Murphy:

Thank you.

Mark:

Thank you. Our next question comes from the line of Nick Coulter at Citi. Please go ahead. Your line is open.

Nick Coulter:

Hi, good morning. Two quick ones if I may please. Firstly, can I ask about switching and to what extent you'd expect to lose some share of wallet to discounters as customers start to shop around again? Essentially, how do you think about that flow and to what extent will you choose to counter those flows please? I'll follow up with a second if I may.

Ken Murphy:

Okay, Nick. I think what I'm really pleased about is actually substantively what's happening right now. So, the pandemic clearly has been unwinding for the last few months. We've seen some normalisation of customer behaviour that would or should in theory favour the discounters and we are seeing some trade back into them, but what we're not seeing is switching losses against the market. We are continuing to win against the market week in, week out, and that trend has maintained itself right the way through the first six weeks of the new year, and what's really pleasing is it's even stronger on a volume basis than on a value basis. So, my personal view is that no matter how the market trends evolve, Tesco is in a really strong position to respond, and we plan to continue winning with customers regardless.

Nick Coulter:

Right, thank you. Then just if I may, just to follow up on Clive's question or one of his questions, when might we see a more meaningful CFC rollout program? How far away are we from that please? Given them the quantum of cost saves that are available in that area. Thank you.

Ken Murphy:

Thank you. You're talking about the urban fulfilment centres?

Nick:

Yeah, absolutely.

Ken Murphy:

So, look, we have eight planned and we're really pleased with the progress. As and when we increase the pace of that, we'll update you Nick. So, we'll have our fifth in the next three weeks, so it's starting to become meaningful.

Nick:

Great. Thank you.

Ken Murphy:

Thank you.

Mark:

And our next question comes from the line of Xavier Le Mene of Bank of America. Please go ahead, your line is open.

Xavier Le Mene:

Thank you very much and good morning. Two questions on my side. The first one first is on the exceptional item that you had for fiscal year '22 as well as fiscal year '22 which was about £240 million. So, what should we expect going forward? Because it seems that the exceptionals are not that exceptional, so just get a sense of what we should expect. The second one is more longer term. So, we understand that for fiscal year '23, it could be challenging because of inflation and consumer pressure. But should we assume that fiscal year '23 is a trough? And then you can build on that? And then from fiscal year '24 onward, we should see growth coming back? And what are your expectations in the mid to long term?

Ken Murphy:

So, I think that the guidance we've given for the coming year is all about maintaining momentum. And all about making sure that we continue to win with customers, continue to win market share and create that virtuous circle that Imran was talking about, or at least accelerate that virtuous circle. We think that puts us in great shape for the medium to long term. In our ambitions, we set out clearly a very clear capital allocation program and a multi-year framework. And we believe that this strategy will allow us to deliver against that over the medium term. Clearly, we cannot predict what the conditions are going to look like in the future, but we feel that we've put ourselves in the best position to win no matter what those conditions are.

Imran Nawaz:

The question on adjusting items/exceptional items. So, look, this year you saw £265 million or so, the biggest chunk of that was settling historic litigation claims. Which frankly, we can draw a line under that. We're done, which is good. Looking ahead, clearly, we want to minimise exceptional items just because I'm not the biggest fan. But as and when we incur them, we'll keep you in the loop, of course. And we'll keep reporting them as they get incurred. The one thing that sticks in my head right now, if you ask me off the bat, is as we do some of the 'Save to Invest' programmes, if we have certain provisions we need to take because they drive good savings and they're unusual because they're one off in nature, we would obviously come back to you and give you a full accounting of that.

Xavier Le Mene:

But there is nothing we should expect specifically today?

Imran Nawaz:

No, there's nothing on my list today. But just it's 'Save to invest', that's the one big ticket item that I have in my mind that as we continue to accelerate from a three year into how much can we do this year, I don't want to be shy on taking out costs in that manner.

Xavier Le Mene:

Okay. Thank you very much.

Mark:

Thank you. And our next question comes from the line of Borja Olcese of JP Morgan. Please go ahead, your line is open.

Borja Olcese:

Thank you. Sorry guys if I'm missing something, I'm just a little bit confused here. So, your profit outlook is sensible in the current context of things. The capital return outlook is clearly reflective of the solid shape of the business. Yet it's the retail cash flow guidance I'm struggling with, £800 million or so of a cash burn your guiding to, when the high end of the profit guide is almost flat year on year. Working cap, you said £100 to £200 million and one max despite a 1% to 2% sales growth. So, where's that cash burn going to come from? It does seem a little bit inconsistent to me when you're saying the market is rational. You're in a better relative position versus the market. You're not over-earning, and you've done all the right things with the extra cash deleveraging and re-investing. What am I missing?

Imran Nawaz:

Yeah. Look, again, it depends on how the top line works out, and when you model out, how you see the working capital phase through. As I said, the central case I have is that some of the £500 will unwind. The one thing I should maybe add is we do expect to spend more at the upper end of the CapEx guidance. So, this year we spent, £1.050. I think the year that we're going to go in, I think I'll expect to spend £150 to £200 more than that, so at the upper end of that. That takes away a little bit of that as well. Tax I think will be a little bit higher, just because we had some one-off benefits. So, when I look at it, that range is the right range. Do I want to do more to the middle of the range than the lower range on the cashflow flow side? Clear. But I just didn't see the need at this point to update that range, because it's the one that we're relying on for our capital allocation framework.

Borja Olcese:

Okay. This was this same range last year, right? And yet you delivered £2.3 billion. Am I correct?

Imran Nawaz:

Yes. I was pleased if I'm honest. So, I like the fact that we delivered strong. We really doubled down on cashflow as a metric. We culturally, in terms of Tesco it's become one of the key focus areas. Just because the virtuous cycle ending up in buybacks and in returns to shareholders is critical, as a critical part. There was also some catch up, shall we say, that was done. Because during COVID period, maybe some of the work was stopped that we then accelerated. Back in January, I did mention very clearly that if I see the run rate that we're seeing, the continued momentum on fuel, which was also a big driver, the continued momentum on Booker catering, which is big driver. I think all of those contributed to a strong performance overall.

Imran Nawaz:

Now as we go into the next year, and we start to see how is this volume thing going to play out? How do we see fuel playing out? What do we think about catering on the outside world? Look, you'd expect me to take some of that down and be a bit more cautious and stick to the guidance we gave. Look, overall if I then look at the three year performance on cash, it will be really strong for Tesco. And it's really the confidence we have to continue on the buyback.

Borja Olcese:

Right. That's helpful. Thank you.

Imran Nawaz:

Sure.

Mark:

Thank you. And we have one further question in queue, that's from the line of Tom Davies at Berenberg. Please go ahead, your line is open

Tom Davies:

Morning guys. Just one question on retail media monetisation, and Clubcard. So obviously some of your grocery players globally have discussed the profit opportunity of leveraging their retail media networks. Are you looking to have a financial target for retail media? And also, how do you view the profits from the channels? Do you do view it as another lever to reinvest in pricing rather than letting it drop through to profit?

Ken Murphy:

So, I think the way we look at media monetisation is as a subset of our overall strategy around personalisation, both from a supplier perspective and from a customer perspective. So, we're really trying to work hard on making sure that whatever we put in front of customers is really relevant and pertinent to that shopping mission or to their life stage. That requires great insight, great intelligence in terms of understanding. It means that we need to be more choiceful about what we display. But consequentially, we give suppliers a much higher rate of conversion and a better bang for their buck. And we give customers the sense that we really get them and what we show them is really relevant and helpful in that moment in time.

Ken Murphy:

So, I look at media monetisation less as a line in a P&L and more as an integral part of a customer strategy that I think has great potential in terms of making customers feel valued, feel understood and feel like they're getting a great proposition from Tesco when it really matters to them. So, we don't waste their time.

Ken Murphy:

Therefore, we've been careful around setting the media budgets as a go get for something that's just about get me as much cash from suppliers as possible, which I've seen in the past asked,

generates a supplier-led push model that works in the short term, but invariably isn't sustainable because you end up frustrating customers and not giving the suppliers the level of return that they would expect.

Ken Murphy:

So, we are working on this progressively, we're getting some great results from our current media plans, and we're getting increasingly sophisticated in terms of our personalisation journey. It's part of the I love my Tesco Clubcard driver as a component of the strategy. And of course, converting over the last two years our customer base from 2 million digital app users to 9 million digital app users is a really key component of that because it means you can get them those offers and those propositions in real time. And then when you ally that with the fact that, of course on a two-year basis our online grocery home shopping business is up 60%, you can see where this could go as an incredibly powerful platform.

Ken Murphy:

We look at our pricing investment from a market perspective, i.e., where do we need to be really competitive and offer customers great value? We don't take money from an income stream and put it into value per se. So those two decisions are independent. We will maintain that value proposition. That's our commitment to customers. And as we build our Tesco Clubcard proposition and personalisation engine over time, we do expect it to be an increasing contributor to profit.

Tom Davies:

Great. Thanks a lot.

Ken Murphy:

Thank you.

Mark:

Thank you. And as there are no further questions in the queue at this time, I'll hand back to our speakers for the closing comments.

Ken Murphy:

Great. Thank you. Thank you everyone for joining us today and for taking the time, some really excellent questions. We feel really pleased with the performance from the Tesco team over the last 12 months, and we feel we're in a great position to continue delivering for customers, delivering for our colleagues, and of course, delivering for shareholders at the same time. Regardless of what the macro environment throws at us. So again, thank you for your time. We really look forward to updating you again when we speak in June, if not sooner, thank you.

ENDS