Tesco

Interim Results 2022/23

Analyst event

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Transcript

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Ken Murphy: Good morning everyone, and welcome to our interim results presentation. I'm joined here in Welwyn, by our CFO, Imran Nawaz. This morning, Imran and I will outline a strong first half performance in what is undoubtedly a very challenging market. We've continued to invest for customers and for colleagues at a time when it is most needed. The strategic priorities we first shared with you one year ago are serving us well, and I will give you an update on our progress shortly.

Over the past few years, we have maintained a relentless focus on value. We have further improved our competitiveness, and in doing so have protected our strong positions in all of our markets. At the same time, we have significantly improved our ability to generate cash and return capital to our shareholders. The challenges around us will remain, and I do not want anyone to underestimate the scale of the volatility and uncertainty in the market. However, as Tesco demonstrated throughout the pandemic, we have developed a level of responsiveness and resilience that sets us apart from many of our peers and gives me confidence that we can continue to create value for all of our stakeholders.

The last six months have been very challenging, and so I'm particularly pleased that we have continued to make great progress. We know that customers are facing unprecedented pressures in the cost of living, and it has therefore been critical that we've continued to support them with our relentless focus on value. Our investments in Aldi Price Match, Low Everyday Prices, and Clubcard prices, means that we are now as competitive as we have ever been.

We have continued to reward loyalty too with Clubcard growing both active users and sales penetration in every one of our markets. Customers are recognizing the value that Clubcard brings, and we are increasingly tailoring it to their specific needs. The progress we have made would not be possible without the hard work and resilience of the entire Tesco team. I want to say a huge thank you to all of our colleagues and our supplier partners for everything they're doing.

I'm particularly pleased to announce this morning, that we have made another investment in pay for our UK store colleagues, in addition to the significant investment we announced in April. Our colleagues are really important stakeholders in our business and are critical in helping us create value for every other stakeholder, and we will continue to do everything we can to support them. I believe the external challenges facing the industry are well understood, and I'm not planning to spend a huge amount of time reiterating them here.

But it would be remiss of me not to acknowledge the extreme pressure many of our customers are under. In June, we said that we were starting to see some small changes in customer behaviour, but that it was difficult to separate them from the effects of post-pandemic normalisation. We can now see tangible changes in behaviour, purely relating to increases in the cost of living. Whether it's switching to Tesco own brand to take advantage of our great prices, or making more subtle changes such as switching from fresh to frozen, we can see customers prioritising value wherever they can.

This can create challenges for us in terms of our mix, even before we overlay the impact of significant commodity and cost inflation. However, with our capability, reach and scale, I see it as our role to protect customers from as much inflation as possible. We will continue to inflate a little bit less and a little bit later than the rest of the market, and take it on ourselves to navigate the other challenges we face as a business to the best of our ability.

Regardless of the environment we find ourselves in, we focus on creating value through a combination of customer satisfaction, market share, and strong cash generation. As I said in April, customer satisfaction is critical to our success. It is the best measure of whether the efforts we are taking are being recognized by customers, and underpins our ability to grow over the medium term. I'm therefore really pleased that our ongoing customer focus continues to be recognized.

Across the market, the pressures I have just outlined have led to reduction in many of the usual customer metrics. However, against this backdrop, Tesco continues to be recommended by customers ahead of all the full line grocers. Our relative performance and our brand net promoter score has also continued to increase, and we are now ranked number one of the full line grocers on this measure. And as you can see, our relative performance gap has continued to widen.

Our goal is to protect, and ideally grow our core UK market share over the medium and long term. I'm pleased with our performance in the half, which builds on 23 periods of switching gains in the prior two years. Versus this time last year, there is a small decline as we lap our period of greatest out-performance, but as you can see, when you look at it on a two or a three year view, we are the only one of the full line grocers to gain share.

There is of course, another dynamic in the market, with the limited range discounters gaining share as a result of them adding millions of square feet of new space over this period. The fact that Tesco have gained despite this impact, demonstrates the strength of our business and clearly in like for like terms, we have significantly outperformed. Our capital discipline remains strong, and we will only invest where we see an attractive return.

Cash is one of the standouts for me in this half, and we are once again in a really strong position, having generated £1.3 billion. Imran will share more detail shortly, but for me, it demonstrates the inherent strength of our business, and enables us to fulfill the commitments we have made as part of our capital allocation framework. Dividends are an important part of that, and we've declared an interim dividend of 3.85 pence in line with our policy.

We have also returned £450 million to shareholders through our ongoing buyback program in the first half, bringing the total to £750 million since we started in October, 2021.

It is inevitable and appropriate that I focus a lot on the UK in these updates, but we have also continued to make great progress across the wider group. Booker has had an outstanding performance, growing in both retail and catering. It has benefited from being in tune with its customers' needs as they emerge from the pandemic, and has continued to innovate its offer, such as through the formation of its Food Club, which now has over 40,000 independent restaurant members.

Ireland has also had a good half, holding on to its strong market share. We have just started to convert the first stores we acquired from Joyce's, and if early signs are anything to go by, we are on to a resounding success. Finally, Central Europe has continued to do a great job championing value in a highly inflationary environment. We have seen a great response to Clubcard prices, supporting an increase in Clubcard penetration to over 70%. I mentioned before, the extreme pressures that many of our customers are under.

As you can see here, across every part of the group, we are working relentlessly to do what we can to help. We have rolled out the same core elements of our value proposition in the UK to our businesses in Ireland, Hungary, the Czech Republic, and Slovakia. In Tesco Mobile and the Bank too, we have stepped forward with new propositions to help customers save money across even more of their household expenses. The way that all our teams have worked together to bring Clubcard prices to every part of our offer is a great example of how we can leverage the skill and scale of the group.

Our unrivaled reach puts us in a unique position to make more products more affordable in more places than anyone else. It is this laser focus on value that has supported the strong performance in the first half, that Imran will now take you through. Imran, over to you.

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 further details on key trends and drivers. Throughout the review, percentage growth rates will be expressed in constant currency unless stated otherwise. Group sales grew by three and a half percent, a strong performance building on the momentum over the last few years. Group profit decreased by 9.8% to £1.3 billion. This reflects the impact of post pandemic normalisation and significant cost inflation, partially upset by very strong progress on Save to Invest. Although not shown here, Statutory Group operating profit was down 43.6% year on year. That is due to a £626 million non-current asset impairment charge driven by higher discount rates. This non-cash movement does not reflect any change in the underlying strength of the business. I'm particularly pleased with our very strong retail cash flow performance of £1.3 billion. The year on year movement reflects the impact of last year's exceptionally strong performance in both profit and working capital.

Net debt at the end of the half was £10 billion, a reduction of £0.5 billion since the year end. This is primarily driven by the very strong cash generation and is after the outflow of £450 million relating to our share buyback. We generated headline earnings per share of 10.67 pence. The year on year change reflects our reduced operating profit, partially upset by a lower tax charge, lower net financing costs, and the benefit of our ongoing share buyback program. In line with our policy, we have proposed an interim dividend of 3.85 pence per ordinary share. As a reminder, our interim dividends are set at 35% of the prior year’s full year dividend.

Total retail sales for the half were £27.6 billion. Our UK and Ireland segment delivered a 2.6% increase in sales driven by further strong performance in Booker. Our Central Europe segment delivered both strong sales and profit growth driven by resilient volumes in an inflationary environment. We saw year on year sales growth in Tesco Bank as revenues recovered strongly due to higher retail spending, demand for travel money, and the annualized benefit of the acquisition of Tesco Underwriting in May last year. The bank generated £67 million of profit in the first half, which I will come back to later.

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. Let's start with the UK. We've seen very different drivers of performance across the half so I'll briefly break it down by channel and then by category. In our large stores, our sales grew by 1.4% over the half. The first quarter reflects the lapping of very strong non-food demand in the prior year. Sales were much stronger in the second quarter, partially driven by warmer weather, the Platinum Jubilee celebrations, and higher rates of inflation. As anticipated, we saw a decline in online sales as we lapped peak demand during last year's lockdown in the first quarter. Our online business remains significantly larger than before the pandemic, and I'm really pleased that we've retained nearly 70% of the customers that we gained over the last two years. You'll see that we delivered a strong performance in our convenience stores throughout the half, driven by a sharp recovery in footfall in towns and cities as customers returned to their workplaces. Sales in our city centre stores grew by 26%.

Turning to performance by category, our food business delivered sales that were up 1.6% over the half, which is after the impact of normalizing from the very high demand in the first quarter last year. We saw strong growth across the second quarter as we traded over a more normal period with some benefit from the exceptionally warm weather. We saw an increase in inflation across the market in the half and started to see the impact of changing customer behaviour, such as switching from branded to own brand products and substituting to better value alternatives. We saw a significant decline in non-food sales in quarter one. That reflects a very strong performance last year when non-essential retailers were closed. Our year on year performance improved significantly in the second quarter and we outperformed the market, although we started to see a softening in demand in the more discretionary areas. I should remind you that our overall non-food participation is relatively small, representing around 8% of sales for the group.

Our strong performance in Ireland is somewhat masked by the impact of lapping elevated sales throughout the pandemic, particularly in the first quarter. We saw like for like sales growth strengthen to 2.4% in the second quarter as the impact eased. Clothing sales were particularly strong as we lapped restrictions last year that prevented us from selling certain products. Our convenience stores have performed strongly and we continue to see strong growth in our online business as we expand our geographic coverage. We opened five new click and collect locations in the half with the service now available in over 70% of our large stores. Online now represents 9% of our sales in Ireland. We completed our acquisition of 10 Joyces Supermarkets in June this year.

In Booker, sales grew across both the retail and catering businesses, building on the strong momentum from last year. The retail business delivered overall growth of 2.2%. Excluding tobacco, sales were up 6.7% driven by strong customer retention in addition to general inflation across the market. Tobacco sales were down 3.7% as demand fell across the market, driven by higher duty free imports as customers resumed traveling abroad post the pandemic. In catering, we saw further strong sales growth driven by a sharp recovery as we traded over last year's restrictions when much of the hospitality sector was closed in the first quarter. We continued our strong momentum into the second quarter with sustained volume growth. Our catering performance includes strong growth in Best Foods Logistics, which had sales growth of 34.6% in the first half.

Moving now to Central Europe. Like for like sales were up 10.4% with growth across all three countries. Inflation has been more significant in our

Central European markets due to macroeconomic factors, including Retail tax changes. Volumes have remained resilient, partially due to government support for customers such as price caps on essential food products. Market share improved across the half on a year on year basis driven by switching gains. Customers have responded really well to the full rollout of Clubcard Prices and our Low Price Guarantee, which further strengthens our value proposition. We saw a strong performance in general merchandise as we were able to offer our full range following non-food sales restrictions last year.

Let's now move on to profit. As you can see, retail operating profit decreased by £138 million year on year, which reflects the net reduction in the UK and ROI segment, partially offset by profit growth in Central Europe. I'll break the movement down in more detail on the next few slides. In the UK and ROI, the profit decline of 11.5% was driven by a number of factors, most notably the year on year normalisation in volumes post the pandemic. Mix was a little bit negative year on year due to the effects of customers switching to own brand products to offset cost of living pressures. Significant operating cost inflation, including our largest ever single year investment in colleague pay and higher energy costs, were partially mitigated by our accelerated Save to Invest program.

Turning to Central Europe, profit was up 19.1%, which reflects the resilient volume performance in the region and well managed inflation in both input and operating costs. Food sales grew strongly and we saw a strong performance in convenience as customers returned to city centre stores. The strong profit performance is after an additional £14 million charge due to an increase in the Hungarian retail sales tax.

In Tesco Bank, we have seen revenue growth driven by an increase in new credit card customers, a recovery in our travel money service, and higher levels of retail spending. The Bank's profit declined year on year, predominantly driven by a higher impairment charge due to upfront charges on new business and worsening macroeconomic indicators. This was partially offset by the profitable growth in travel money and the ATM business. This year's operating profit includes an £18 million contribution from Tesco Underwriting being fully consolidated following the completion of the acquisition in May last year. The Bank's balance sheet remains strong.

This slide gives you more detail on the components of our statutory profit performance, which decreased by 68.1%, primarily as a result of the non-cash impairment of non-current assets that I mentioned previously. Net finance costs before fair value re-measurements were £88 million lower than last year. This was driven by net pension finance income this year as a result of our overall group pension surplus compared to a charge last year. Net finance costs include a fair value re-measurement charge of £75 million, primarily relating to the mark to market movement on inflation linked swaps, which was a significant change to the prior year due to an increase in discount rates. Our tax charge was £148 million down from £313 million in the prior year. This reflects lower operating profit and a one-off charge in the prior year that related to a revaluation of our deferred tax liability.

Moving now to cash, we've generated £1.3 billion of retail free cash on top of an exceptionally strong performance last year. Retail cash from operations was strong at £2 billion. Our total working capital inflow was also strong at £390 million, driven mainly by higher trade balances due to cost price inflation and higher sales at the end of the half. Both of these amounts were lower year on year due to reduction in food volumes and the effects of the sharp recovery in fuel volumes last year. Capital expenditure in the half was £507 million, and we have provided the usual breakdown both by region and type in the appendices. Our CapEx remains on track to be in line with full year guidance.

We paid £294 million of interest costs, of which £188 million related to finance charges on lease liabilities and £106 million to interest paid on bank debt. Interest costs reduced year on year as a result of property buybacks lowering our lease liabilities. Our cash tax paid was £45 million, which is broadly in line with last year. This is after the continued benefit from the one off pension contribution in 2021 following the disposal of our Asia business. It also reflects the super deduction allowance on certain capital investments, which was introduced in March 2021. Finally, there was a £51 million movement in relation to the purchase of shares to satisfy share schemes.

Turning to the balance sheet, net debt at the end of the half was £10 billion, half a billion lower than the year end primarily driven by reduction in underlying net debt before lease liabilities due to our strong cash generation. This position at the end of the half is net of the £450 million worth of shares that we have bought back for the first half. Lease liabilities increased marginally to £8 billion, largely due to the recognition of new leases related to the leaseback of the 17 stores that we sold in Central Europe that I mentioned earlier.

The IAS 19 pension deficit was broadly in line with the year end. As a reminder, only pension schemes which are in a net deficit position are included in our total indebtedness. At a total level, we continue to carry a post-tax pension surplus of £1.1 billion. I'm really pleased to confirm that we have agreed the actuarial pension valuation as of 31st of March 2022 with the trustees at a surplus of £0.9 billion. We have also been able to agree with the trustees that we don't need to make any pension deficit contributions ahead of the next tri-annual valuation in 2025. Furthermore, the expense payments to the scheme by Tesco were reduced by £8 million per year to £17 million. Our net debt ratio was two and a half times, within our published guidance range and stable since year end, and our fixed charge cover was 3.5 times also in line with the prior year end.

Before I finish, I wanted to talk briefly about the updated guidance that we've published today. As you will have seen in the statement, despite ongoing challenges in the market, I'm pleased that we are able to maintain our profit guidance within our previous range, albeit towards the lower end. We therefore expect full year retail adjusted operating profits of between £2.4 and £2.5 billion. Significant uncertainties in the external environment do still exist, most notably how consumer behaviour continues to evolve. Our strong and ongoing focus on cash and a more positive expectation on working capital means that we have upgraded our expectation for full year retail free cash flow to be at least £1.8 billion. We continue to expect Bank adjusted operating profits of around £120 to £160 million.

To summarize, as you have seen today, we have reported a solid performance despite the tough backdrop. We have confidence in our capital allocation and multi-year performance frameworks continuing to guide our actions so that we can create sustainable long-term value for every Tesco stakeholder. In line with our dividend policy of 35% of prior year earnings, I'm pleased that we have been able to announce an interim dividend of 3.85 pence. As part of our ongoing capital return program, we repurchased £450 million worth of Tesco shares in the first half, which takes us to a total of £750 million since we started the program last year. We are on track to buy back a total of £1.05 billion by April 2023. Thank you very much for your time, and I'll now hand back to Ken.

Ken Murphy: Thank you, Imran. Now to our strategic priorities. As a reminder, there are four priorities that help us stay competitive, accelerate our growth, and ensure that we can sustainably generate strong levels of retail free cash flow. I hope you are starting to get familiar with them, but as a reminder, they are Magnetic Value for customers, I love my Tesco Clubcard, Easily the most convenient, and Save to Invest. I'm going to give you a relatively brief update on each of the drivers this morning.

Magnetic Value and Save to Invest have been particularly critical given the inflationary environment, but all four have kept us moving forward with our long term plans. Great prices are an essential component of Magnetic Value. And as I've just said, they're particularly important in the current environment. Clearly, the entire market has had to cope with significant inflationary pressures, and inevitably, this has led to price increases for customers.

At Tesco, we have continued to do everything we can to hold back inflation wherever possible. Where it has been passed on, we are ensuring that it is a little bit less and a little bit later than the rest of the market. You can see that this has allowed us to maintain a strong price position with our price index showing that we have consistently been cheaper than the market for the last 56 weeks. Importantly, we're also at the most competitive we have ever been versus the limited range discounters. Customers are recognizing our ongoing commitment to value with our perception score relative to the market continuing to strengthen.

Aldi Price Match has been the cornerstone of our value proposition, helping to remove price as a reason for customers to shop elsewhere. It remains a key component alongside Low Everyday Prices and Clubcard Prices. As customers have sought out the great value that it offers, we have made it even easier to access by increasing the distribution with a wider range of products in more stores across the estate. As a result, in addition to featuring in virtually all large baskets, Aldi Price Match now features in over 80% of our top-up shops. Clubcard Prices have now been rolled out across the entire group and offer customers great deals on a wide range of products, ensuring they can save across food, clothing, Tesco Bank, and Tesco Mobile.

Finally, Low Everyday Prices. You will have seen today that we have launched a significant new price lock commitment, freezing low prices on over 1,000 products until 2023. Our Low Everyday Prices campaign covers products and brands that customers buy in week in, week out. It covers everything from cupboard staples and tea time favorites, through to household and health and beauty products. As we head into the winter months and great value becomes even more important for our customers, we hope that this new price lock commitment will provide even more confidence that there is no need for them to shop elsewhere.

When customers' budgets are under pressure, they need to have confidence that the food that they are buying is of great quality. Along with our progress on value, our quality perception has gone from strength to strength, increasing 208 basis points year on year and ahead of the market. We have strength in our premium offering with our Finest range increasing by more than 13% year on year. Our Finest performance has remained strong and continues to be a focus for us as customers look to do more of their entertaining and socializing at home. Finest is just one element of the improvements we've made to our dining in offer, and we're pleased to increase our market share in the important Dinner for Tonight segment by 83 basis points year on year.

Ken Murphy: The two other components of Magnetic Value are health and sustainability. Earlier in the half, we launched our Better Baskets campaign, making it easier for customers to make healthier and more sustainable choices without compromising on price every time they shop with us.

On climate change, we have been continuing to develop the strategy behind our ambitious value chain targets and making further progress in electrifying our transport. We have introduced HGV trailers with refrigeration units powered by solar panels, each saving around 2000 litres of diesel per year. We also became the first retailer to launch a zero-emission electric lorry, servicing over 400 stores in Greater London. Each lorry is expected to replace around 30,000 diesel-fueled road miles every year.

We continue to work closely with our suppliers, with a particular focus on British agriculture. We are helping support British farmers with the many challenges they are facing. For example, giving extra funding to pig farmers and increasing the price we pay dairy farmers for fresh milk. We are also working hard to reduce food and packaging waste. We accelerated our target to halve food waste by five years, bringing it forward to 2025. On plastic, we have now removed multi-pack wrap from all of our own brand canned fizzy drinks, saving 12 million pieces of plastic a year.

Moving now to the second of our strategic priorities. I love my Tesco Clubcard. We've made great progress throughout the half on Clubcard. With Clubcard prices fully rolled out across all markets and businesses and Clubcard satisfaction up five points year on year. Clubcard penetration has also increased significantly and is proving an invaluable tool for customers as they navigate the pressures they are facing. Clubcards are now used on 75% of sales across all stores in the UK. The number of active Clubcard households is now at over 20 million, an increase of just over three million versus last year. Alongside this, our Clubcard App is gaining even greater traction, now with 10 million users in the UK, one million in Central Europe, and over 300,000 in Ireland. And we're rewarding customers even further. We have launched in-app personalization to 2 million Clubcard holders giving them coupons tailored to the areas that matter most to them.

I wanted to take a few moments to remind you how the progress we are making in Clubcard fits in our wider digital platform strategy.

The points I've just outlined are all about putting the foundations in place, creating a strong proposition through Clubcard prices and enabled us to significantly increase penetration, at the same time as migrating customers onto our digital offering. We've also been developing our capability in parallel. This includes enhancing our ability to personalize, strengthening our digital customer experience, and reinvigorating our data science business, dunnhumby. Although it is early days, we have already started to benefit from the application of this capability.

As I've already mentioned, we have applied many of the initiatives that we have launched in the UK across the group. We are building the strong base dunnhumby has already established with suppliers through dunnhumby shop, and we have launched a new service, Tesco Media and Insights, which is starting to work with a range of consumer goods brands to monetize some of the new opportunities we have created. While the bringing together of these tools and capabilities is still relatively new, I see it as one of the most important long-term opportunities for us to focus on.

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. I mentioned back in April that we were expecting further normalisation in the online market in the current year, and this is what we have seen. Orders, while still strong at over 1.1 million per week, are down around 10% year on year. Happily, where we are seeing customers return to shopping in-store, a large proportion of these are doing so with us. Our online business still remains significantly ahead of pre pandemic levels and we've seen a robust performance in market share, holding broadly flat year on year. Our online proposition is supported by the combination of urban fulfillment centers, Click & Collect sites, and Whoosh, our super fast home delivery service. We opened our fifth urban fulfillment center in Rutherglen in May, and plan to open two more later this year.

As we continue to test and learn, we've made improvements to our processes, software, and hardware leading to a much faster ramp-up to capacity in Rutherglen compared with our earlier urban fulfillment centers. We have continued our rollout of Click & Collect locations with circa 70% of all UK households now within a 25 minute drive of a site. We've worked hard to improve the customer experience, launching curbside pickup in 180 locations. We have more than doubled the number of stores where Tesco Whoosh is available to 442, and expect to reach a total of more than 800 by the end of the financial year.

Our convenience business has continued to perform strongly coming out of the pandemic. We have continued with our opening program in the UK with

17 new Express stores in the last six months and more planned for the remainder of the year. We have also opened a small number of stores in Ireland and Central Europe. We're continuing to expand the Booker network with a net increase of 195 new retail openings, as well as increasing the number of catering customers.

Our final strategic priority is Save to Invest. Last year, we set ourselves the goal of being able to save around one billion of costs over three years to help offset the impact of cost inflation on our business each year. We've made really good progress. To give some examples, we have simplified our stock and replenishment routines in store, ensuring that colleagues' time is used as efficiently as possible. Our reduced stock control routines have saved nearly 47,000 hours a week as a result. We also moved more replenishment from nights to days, enabling more colleagues to be available on the shop floor to help customers at peak times. We have reviewed many of our supplier contracts for goods and services not for resale, re-tendering some to achieve better prices, and consolidating others to reduce levels of duplication. We said in April that given the significant cost pressures we are facing, we would look to accelerate the program.

I'm pleased to say that we are well ahead of our original three year plan and on track to deliver savings of around £500 million this year. Based on our progress so far and the momentum we've established, we are now seeking to deliver the original target of around one billion of savings by the end of February 2024, a year earlier than initially planned.

In summary, we are pleased to have delivered a strong performance in a challenging market, and to have done so at the same time as investing for our customers and colleagues at a time when they need us most. Our strategic priorities are serving us well. They will continue to guide our progress for the long term as we double down and relentlessly focus on value, competitiveness and operational execution. I am pleased that we are on track to deliver the profit we have outlined in our guidance this morning. It is a challenging environment and we all face significant uncertainties in the months ahead, but we are confident in our ability to continue generating strong cash flows and creating value for shareholders. Thank you for your time so far. Imran and I are now really happy to take your questions.

Ken Murphy: As ever, we'd like to give everyone a fair chance to get their questions in. So if you could limit your initial questions to one or maximum two, then we'd really appreciate it. Then, of course, if you have any follow-up questions thereafter, we'd be more than happy to take them. So with that I'll pass back to the operator and we'll take your questions. Thank you.

Call Operator: Thank you. If you wish to ask a question, please dial 01 on your telephone keypad now to enter the queue. Once your name's been announced, you can ask your question. If you find your question is answered before it's your turn to speak, you can dial 02 to cancel. And if you're reviewing the webcast, please ensure that is muted when it's your turn to speak. So once again, that's 01 to ask a question, or 02 if you need to cancel.

Our first question comes from the line of Andrew Gwynn at BNP Exane. Please go ahead. Your line is open.

Andrew Gwynn: Good morning, Ken. Good morning, Imran. Hope you're well. Just got one question then actually, but why is £2.4 to £2.5 billion the right answer? Billions of cost inflation. So why that specific range? Thank you.

Ken Murphy: Thanks, Andrew. Great question. I think what it represents for us is that balance between making sure that we are the most competitive we've ever been in terms of value for customers, making sure that we can continue to invest in our colleagues and as you saw today, we've made a further investment in those, and make sure we invest the right level of capital for the medium growth that we're looking to sustainably deliver for shareholders. And then, of course, making sure that we also reward shareholders through a combination of the right dividend policy and the share buyback program. So we think it's all about balance. We think that number achieves the best balance.

Andrew Gwynn: Okay. Thank you very much.

Ken Murphy: Thank you, Andrew.

Call Operator: Thank you. Our next question comes from the line of Rob Joyce at Goldman Sachs. Please go ahead, your line is open.

Rob Joyce: Thanks very much for taking the questions. I'll do two that are pretty related. Imran, in terms of understanding a bit more that profit bridge on slide 18, just thinking that in a full year, I guess one thing we won't see again is the post-pandemic sales normalisation. Can we isolate over the full year how much the volume impact you're expecting from the sort of COVID reversal is going to impact profitability? Back of the envelope, I'm thinking around £200 million sort of negative impact from that reversal in the current year. And the second one, appreciate a lot of uncertainties, but to the extent you can, I know I've seen some numbers overnight apparently, and our numbers are broadly at sort of flat profits on the EBIT line in FY24. Can you just give a comment as to whether that looks reasonable at this early stage? Thank you.

Imran Nawaz: Okay, so let me give you sort of the two, I'll take one after the other. So on the first one, look, I mean in April, if you remember we gave a range of £2.4 to £2.6 bn and at that time we said to you there's three drivers that we have uncertainties on. How much will the COVID unwind be, what will happen with customer down trade, and what will happen on inflation? And frankly the backdrop to the customer environment, also the competitive environment. Six months later, I'm kind of pleased to say that the way we saw it is sort of how it played out. COVID unwound was around, from an estimate, we lost roughly half of what we had gained, so to speak, from a volume impact. So you can do the math on that.

Inflation, we managed quite well on the cost line because we were very well hedged. And I'd say on the down trade, while you saw some down trading, I take the positive from that, we were able to serve those customers looking for better value. So when I look at the bridge for the half year, it sort of played out pretty much as anticipated. I think the second half's going to be more of the same. That unwind, I think now is in the base and I'm not sort of worried about it going forward, because now this is sort of a like normal level of trade and I think what we've demonstrated is, despite that big unwind coming to us, we've actually managed quite well to offset most of that.

Look, I guess the question that you're asking for '23/'24 is, I'll give you my view, it is really early to give you guidance for next year. And the way we're thinking about it is we can control and we must control what's in our destiny to control. So when we look at the cost saving program, when we look at our investments in customer, whether that's Aldi Price Match, whether it's Clubcard pricing, whether it's Low Everyday Prices, I think I'm very confident that the strategy we have is delivering and you saw it in the first half numbers and I'm confident it will do the same thing again for next year. I think at this early stage with the uncertainties around, I think it'll be too early to give you a commentary on how I see profit play out. But again, my message to you is what we're doing is working as long as we focus on what we can control.

Rob Joyce: Okay, thank you.

Call Operator: Thank you. Our next question comes from the line of James Grzinic of Jefferies. Please go ahead. Your line is open.

James Grzinic: Yes, good morning all. Just a very quick follow-up from Rob really. Imran, in terms of the moving thought to next year, when you think about next year compared to this year, I'm particularly interested in terms of how you feel about the mix of margin and the scale of the incremental opex challenges next year compared to what the business is seeing this year.

Imran Nawaz: Look, I mean you remember this year when we look in April, I gave you sort of an indication, right? I told you, look, payroll costs between store expenses and distribution would be an incremental cost of around £300 million, energy roughly of the same scale. And then we stepped up our Save to Invest program to help us offset a big chunk of that. As I look ahead, it's clear to me that energy costs will continue to be a headwind as well, and clearly we will continue to do the right thing on the payroll side for our colleagues.

But having said that, at the same time we are continuing to look at the portfolio, we're continuing to look at the range and frankly as you saw, we're trying to do the Save to Invest program in two years as opposed to three such that we have a good run, if you wish, into next year. Now, again, how it all plays out with how customers will feel, what the mix impact will be, what the environment will be like, I think it's just way too early to call. I think reality, also, is right now we're focused on making sure we deliver this year and the second half as well as we did on the first half.

James Grzinic: Understood. Thank you.

Call Operator: Thank you. Our next question comes from the line of Clive Black at Shore Capital Markets. Please go ahead. Your line is open.

Clive Black: Thank you again, gentlemen, and good morning. Just one question really for Ken and Imran. What worries you most about FY24? I mean, I think it's understandable the questions are about that year because the market has reduced your share price over earnings worries on that outlook. What is it that concerns you most about the next 12 to 18 months, please?

Ken Murphy: I mean, clearly for us, the one thing that's outside our control is the energy inflation, that's something that we just really don't know how it's going to play out yet. I think what we're really pleased about, as Imran says, is that we have controlled what's within our gift to control and that's what's allowed us to deliver such a strong performance at the half year. And we believe that's what's going to take us through the rest of the year. I mean clearly strategically we're constantly working on making sure that we can do that on a sustainable basis.

Imran Nawaz: And if I could just double down on that, when I look at the north star of value for customers combined with doing everything we can in the background to accelerate savings without impacting the customer shop, I think is the right strategy and is delivering. And I think therefore it gives a bit of confidence as well as you go into next year that doing what is working and doing it even better is going to have to continue to be the formula we have.

Clive Black: Thank you. Can you elaborate maybe for us where you stand on energy from February '23 please?

Imran Nawaz: Last time when we spoke in April, we were fully hedged for the year ahead. I can say that now because the year is running. Now, clearly for next year, we have hedges in place as you would expect. A company our size, we have structured processes in place where we take rolling coverage. There are open exposures still out there for next year but that's part of any year frankly. It's not something that concerns me, it's just something we need to manage through and get it in the right way. I would not want to give you the specific percentages, only because I feel that's commercially sensitive to share given the industry we're in.

Clive Black: Thank you. No, that's really helpful. Appreciate it.

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

William Woods: Hi. Good morning. I just wanted to call back to this year. By maintaining your full year operating profit guidance and if you assume relatively continued levels of inflation, I think you're implying a 40 to 50 basis point hit half on half to your retail margins, despite stronger H2 seasonality. Is that the right way to think about it? And can you just break down what you think the key drivers of a margin hit would be, split I guess between margin mix and cost increases? Thanks.

Imran Nawaz: I think the biggest driver in the first half versus the second half if you think about it is our payroll increases coming to play midway through the year, so as of July, so you have a bigger proportion of the cost increases in the second half versus the first half. Similarly on energy, even though we we're hedged, clearly as you hedge, the cost increases has a bigger proportion in the second half than the first half. But then at the same time, from a good point of view, we've also got the Save to Invest getting momentum into the second half more than the first half. I'd still say at the end, you probably have a net slightly down because of the energy that you can't fully offset in one half alone, so I would say if you keep it very simple, those are the key moving blocks. I think mix might play a small role but it's not significant enough to call out.

William Woods: Okay, thank you.

Imran Nawaz: Sure.

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

Fabienne Caron: Yes. So good morning, everyone. Two quick from my side. The first one that can you help us understand the volume decline in the market in the UK half one compared to your volume decline that you saw in food would be the first question. And the second question is do you see any impact of the weaker sterling on your business?

Imran Nawaz: Look, let me take the second question and I'll go to you on the volume if you want. On Forex, clearly, we have exposures like every business. For us, it's mostly dollars and euros. We are very well hedged if I look ahead and then clearly for next financial year, we also have hedges in place, but again, there are some open exposures. But again, frankly, it's what we do every day and we do it well and I feel comfortable that this is not something that's going to give us a new sort of challenge that we need to learn how to deal with. It's something we're doing every day. On volumes?

Ken Murphy: Yeah. Thank you. Thank you Fabienne. So on volumes, as you would've expected, throughout the first half, we have seen a normalisation of customer behaviour. And so first of all, we saw greater participation in the eating out market, which of course, Booker was the main beneficiary and underpinned an incredibly strong six months by Booker. I think you're also seeing a normalisation of in-home shopping habits, so a higher frequency of shopping visit, smaller basket sizes, a shift from online to in store, which has had the effect of basically fragmenting the shopping trips closer to levels seen pre pandemic, still higher than pre pandemic levels but closer to pre pandemic levels. I think that to the largest extent, we have seen also the underlying volumes relatively stable, albeit that there are some trade down to own brand products that are cheaper and also from fresh to frozen.

Fabienne Caron: Thank you very much.

Call Operator: Thank you. Our next question comes from the line of Xavier Le Mene from Bank of America. Just a reminder from our assistants, if you do wish to ask a question, please dial zero one on your telephone keypads now. Xavier, your line is open. Please go ahead.

Xavier Le Mene: I may. The first one, can you potentially comment on the competitive landscape? So we heard a lot about low price investment coming from Sainsbury, Morrisons and Asda, so how do you feel and what's your experience there? That would be the first one. And then looking at the market share, can you potentially comment to switching data? So what are you seeing? Are you losing to Aldi and Lidl? Are you winning from others? It would be quite interesting to know what you are seeing there.

Ken Murphy: Sure. Thank you. Okay. So look, the first thing to say is that we are very respectful of all our competitors. We operate in a highly competitive market and we think that's a good thing because it keeps us sharp. We're very focused on our medium to long term strategy, which is really about being the best value proposition in the market across the widest possible range, and it's basically having something for everyone. The second is to be the most comprehensive retailer in the market, available in every channel, really working on proximity and convenience for our customer base. And the third of course is to make sure that we reward that behaviour through our loyalty platform and also make sure that we get to know customers that little bit better through that understanding of customer data. And that's really paying dividends for us. We don't really worry too much what the other competitors are up to. We clearly keep a close eye on price indices and price competitiveness, and that's something that has improved over the last six months.

In terms of market share and market share performance, we deliberately showed the three year market share performance to illustrate a point, which is that despite all of the activities over the last three years, Tesco is the only one of the full line grocers to maintain its market share position, and that really is a testimony to just how much effort and energy our colleagues and our people have put into our customer proposition from a value point of view and a convenience point of view and that's despite the fact that the limited range discounters have added millions of square feet of new space over the last three years. And I think going forward, that's going to continue to be our focus and we believe we're in a really strong position to maintain that competitiveness.

Xavier Le Mene: Thank you.

Operator: Thank you. Our next question comes from the line of Sreedhar Mahamkali from UBS. Please go ahead. Your line is open.

Sreedhar Mahamkali: Good morning. Yeah, thanks for taking my questions. Two related ones I guess. I suppose I'm just following up James' question earlier on next year puts and takes, slightly differently maybe. I think, Imran, you talked about £500 million Save to Invest contribution this year offsetting £600 million inflation. You've also brought forward savings into next year to another £500 million. Is it fair to think the shape next year is likely to be the same as this year, i.e. £500 versus £600 kind of magnitude, i.e. the £500 million largely offsetting the cost inflation? Or do you see anything materially different? That's the first one. Secondly, should we be thinking about any cash costs associated with this £1 billion of Save to Invest, please? Thank you.

Imran Nawaz: Yeah, so first, as you rightly point out, it's terrific progress on the savings program. It's a small line in a release, but at the end of the day, there's a lot of work that goes behind it to make it happen. So I think the first sort of success factor that we're really happy about is a run rate of £300 million that we started the year off to become £500 for this year feels good. There are some cash costs that we highlight, but they're not significant.

Look, I think as we look ahead into next year and want to do the £500 million on top, the nature of those is really a review of all the processes, whether it's replenishment processes, whether it's warehousing, whether it's procurement. How can we eliminate waste, small processes that don't add any value and actually just deliver by simplifying the lives of our people to win in the market.

The way I think about it philosophically is that savings should help us avoid passing on inflation because we can therefore fight for the customer. But as you rightly point out, for next year, it is quite clear that there will be increases on some of the operating cost lines as well. When I think about a P&L, I think not just about the two lines. So if we looked at energy and payroll and savings, I think it's a whole mix of what do we need to continue to do to win on mix, on volume, beat the competition, and really make the whole thing sing and dance to deliver the cash outflow that we've committed to delivering the famous £1.4 to £1.8 billion. That's the philosophy I have, but again, it's just too early to give you more details beyond this stage at this time. I'd say on your, yeah, I think that's it. I think we'll find out on the shape as when we speak in April as to how it all played out.

Sreedhar Mahamkali: Thank you.

Imran Nawaz: Sure.

Call Operator: Thank you. And just as a final reminder, if you do have a question, please dial zero one on your telephones now. And the 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 for taking my questions. It's a continuation of a previous one. So basically when we look at current year guidance, underlying retail operating profit guidance would be around two billion, sort of 20% less if there was no cost saving program. And we obviously understand that there will be another £500 million, but how do you look at years beyond 2024? Do you expect any additional programs? We do understand there will be hopefully a much lower opex and cost of goods sold hit in the year ahead, but is there any new sustainable sort of absolute EBITDA level you are targeting longer term?

Ken Murphy: Well, I think Victoria, the first thing to say is that we set out our strategic drivers last year with that medium term in mind, and they're really where we're looking to drive sustainable, both sales profit and then ultimately cash generation because we think that is going to be the recipe for success for Tesco. And we absolutely believe in those strategic drivers.

Clearly we are facing external challenges, inflationary pressures that everybody is facing, but we believe that the underlying strength and resilience of the Tesco business is unique and that has been demonstrated day in, day out by the performance. We're clearly feel it's incredibly important to stay strong, really strong on value. We think that building out and maintaining that omni presence from a network point of view is clearly as important. But then ultimately, as the medium term kicks in, we think that we need to make our data resources and capability, our loyalty platform and our insights capability work harder for us, and we are absolutely committed to that.

So what I can tell you is that we think we have the right ingredients within our strategic framework to deliver that medium term resilient, strong, sustainable profit growth and cash generation.

Imran Nawaz: And Victoria, in a way, the way I look at it as well is ultimately working through the headwinds that you refer to, it's making us say, we will emerge from all of this as a stronger, better Tesco. So ultimately the savings we're putting into place, not temporary of nature, they're sustainably reducing our cost base, giving us fuel. So as and when some of the inflation dissipates, what you're left with is a stronger company than where you started. And that to me is actually no bad thing and gives confidence when you think looking ahead as to the shape of the company.

Victoria Petrova: Thank you very much.

Call Operator: Thank you. Our next question comes from the line of Nick Coulter at Citi. Please go ahead, your line is open.

Nick Coulter: Morning. Thanks for taking my questions. Can I ask about Booker and catering specifically, to what extent you think you're taking share and whether any of the trading down trends in the UK core are also showing in Booker's catering business? Then I guess secondly, more broadly, how has consumer behaviour and focus group feedback evolved over the half and the quarter please? Thank you.

Ken Murphy: Thanks Nick. And I'm glad you brought up Booker because it really has been a star performer now for quite some time, right the way through the pandemic. Even though a lot of catering was closed, Booker continued to win share and actually that accelerated as catering opened back up because it is the best run wholesaler in the market. So I think that if you look at Booker's performance, there is a part due to the opening up of catering post pandemic, but there is also a very strong element of it is Booker winning market share. And that principally is underpinned by Booker focusing on who are the best caterers in the market and making sure that they're really well looked after.

And then as those caterers win, Booker is winning with them. And that really has been the story of the success of Booker over the last six months particularly. We're also of course constantly innovating the network in Booker. So we've established two retail hubs to absorb more and more of our retail trade and create space to grow even further in catering. So we feel really optimistic about the future for Booker. We think it's going from strength to strength. We think people will still want to celebrate this Christmas and we know that Booker is probably the best placed wholesaler to support the industry.

Nick Coulter: Thank you.

Ken Murphy: Thank you.

Nick Coulter: And then whether you're seeing any trading down trends in Booker and more broadly the consumer behaviour?

Ken Murphy: Interestingly, one of the things that Booker's Catering, best catering customers are most adept at is managing their menus to suit the customer's pockets. And Booker is very good at being very agile and adapting their offering to suit the caterers' menu changes. And that is something that's really part of the underpinning of the success, both for the catering customers and for Booker. So we think that Booker's catering customers will be the best value proposition out there this Christmas and that I think will help them outperform the market.

Nick Coulter: Got it. Thank you. Then obviously you do have the leading consumer insight business in the UK, so it'd be super helpful to get a sense of how you read the consumer sentiments as it's evolved over the last quarter. Thank you.

Ken Murphy: Well, clearly consumer sentiment is influenced by everything around them. And so they're dealing with inflation, they're dealing with energy, they're dealing with the tragic death of the Queen, which was a really big deal for the nation. And so all of these are playing on the consumer's mind, and what the consumer is looking for therefore is reassurance, stability, and consistency. And that's what Tesco has been all about. It's all been about being able to be a reliable source of value, a trusted friend to go and wander around and get help when you need it, find everything you need, and be reassured that you are paying the best possible price when you come to us, and that is really what we've been all about. We have seen a trend where people are looking to treat themselves more at home, and so we're obviously investing heavily in our Finest range. We've extended that by over 13% over the last six months and we've seen great traction in that, and we've increased our market share of that very important food-for-tonight mission, which we historically had under traded in.

Nick Coulter: That's super helpful. Thank you.

Ken Murphy: Thanks.

Call Operator: Thank you. And we have a further question from Xavier Le Mene of Bank of America Securities. Please go ahead, your line is open.

Xavier Le Mene: Yes. Sorry, one more question if I may. Just, you mentioned actually Clubcard and then the data on new services with your suppliers and you mentioned a long term opportunity, but would you be able potentially to help us to quantify that opportunity longer term?

Ken Murphy: Well, all I can tell you is that it's something that we are in the early stages of. It's something that we're building over time, and as the presentation laid out for you, the first thing that we focused on and have been doing for the last two years, is really driving up penetration of the Clubcard. And we're really pleased with the progress on that. So we've increased our active user base to over 20 million, and we have 10 million people now using the app on a regular basis, and so that's given us a fantastic basis to really be able to exploit the capability.

The second stage, and some of that's been working in parallel, has been really to build the capability, both within dunnhumby and Tesco, to make the best use of that data. And that's included testing and trialing over 2 million personalised promotions through the app.

And the third, of course, is the application of that, and that is really what the next three years holds for us, and it's one of the things that's going to be key, a pillar of our strategic priorities going forward.

Xavier Le Mene: Okay. So no numbers yet?

Ken Murphy: Not yet.

Xavier Le Mene: Thank you.

Ken Murphy: Thank you.

Call Operator: Thank you. And currently we have one further question in the queue, that's from the line of James Anstead at Barclays. Please go ahead, your line is open.

James Anstead: Good morning. Two quick questions, please. Firstly on customer behaviour and the changes you're seeing, is that something that's developing reasonably steadily, or are you seeing those behavioural changes accelerate maybe over the last few months and weeks as energy bills have risen, in particular? That would the first question, and the second one would be, I just wondered how you are setting yourself up for Christmas given the backdrop of behavioural changes, particularly, I guess, in terms of levels of non-food. It sounds like on Finest, for example, you're optimistic there'll be a lot of demand there, but are you setting yourself up any differently from a more regular Christmas?

Ken Murphy: So yeah, thanks, James. There's a few things going on here that are worth calling out. I think the first thing is that as the cost of living really bit, customer behaviour changed relatively quickly. Customers are quick to respond to their environment. And so we saw people changing shopping behaviours quite quickly through the summer. We saw them trading down quite quickly during the summer. Of course, the summer itself influences behaviour, and we've had some great weather and that helped trade. But, generally speaking, a lot of those trends bedded in quite early and we're seeing a kind of continuing pattern of that, so no violent deterioration since then. At the end of the day, people have to eat and our job is to make sure they can eat as cheaply as possible with the best quality product.

The second thing we're seeing, of course, is that people are living from paycheck to paycheck. So you're seeing a spike that's a bit more accentuated through pay days and we're adapting our proposition to that. But you're also seeing people looking to plan ahead. So, hence we brought forward our back to school proposition earlier in the summer to allow parents to plan and smooth out that spike of spend when their kids go back to school. And we're doing the same for Christmas.

We know from our insight that customers are determined to celebrate Christmas. They really need the opportunity to kind of celebrate with their friends and family and forget about what's going on around them, but they want to do so in an affordable way. So, for example, we ran a very significant beer, wines, and spirits event last week together with a clothing proposition. This week we've gone into a half price sale on toys. We think that gifts this year will be smaller and that people will want to pre buy them and plan them in the run up to Christmas. And so our Christmas proposition is trying to mirror that expected shopping behaviour. We're also in a different situation from a stock management perspective. This time last year we had a lot of disruption in the supply chain. This year we're planning a smoother, more efficient flow of stock through the network into the stores. So they're probably some of the key changes we're making to the Christmas offer this year.

James Anstead: That's very helpful. Thank you.

Ken Murphy: Thanks, James.

Call Operator: Thank you. And there are no further questions on the phone, so at this time I'll hand the floor back to our speakers.

Ken Murphy: Well, listen, thank you all for joining us today and taking the time to listen to our presentations, and thank you for all the great questions we had. As you can see, we've delivered a very strong set of results in very challenging conditions. I think it's a real testimony to the resilience of our business and a testimony to what a great team we have at Tesco, and how much and how passionate they are about looking after the customers and communities they serve.

We hope you all have a great Christmas, and we wish both England and Wales all the very best in the World Cup, and we're looking forward to seeing you all in January, if not before. Thank you.

ENDS