

Tesco PLC

Q1 Analyst Call

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Transcript

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Ken Murphy:

Good morning, everyone. Thank you for joining us for our quarter one results call.

I'm here in Welwyn, as usual with Imran, and in a moment, we'll open up the lines for your questions. I want to start by saying a huge thank you to the entire Tesco team for their great work and dedication. Their commitment means that we can continue to deliver great value and service to our customers every day.

We've had a strong first quarter delivering volume growth across the UK, the Republic of Ireland, and Central Europe. Inflation has continued to ease since we reported our Full Year Results in April and we've remained focused on delivering the best possible value for our customers. Aldi price match is now across 700 lines combined with low everyday prices and Clubcard prices, it enables us to be the cheapest full line grocer, a position we've now held for the last 19 months.

Our focus, however, is not only on value and we've continued to invest in product quality and innovation. Scotland's game against Germany this evening kicks off a great couple of months of sport. We have just relaunched our finest dine-in for two offer with our new summer menu focusing on pub classics done brilliantly. And we have improved our picnic and deli and fire pit ranges ahead of all those summer parties.

Our focus on innovation and quality throughout our offer is supporting switching gains from the premium retailers, which we've now seen consistently for almost two years. Sales of Tesco finances continue to grow strongly up by over 12% in the quarter.

Another key driver of our performance is our focus on service and customer experience. We continue to have more colleagues on the shop floor, making sure our customers can always find what they're looking for, that queues are kept to a minimum and shelves are always replenished. And we've all to improved availability by around one and a half percentage points year-on-year in both packaged and fresh food.

We're continuing to develop Clubcard enhancing ways to personalise the experience. For example, we've recently began trialling a new interactive initiative which allows customers to take part in a series of challenges based on their shopping habits with the chance to earn up to £50 of additional Clubcard points. Clubcard is growing and satisfaction scores are up helping cement its position as the most popular grocery loyalty scheme in the country.

Our progress is clearly demonstrated by our growth in market share. With the latest Kantar read showing the highest gains for the last two years. This has been supported by 15 consecutive periods of switching gains, with our customers shopping as more often and with more in their baskets.

Our brand perception and customer satisfaction scores tell a similar story with growth across all measures ahead of our competitors. As you know, a core part of our strategy is to serve customers wherever, whenever, and however they want to be served. That includes providing them with the greatest choice of products, and last week we launched Tesco Marketplace. Marketplace is a new online platform which gives our customers the opportunity to shop a broader range of thousands of products alongside the groceries they know and love. It's early days and we're focused on growing the offer and expanding the range to bring the widest selection and best products to our customers.

Last week, we announced Booker's acquisition of the wine and spirit merchant, Venus. Venus is a well-respected and fast-growing supplier of drinks to the on trade, which significantly enhances the range of premium drinks we can offer Booker customers.

Booker continues to perform strongly despite the ongoing decline in the tobacco market and the strength of prior year comparatives with the core retail and catering businesses delivering underlying growth and outperforming the market. I'm really pleased with our progress in the first quarter. Our performance is strong, our in-store execution is best in class and we're making meaningful strategic progress. With sales trend in line with our expectations and the business well positioned for the months ahead, I'm pleased to reiterate our guidance for the Full Year.

Thank you all for listening, and I'll now hand back to the operator for questions. Thank you.

Operator: Thank you, sir. Ladies and gentlemen, if you wish to ask a question, please signal by pressing *1 on your telephone keypad. If you wish to cancel your request, please press *2. Again, please press *1 to ask a question. The first question comes from James Anstead from Barclays. Please go ahead. Your line is open.

James Anstead: Good morning, two questions please. So firstly on Booker which had this like for decline in the first quarter, you've given some very clear explanations about some of the moving parts behind that negative number. I just wonder, you perhaps got some better idea than us of some of those factors and how they'll move later in the year. Should we be cautious about that number staying negative for a number of quarters or are you optimistic that with less challenging comps that might move back into positive territory? That's the first question.

The second one on Central Europe, I know it's not the biggest part of the business, but I think back in April, Imran was quite optimistic that central European profitability would rebound quite nicely this year. It looks like the quarter has started well, so has that given you some confidence about that profit recovery being delivered? Thank you.

Ken Murphy: Thanks, James. I'll take the second question. First, I think I'd start by saying that Central Europe is performing in line with our expectations in the first quarter, so pleased with that. And on Booker, I think that what you should be banking on is that we'll continue to outperform the market in both retail and catering. And I think that our confidence in Booker is underpinned by our willingness to invest in acquisitions like Venus, which we think is a great addition to the Booker portfolio.

James Anstead: Just a quick follow up on Booker with Best Foods, because my understanding is Best Foods to some degree has been rationalising some of its customer base. Is that a factor that perhaps that's just an ongoing process and doesn't come to a particular end point or is there a quarter where that headwind starts to drop out?

Imran Nawaz: But maybe just maybe also give you my views on Booker and then also on Best Foods. I mean, exactly like Ken said, look, I also feel very good about the overall Booker performance. For context, we lapped around 16% growth in retail and around 10% in catering. So what I thought, it's great to see that both divisions are outperforming the market and showing real growth.

And then as we had talked already last year, we anticipate that Best Foods Logistics driven by pruning as well as the softer market, we would continue to see declines. And similarly on tobacco, I expect to see both of those to be negative territory for the rest of the year. Now reality also is, as we've said, James, both of those are relatively low margin and therefore, is all within the guidance that we've given.

James Anstead: Okay, that's very clear. Thank you.

Operator: Our next question comes from Monique Pollard from Citi. Please go ahead.

Monique Pollard: Hello. Morning everyone. I just had a couple of questions too if I can. The first one, just quickly back on Booker, I just wondered if you could help us understand, I don't know, rough size or profitability impact of those two, the tobacco and the Best Food Logistics within Booker to get a sense of whether that's any kind of material profit headwind. And then second, just bigger picture market update, whether you are still expecting low single digit inflation for the full year piece.

Imran Nawaz: Look, I mean, on your first question on Best Food Logistics and profitability. Look, it's not a material piece of the profit, so it's less than a handful of million. So that gives you a sense of the scale on that business. In terms of inflation and how we've seen it. Look, when we entered the year we set our central case for the plan for the year would be a low level of inflation, low single digit, right? And when you look at how the year started, it's panned out exactly like that, right? Kantar read in the first... As we started, the financial year was what? Four and a half percent and it's now around two and a half, we've been below that.

So it's exactly there where we thought it would be. Now, as we look ahead, our central case continues to be low levels of inflation. Now clearly underneath that you'll have moving pieces on the commodity side, which we'll continue to monitor to make sure we're ready for whatever happens, but that certainly continues to be the base case for us.

Monique Pollard: Excellent, thank you very much.

Operator: Our next question comes from William Woods from Bernstein. Please go ahead.

William Woods: Good morning. The first question is just building on that inflation question, do you think that we'll start to see some inflection in food prices over the next 6 to 12 weeks? I know you've talked about that before, particularly as minimum wages feed through. And then the second one is can you just give us an update on what you're seeing in terms of consumer spending, habits, volumes, etc, and how the weather has been affecting trading over the last few weeks? Thanks.

Ken Murphy: Thanks. Hi, Julian. So our base case assumption on very low single digit inflation remains in force and I think that is taking into account all of the factors including national living wage impact and commodities volatility because we're seeing some commodities down, some commodities up and weather. And I think also the increase in promotional funding. So they're all factors that are playing into inflation in the market, but we're talking 1, 2% probably as the range. On the second question, in terms of consumer spending, we're seeing it hold up very well, particularly in food.

So we're seeing volume growth across all of our markets and we're very encouraged by that. Let's see, as the summer progresses, clearly weather plays its part, but we have a fantastic summer of sport lined up with the Euros kicking off imminently and then the Olympics later on in the summer, which we think will be great occasions to celebrate and we've got a fantastic trade plan and product lineup ready to go for the summer.

Imran Nawaz: And maybe also just to add on weather impact, the fact that we are 7% non-food and 93% food is obviously not unhelpful when it comes to big ticket items that are impacted by weather as well.

William Woods: Excellent, thank you.

Operator: Our next question comes from Izabel Dobрева from Morgan Stanley, please go ahead. Your line is open.

Izabel Dobрева: Hello, good morning. I had a couple of questions. I was wondering if you could give us an update on the Irish business, given that the market share trend and the like for likes has been very resilient, could you give us some colour of what's happening on the ground and what your strategy is for that business? And then I have a second question in place. I appreciate that you've only just launched it,

but could you maybe share what the initial customer response has been and how you're thinking about how big this can get maybe in terms of number of SKUs or what level of product category expansion you have in mind?

And then my final question is a little bit more conceptual, it's to do with the personalisation of promotions. I was wondering, are you seeing this as a competitive differentiator yet in terms of how you are attracting promo funding from suppliers? So do you think your ability to use that data to maximise the volume response to promo means that you are attracting greater promotions than your peers or do you think that the proactivity is so widespread and the data is too young to be able to make it a differentiator at this stage?

Ken Murphy:

Well, Izabel, you have been up early this morning. Great questions. Thank you. So first one on the Irish business. Yes, our Irish business is performing extremely well. It has been consistently winning share now for over a year, including against the discounters. So we're very pleased with the Irish business. And actually, it's underpinned by a very strong value proposition, a very strong product innovation pipeline, benefiting from the group innovation platform and also benefiting from group technology in terms of the improvements to the Clubcard app, the introduction of Clubcard pricing, the introduction of the Aldi price match have all really helped accelerate Irish performance. What I would add on top of that, which I'm particularly pleased about, is the work that the Irish business has done on its store environment. It has been real standout in terms of its innovation on the fresh first strategy on its bakery innovation and the innovation now it's had in home and clothing.

And so, there's been a really meaningful improvement to the store environment in Ireland, which I think has been an inspiration for the rest of the group. And so, very pleased with that performance and I think we should expect it to continue. The second question around marketplace is that we've spent a lot of time over the last four years or so becoming super efficient, streamlining the business, rationalising skews down to the range that really we think is essential for customers. Marketplace is really about then building out that proposition to broaden our appeal, broaden our range in all food and food related missions and I would stretch that into clothing and home to make sure that we were to the greatest extent possible, a one-stop shop for customers. And that really is the strategic thinking behind marketplace. The difference between this marketplace execution and the old Tesco direct is it's fully integrated onto our core grocery home shopping platform, even if the delivery mechanism is obviously fulfilled by a third party and therefore comes on a different time cycle.

So that's the kind of strategic rationale behind it. We have set internal ambitious targets, but really our focus for the next 12 months will be around refining the proposition, growing the range, making the range more relevant and refining the customer experience so it's seamless and slick, making sure the delivery experience and the product quality is everything you'd expect from Tesco. On the last question, personalisation we definitely see as a differentiator. It's a very important part of the retail landscape today in our view. I think that customers

very willingly participate in schemes like Clubcard, but the quid pro quo is they expect you to use that data to solve problems for them to make their lives easier, to filter out all the irrelevant stuff and serve them up the really relevant propositions and offers that help them in their daily lives. And I think we've got to fulfil our end of that bargain and that's our ambition with personalisation. And clearly that also helps our suppliers to target the customers that actually want to hear about their products and their deals.

Operator: Thank you. We'll now take our next question from Clive Black from Shore Capital. Please go ahead. Your line is open.

Clive Black: Thank you. Good morning, gentlemen. Thanks for the words, although I should say can neither Ireland or Northern Ireland are at the Euro, so it's only passing interest to me. On a few questions following up those of the others, the weather is not something that folks really want to talk about on calls, but are you factoring in more of the same for your Q2 or could there be risk on the upside should Mr. Sunshine actually turn up? Secondly, one of the interesting features of your statement was the performance of finest. With inflation falling and living standards rising in the UK, is mix actually something that we should be thinking about a little bit more than purely price and volume? And then just lastly, although very helpful Imran, for the split between food and non-food, is demand levels for non-food or particularly discretionary goods surprisingly weak for you or is it something that's going to plan? Thank you.

Imran Nawaz: So I'll take the food non-food last and then we can work our way back up. Look, actually I was pleased with the performance on non-food for the first quarter. So clothing we had in nice growth and that was both volume led growth, which is nice to see. And then general merchandise was actually flattish and in growth if I exclude the work we'd been doing on pruning. So from that perspective, very happy on both home and clothing on that performance. On the Finest, look, clearly driving profitable mix is important. Finest is a fantastic vehicle. As you say, for yet another quarter we see double-digit growth in finest. It's a creative, when I look at own label, it sort of plays a nice role and the fact that it is volume led growth in Finest is great to see and led as you saw through the consecutive months of switching gains from premium retailers, which is great to see. Maybe Ken, I'll pass to you on the weather.

Ken Murphy: Oh gee, thanks, Imran. Hang on, Clive, I'm just giving my crystal ball a bit of a polish here. Look, weather is a thing in food and non-food retailing. Everybody's aware of that. I think our focus has been can we consistently outperform the market and that's been our focus and so far so good. And that's our plan for the rest of the summer.

Clive Black: In that respect though, Ken, I guess, the question I'm just asking, are you more or less now anticipating more of the same or could there be a nice tailwind for you if there was actually a period of sustained good weather?

Ken Murphy: So look, our base planning assumption every year is for an average summer, and then we kind of adapt the plan depending on what happens in front of our faces. So look, clearly the weather is less than ideal right now and is likely to stay this way for the next couple of weeks, but then could come good. If you remember last year the opposite happened, so we had a very good May, June and then July, August, we're very poor. So look, I wouldn't prejudge the summer, it's early days. And obviously we have a very strong sporting calendar, which always helps.

Clive Black: I hope you're not planning for them to be in the quarter-finals, but otherwise enjoy the football. Thank you.

Ken Murphy: Thank you, Clive.

Imran Nawaz: Thank you.

Operator: Thank you. We will now take our last question from Sreedhar Mahamkali from UBS. Please go ahead.

Sreedhar Mahamkali: Hi, good morning. Thanks for taking my questions. I have three short ones. Hopefully just going back onto the loyalty pricing, Ken, I suppose to the extent you can, could you discuss how your engagement has been with CMA on the subject? What are you saying to them to the extent you can share? And clearly we hear from them in a few weeks, it seems like that's the first one. The secondly, maybe just in terms of competitive intensity in the market through the quarter, as inflation continues to fall swiftly, clearly quite a lot of your competitors are coming from behind you in terms of volume. Is there any change in the competitive intensity that you are noticing? That's the second one. Thirdly, to the extent again, what are the long-term ambitions on marketplace? I know it's just start growing. How should we think about in the medium term what you are expecting to see? What makes it a success?

Ken Murphy: Great. So look, we've been collaborating and cooperating very fully with the CMA on loyalty pricing, nothing in our interactions. With the CMA at this stage with unduly worry us. To be honest with you, I think it's been a very reasonable and open conversation. We feel very good about the fact that we operate an everyday low price mechanism on over 2,000 lines in our stores, which means consumers can access value without any membership of any scheme in all of our shops. And then clearly in a very well understood deal, Clubcard customers then access great deals on all those value added kind of brand lines through the Clubcard prices mechanism. So you may see some modifications to the rules, but other than that, we're not anticipating anything else.

And clearly the election has an impact, well on timing, etc. The second thing in terms of competitive intensity, this market is about as competitively intense as you can get in any market I've ever been in my life. With 11 full national competitors in grocery all competing for baskets, it is a battle every day to win

the customer's basket. And that we don't see changing. There hasn't necessarily been a change in that competitive intensity. I think it is remained equally intensive, is the way I would describe it.

Imran Nawaz: Yeah, I think that's right. I mean, just to build on that, the thing, as you know, we measure our price indices versus our competitors rigorously every week. And the good thing as we've inflated less than the market versus at least what Kantar measures, we have continued to protect and slightly expand on the price indexes that we have, which is a good thing. And that gives you a sense. But I think the main point is Ken's, which is this continues to be a very competitive and intense market.

Ken Murphy: On the third question in terms of the longer term ambitions of marketplace, I think I laid it out in the previous answer, which is that we see it as a way of complementing our highly streamlined, highly efficient in-store ranging. This is a chance in a very capital out way for us to build out the range of off products we can offer customers for those more specialised, differentiated products in a way that doesn't compromise our operating efficiency. So we're feeling that that's an important addition to our proposition and kind of overtime and everything that's food or food related, we are looking to make Tesco a one-stop shop for customers.

Clearly they attract Clubcard points and all of those. And our ambition is to make that customer experience as streamlined and as frictionless and as convenient as possible and as inspiring as possible. And clearly the more work we do on personalisation attribution, the more we can make sure that the products that customers are getting and displayed on their personal homepages or whatever are the most relevant to them. And really we haven't set any limits on the growth related to this, we're just really focused on making it the best possible experience.

Imran Nawaz: Thank you.

Ken Murphy: Thank you.

Operator: Thank you. For this, I'd like to hand a call back over to Ken Murphy for closing remarks. Over to you, sir.

Ken Murphy: Thanks very much. Thank you all for your questions. I think that just to recap, this has been a good start to the year for the company. We're particularly pleased with the level of outperformance versus the market in our core Irish and UK markets. Our ambition is to maintain that momentum as we go into the summer and we look forward to seeing you all again in October. Thank you.