Tesco PLC – Interim Results 2023/24

Analyst Call

Wednesday 4th October 2023

Transcript

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Ken Murphy: Good morning everyone, and welcome. Imran and I are delighted to present our Interim Results to you this morning. We've made a really good start to the year. Most importantly, we are winning with customers. Our continued investments in value and quality are being recognised with increased satisfaction scores and growing market share. We know how challenging it is for many households across the country as they continue to grapple with the ongoing cost of living pressures. We have worked hard to make sure our offer is as competitive as possible in the first half, and remain committed to doing everything we can to drive down food bills in the months ahead.

Over the last three years, we have strengthened the foundations of the business. We have built out an unrivalled value proposition, laid the groundwork for our digital platform, made Tesco more accessible than ever before, and driven efficiencies in everything we do. I'm really proud of the further progress the team has made against our strategic priorities in the first half and, more broadly, I want to thank them for the brilliant contribution they're making every single day.

As you will have seen from this morning's announcement, our relentless focus on customers has enabled us to deliver a really strong first half performance. Sales are up nearly 9%, and profit and cash are ahead of expectations, helped by a better than expected volume performance and strong progress on Save to Invest. A strong, sustainable financial performance allows us to carry on making the investments we need to stay competitive for our customers. So I'm delighted with where we are at this stage in the year.

Customer satisfaction is absolutely critical to our success. It allows us to see how well customers are responding to our proposition and how they perceive us relative to our peers. Our Brand Net Promoter Score has increased once again, driven by improvements in our range and overall shopping experience. This is critical at a time where customers are choosing to shop across our different value tiers and ranges.

Alongside customer satisfaction, one of our key goals is to grow, or at least maintain our core UK market share, and I'm delighted that at the end of this half, we have seen the largest year-on-year market share growth of all the full-line grocers.

Our growth has been driven by both stores and online, with total switching gains for six consecutive periods. This is, of course, despite others in the market continuing to open new space, which shows that customers are recognising our investment in value, outstanding quality and market-leading availability, and they're voting with their feet. Given the challenges many of our customers are facing, value remains paramount. We see it as our role to help customers spend less wherever we can. We do this via our powerful combination of Aldi Price Match, Low Everyday Prices, and Clubcard Prices. This means customers can rely on getting the best prices in the market on their everyday essentials, in addition to outstanding offers on their favourite brands.

To help customers find products and recipes that support them to feed their families for a fantastic price, we recently launched our 'True Value' campaign. This builds on the strength of Aldi Price Match to provide inspiration and new meal ideas using everyday products. We've also highlighted 'Price Cuts', where we have been able to reduce the price of hundreds of essential items, from food lines such as pasta, to baby products, such as nappies. Additional expenses also occur while our customers are on the move. That's why, over the summer, we brought back our highly successful 'Kids Eat Free' meals in our Tesco cafes.

We wouldn't have been able to help customers spend less if it weren't for the strength and depth of our relationship that we have with our supplier partners. Throughout the first half, we have worked hard to ensure that we can pass savings on to customers as prices on many key commodities have started to fall. We have strengthened the capability in our sourcing team, leveraging data and insight to help us track ingredient and product costs, ensuring that we lead the way on price reductions wherever we can.

We know that alongside value, quality is also critically important. We have made a concerted effort to put innovation back at the heart of our offer, and this is making a real difference to the products our customers experience. Throughout the half, we have further improved our range, launching over 300 new products and redeveloping and reformulating more than 1100, from pasta to fresh fish, helping us offer even better quality at great prices. We're seeing growth at both ends of the basket, with particularly strong performance in the 'Dinner For Tonight' mission, as customers look to save by choosing to eat in rather than eat out. We further strengthened the quality and presentation of the range to support this trend, which has contributed to 13 consecutive periods of net switching gains from premium retailers.

The strength of our performance would not be possible without our brilliant colleagues and the work they do day-in and day-out for customers. As I mentioned in April, we were pleased to award a record pay increase for the second year running. Since April 2021, our total investment in colleague pay is now more than £1 billion. On top of this, we have also enhanced our wellbeing offer, giving UK colleagues access to virtual GP appointments seven days a week, and expanding the services available on our Employee Assistance programme.

It's hugely important to us that our colleagues reflect the communities they serve and that everybody is made to feel welcome at Tesco. I'm therefore really proud that we've become the first major supermarket to offer the right to request flexible working hours for any colleague. We've also announced further improvements to our maternity, adoption, and kinship leave policies.

With the external pressures that we are facing, it's also incredibly important that we continue to support our suppliers, communities, and planet as set out in our core purpose. We've continued to take extra steps to support British agriculture. Within the half, we have invested in developing a Future Farmers programme and announced a further £10 million of financial backing to UK egg farmers. Being recognised as the leading retailer in the Advantage supplier survey for the eighth consecutive year is testament to the strength of relationships we have with not just the agricultural sector, but with all of our suppliers.

Our scale also gives us a fantastic opportunity to make a big difference to the communities we serve. In the past six months, we have launched a £5 million Stronger Starts grant Scheme, which aims to boost school funds for extra food and new sports and play equipment to keep children active. Around 5,300 schools across the UK will benefit from the programme, and I'm excited to see what we can achieve.

We are also making progress towards our commitment to be carbon-neutral in our own operations by 2035, and our ambitious target of net-zero emissions across our entire value chain by 2050. We have become one of the first companies globally to have validated science-based targets on all greenhouse gas emissions, including Scope 3. We will only achieve these long-term goals by making continued progress in the short-term too. And during the half, we launched our 500th electric delivery van and announced the expansion of our low-carbon fertiliser trials.

So, it's been a good first half for every stakeholder in Tesco. I'll now hand over to Imran, who is going to take you through our financial performance in more detail. Over to you, Imran.

Imran Nawaz: Thank you, Ken, and good morning everyone. I will start by giving an overview of our results for the first half of the year, followed by some more detail on the performance across each of the business segments. Throughout my review, percentage growth rates will be expressed in constant currency, unless stated otherwise.

We delivered a strong sales performance across the Group with retail sales growth of 8.2% and like-for-like for growth of 7.8%. Although inflation continued to play a clear role across all of our markets, the impact eased across the half as global commodity prices started to fall. We've worked hard to pass the benefit onto customers through lower prices, and volume trends have improved across the half. Retail adjusted operating profit grew by 13.5% year-on-year to £1.4bn, driven by another strong Save to Invest delivery. We delivered £290m of savings in the first half, and we have plans in place to deliver a similar amount in the second half. While not shown here, Group statutory operating profit increased by 105.5% year-on-year. This is primarily due to last year's exceptionally large non-current asset impairment charge of £626 million. This was largely driven by the sharp increase in discount rates last year. Discount rates have been broadly stable since the year-end, and there was no impairment charge or release in the first half of this year. We generated retail free cash flow of £1.4 billion, which was £85 million higher than last year, driven by stronger retail profits. Partially offset by an increase in capex.

Net debt was £9.9 billion at the end of the first half, which was £605 million lower than at year-end. This improvement in net debt was driven by a strong cash generation in the first half and a £250 million special dividend received from Tesco Bank. Combined, these more than offset over £1 billion of shareholder returns in the half, comprising the final dividend payment as well as the ongoing share buyback programme. As a result, we have generated headline earnings per share of 12.26 pence, or 16.8% ahead of last year.

Total retail sales for the first half were £30 billion. Our UK and Ireland segment delivered 8.8% growth. Sales growth was stronger in the first quarter with like-for-like sales of 8.8%, followed by 8% in the second quarter as we saw the contribution from inflation fall and traded over exceptionally warm weather last year. In Central Europe, the trading environment continues to be challenging. Sales grew by 1.4%, which reflects the volume impact from sustained high levels of inflation, as well as the scaling back of government stimulus actions. Tesco Bank sales grew by 16.5%, primarily driven by higher interest income from credit cards as interest bearing balances and yields increased.

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.

We delivered like-for-like growth of 8.7% in the UK. Food sales were particularly strong, growing by 10.6%, reflecting a better than anticipated volume performance as we continue to inflate behind the market. Price inflation fell gradually across the half as our teams worked closely with suppliers to pass on lower cost prices to customers as quickly as possible.

Home and Clothing sales, which account for around 7% of total UK sales, declined by 4.8%. This primarily reflects the impact of strategic ranging decisions, including exiting low returning categories such as large electricals and footwear. Excluding these impacts, sales were broadly flat. We outperformed the rest of the market in Clothing across the half and we further improved our value perception against our key competitors.

Large store sales grew by 9.3%, driven by strong execution, market leading availability, and an upweighted trade plan over key events, including the King's Coronation. Convenience store sales grew by 5.1% and were most impacted by the poor weather over the summer. Our city and town centre Express stores performed particularly well, growing by 7.5%. Our online sales grew by 10% year-on-year, and participation has now stabilised at around 13% of UK sales, which is 4 percentage points higher than pre-pandemic.

We are really pleased with our market share performance, gaining 71 basis points in the half. Tesco Whoosh continues to deliver incremental sales growth and is now in over 1,400 stores.

In Ireland, total sales grew by 10% in the first half, with like-for-like sales up 6.9%. New space, therefore contributed 3.1% to growth driven by the Joyce's stores we acquired last year, as well as a new Tesco Superstore, which we opened in Adamstown. We launched a new 'Price Cuts' campaign highlighting reduced prices on over 700 food products and contributing to a steady decline in inflation across the half.

Booker continues to deliver solid growth across both retail and catering divisions. Total Booker like-for-like sales grew by 7.5% in the first half of the year, and growth was even stronger excluding tobacco at 11.5%. Retail sales excluding tobacco grew by 14.2%, driven by the addition of 143 new retail partners, as well as our continued focus on price, choice and service. Catering sales grew by 9.1% as we built on our already strong offer, including a further improvement in availability.

In Central Europe, the impact of inflation continues to be felt to a greater extent than in our other markets putting downward pressure on volumes. Inflation is being felt most strongly in Hungary, where two year retail inflation reached around 50%. Like-for-like sales increased by 0.9%, reflecting the scaling back of last year's government stimulus in Hungary, as well as a general volume contraction in the market. Food sales grew by 1.9% in the first half. Similar to our other markets, inflation eased in the second quarter as we cut prices on thousands of products across the region. Non-food sales declined by 4.6%, reflecting an overall reduction in discretionary spend across the market. We launched a new basics kids and baby clothing range in response to customers' needs for great value on family essentials.

Moving now to our profit performance. We delivered £1.4 billion of retail adjusted operating profit, which was £169 million ahead of last year, driven by a strong performance in the UK and Ireland segment due to our ongoing accelerated Save to Invest delivery to and another strong contribution from Booker. The retail operating margin in the UK and Ireland segment was 4.4%, which has now recovered to pre-pandemic levels and reflects the cumulative effect of our Save to Invest delivery over the past 18 months. In Central Europe, retail adjusted operating profit of £46 million fell by £33 million year-on-year, which was entirely driven by the challenging trading conditions in Hungary. Slovakia and the Czech Republic continued to perform well.

I will break the movements in each segment in more detail over the next few slides. In the UK and Ireland segment, adjusted operating profit grew by £202 million year-on-year. We delivered further savings through our Save to Invest programme with key initiatives delivered in the half, including further reductions in energy consumption, simplifying the replenishment of our promotional stock, and optimising management structures in our large stores. Volumes were more resilient than we expected, supported by our ongoing customer investments. We were able to manage significant cost headwinds effectively, dealing with particularly high levels of inflation in both energy and colleague pay, whilst passing through thousands of price cuts and inflating behind the market. Booker delivered another very strong contribution driven by the ongoing growth across both the retail and catering divisions.

Turning to Central Europe now where retail operating profits stepped back £33 million year-on-year, reflecting a range of external factors impacting our business in Hungary. The country faced significant currency devaluation year-on-year, which drove up the prices we pay our suppliers. In addition, the challenging trading environment in Hungary combined with local regulatory actions, including price caps and mandatory promotions on everyday grocery items, impeded the industry's ability to recover these cost headwinds.

Tesco Bank's performance was strong in the first half. Bank revenue increased by 16.5% year-on-year to £702 million, primarily driven by higher credit card balances and yields. We also delivered a strong performance in insurance, driven by competitive pricing and high renewal rates. The Bank's adjusted operating profit of £65 million, grew by 25% year-on-year, reflecting strong income growth in credit cards and a lower impairment charge due to the improved long-term macroeconomic forecasts compared to the equivalent time last year.

Tesco Bank paid a one-off special dividend of £250 million to the Group in the first half, which reflects the strength of the Bank's balance sheet and capital ratios. The Bank will continue to pay an annual dividend to the Group of around 50% of earnings every year. This slide provides further detail on the components of our statutory profit performance, which increased by £677 million year-on-year. The primary driver of this increase is clearly the £626 million non-cash impairment charge that we took last year and was driven by significant increases in discount rates. Net finance costs reduced by £58 million primarily due to fair value re-measurements related to mark-to-market movements on index-linked swaps. The Group tax charge increased by £144 million to £288 million driven by the increase in UK Corporation tax rates from 19% to 25% as well as the significant growth in operating profit I have just referred to.

Moving now to our retail cash performance, which continues to be very strong, we delivered retail free cashflow of £1.4 billion in the first half including a working capital inflow of £368 million, which was driven by the continued effect from rising cost prices, which increases our trade balances. Cash capex was £88 million higher than last year reflecting incremental investment in our store refresh programme, new store openings, and an earlier spending profile year on year.

We now anticipate Group capex to be around £1.3 billion for the full year, a little ahead of our current guidance range. We saw a £21 million reduction in interest paid driven by higher levels of interest received on our short-term cash deposits. Given the strength of our cash generation in the first half, we now expect to generate retail free cashflow of between £1.8 and £2 billion for the full year, ahead of our long term guidance range. This is of course excluding the

£250 million special dividend received from Tesco Bank, which is not included in our headline retail free cashflow measure.

Turning now to the balance sheet, which has further strengthened in the half. Overall net debt reduced by £0.6 billion as the retail free cashflow generation I have just described and the £250 million special dividend received from Tesco Bank more than offset the cash return to shareholders in the half. We paid a £509 million prior year final dividend and we bought back a further £503 million of our own shares. Our net debt to EBITDA ratio improved significantly and now sits at the bottom of our target range at 2.3 times driven by the improvement in retail EBITDA as well as a reduction in net debt before lease liabilities.

Lease liabilities reduced by £30 million since year end as increases due to lease renewals and rent reviews were more than offset by the reducing nature of the overall liability. Our fixed charge cover also improved from 3.5 times to 3.6 times by the end of the half due to our increase in retail EBITDA.

Although we continue to see some uncertainty in the outlook for the second half, the strength of our performance in the first half means we are making some increases to our current financial year guidance.

We now expect to deliver retail adjusted operating profit between £2.6 billion and £2.7 billion. We also expect retail free cashflow of between £1.8 billion and £2 billion, which is ahead of our medium term target range of £1.4 billion to £1.8 billion. We continue to expect Bank adjusted operating profits of between £130 million and £160 million. As I mentioned earlier, we have made good progress on our share buyback programme across the half and we are on track to complete our commitment to buy a total of £750 million worth of shares by April 2024.

To summarise, we have delivered a strong start to the year across sales, profit, and cash. We've set our interim dividend at 3.85 pence per share in line with our interim dividend policy and we have continued to make good progress on our ongoing capital return programme. We have now purchased around £1.6 billion worth of shares since launching the programme in October 2021. I will now hand back to Ken.

Ken Murphy: Thank you, Imran. During the half, we have made further progress against our strategic priorities and while I'm not planning to take you through every point of detail, I will touch on some of the key highlights starting with Magnetic Value. Our unrivalled value combination of Aldi Price Match, Low Everyday Prices, and Clubcard Prices has been instrumental in supporting our customers during these challenging times. During the half, we have continued to increase our distribution of Aldi Price Match products, further removing the need for customers to shop elsewhere in their search for value.

In addition, we have continued to lock the price of over 1,000 products with our Low Everyday Prices, providing customers with the certainty that they are seeking on everyday essentials. We have seen promotional participation increasing across the industry and while we are keen to ensure that our base prices stay as low as possible, we have also ensured that Clubcard Prices continue to offer the best deals in the market. We now have around 8,000 products on Clubcard Prices at any one time, offering customers the chance to save hundreds of pounds a year on their favourite products.

On top of this powerful combination, we recently launched a 'Price Cuts' campaign to highlight that not only are we holding back inflation, but that we are actually reducing the price of many items. Throughout the half, we have lowered the price of around 2,500 products by an average of around 12%. All of these efforts have enabled us to become the most competitive we have ever been. During the half, we've consistently been the cheapest of the full-line grocers and our price differential to the discounters has also reached an all time low.

This is an important achievement for us and one we do not take for granted. We will continue to do everything we can to pass savings onto customers wherever we can and are looking forward to helping customers have a fantastic Christmas by shopping at Tesco. We have also made further progress on quality. Throughout the half, we have seen particularly strong performance in our Finest range with volume growth supported by over 150 new products. Health is also an important driver of quality and therefore of Magnetic Value.

We have launched some great products in this area in recent months, such as our Finest signature vegetable dishes, which help customers replace or reduce meat consumption with healthier meat-free alternatives. I'm really pleased that we've continued to make progress towards our target of 65% healthy sales by 2025. Over the last few years, we've been working hard to build out a unique and powerful digital platform powered by the scale and reach of Clubcard.

We have driven up Clubcard penetration in every part of the Group and increased the number of customers using an app to interact with us from less than 2 million to now over 16 million. During the half, we have seen digital engagement increase with 7.5 million customers using their digital Clubcard at the till and a 20% increase in the number of customers engaging with Clubcard via the web app or phone wallet. The app isn't just for online use, customers can now use it to create shopping lists, check stock levels in store, and also for Whoosh deliveries. Strategically, more customers interacting with Tesco more frequently for more shopping missions creates stronger relationships, drives loyalty, and creates further opportunity for growth. Personalising our offering is increasingly important to our proposition.

We can use Clubcard powered by dunnhumby to understand our customers better than anyone in order to support them in their shopping journey whether in store or online. This half we have issued 86 million personalised coupons to nearly 6 million customers and have seen a four times greater return on these compared to their non-personalised equivalents. Personalisation and digitisation is not only about the app, but also in store and online.

We have increased the number of digital screens in our stores adding over 750 in the half and delivering nearly 120 different campaigns. We now have more than 300 suppliers using our online sponsored search functionality with 77 million daily impressions on our website all made possible through dunnhumby's data science capabilities. Moving to 'Easily the Most Convenient'. Our performance in online is a particular highlight. Our online proposition has continued to strengthen post the pandemic and while orders are stabilising at around 1.1 million per week, our market share remains very strong at around 36%, and during the half has grown by 71 basis points. This has been driven by further improvements in our already market leading service with online availability now running at over 97% and the number of 'perfect orders' up by 12 percentage points year-on-year, all of which has helped lead to gains from our online competitors.

We also continue to increase our capacity and efficiency with a further three Urban Fulfilment Centres, two in the first half and one in the last month. Combined, these will allow us to fulfil an extra 1 million orders per year.

We've also continued to expand our Whoosh rapid delivery proposition. During the half, we added more than 400 new stores, taking us to a total of 1,414 and are now reaching around 60% of the population. We have also added a larger basket functionality, which now operates in over 900 of these stores, helping customers to get everything they need whenever they want. Whoosh has been a great addition to our offering and has been made possible by leveraging our extensive Tesco Express network requiring very little capital investment. We were really pleased to see Whoosh recognised as E-commerce Initiative of the Year at the recent Grocer Gold Awards, a testament to the operational efficiency reach and innovation behind the proposition.

Moving now to our store estate. We have also invested in and continue to develop our large store offering with 115 stores updated through our refresh programme. Highlights include an improved bakery offering in addition to a rebalancing of our non-food space, frequently adding in more space for our F&F clothing ranges. We have also added a further 402 retail partner in-store offerings, including brands such as YO! Sushi, Costa Express, and Greggs, helping to broaden our customer offering and make our stores an even more convenient and compelling place to shop.

Our market-leading availability in large stores has also gone from strength to strength as we continue to refine and simplify our end-to-end operations across the estate. We've continued to grow our convenience network also. We opened 16 new Tesco Express stores in the UK in addition to refining our range to include cheaper alternatives on around 50 key lines, including many own brand products that were on average over 40% cheaper than the products they replaced.

One Stop has performed well with 11 new owned stores and 16 new franchise stores. We've continued to broaden out our One Stop product range and saw record fresh sales participation this half. Our convenience network in the UK is further enhanced by our Booker offering, which added 143 net new Booker retail partners to its existing network of over 7,000 this half. Our addition last year of the Jack's product range has been a particular highlight with 20% sales growth year-on-year and over 40,000 retail customers now stocking it.

As Imran mentioned earlier, Booker has delivered an exceptionally strong performance this half, driving growth and creating new opportunities. I've touched on the growth in Booker's retail business already, so I'll focus now on the catering side of the business where we have supported customers by adapting our ranges to offer great menu choices at fantastic prices. We further strengthened this by locking the price on 650 essential products over the peak summer trading period, and we're extending this to over 700 products for Christmas. Our Booker Food Clubs have also gone from strength to strength with over 50,000 customers now signed up to receive discounted prices on 95 of our most popular products across drinks, snacks, and essential food products.

We have also used this capacity created by Best Food Logistics to create a new Chef Central offering for multi-site customers, typically hospitality chains with between 25 and 100 sites. Chef Central offers customers a defined product range, allowing them to offer standardised menus across their business, managing costs and placing orders centrally.

Save to Invest has been key to our strategic and financial progress this half. We are constantly looking for opportunities to drive a simpler and more efficient operating model so that we can reinvest into the business to best support our customers and other stakeholders. We have made strong progress across all areas such as goods and services not for resale, property, operations and central overheads. Examples include streamlining of our Express checkout experience with increased self-service and upgrading checkout systems and simplifying our replenishment routines in large stores to deliver both availability and efficiency gains. During the half, we have delivered circa £290 million of savings, meaning we are on track to deliver at least £1.1 billion cumulative savings between February 2022 and February 2024.

In summary, our performance this half has been driven by our relentless focus on great value and quality for customers. We are committed to doing everything we can to drive down food bills and make sure that customers can have a fantastic and affordable Christmas by shopping with Tesco. We are confident that we have the right strategy to keep winning and are pleased with the progress we have made. Our financial performance in the first half has allowed us to upgrade our expectations for the full year and means that we are in a strong position to continue to deliver for all of our stakeholders.

Thank you for your time so far and we're really happy now to take whatever questions you may have.

Moderator: Thank you, Ken. Any analysts who would like to ask a question should ensure their camera is turned on and they raise their hand by clicking on the reactions button at the bottom of the screen and clicking on the raise hand icon. Please ensure that you unmute your microphone only when you're introduced. And if you no longer wish to ask a question, you can lower your hand by clicking on the lower hand icon also in the reactions button at the bottom of your screen. We'll now take our first question from Andrew Gwynn of BNP Paribas Exane. Please go ahead.

Andrew Gwynn: Yeah, good morning, team. Yeah, two questions if I can. So firstly on the guidance, I suppose there's an argument to say that you've banked the beat from the first half into the guidance. So what are the uncertainties you see in the second half and what's the prospect of coming in at the top end or even beyond? Second question, and we've had a lot of comment there obviously about the big stores, and rethinking, if you will. Should we expect some pretty significant changes in range within the grocery proposition? Thank you very much.

Ken Murphy: Morning, Andrew. I'll take the last question first and I'll pass Imran to talk to you in a bit more detail about guidance. I think that our category reset is a major reset, it's something that we do periodically, but we don't do every year, and it is trying to leverage the latest insights in terms of what customers want from us in their shopping mission, what's the optimised range for each of our stores and our catchments, and how do we ensure that we give customers the best possible offer, but in a very streamlined and optimised way from an end-to-end simplification point of view because we've always got one eye on our operating cost ratios and making sure that we can maintain the level of competitiveness that we've achieved in terms of pricing and value overall. So that's really what the category reset's kind of designed to achieve.

What you'll see is that in some categories we're actually close to optimum and we're very happy with the range. You'll see very little change. And then some categories you may see more dramatic change depending on the output of the insight and the analysis that we do. What we are trying to do is progressively get more sophisticated in those ranging choices and using at least machine learning and artificial intelligence in that way to improve the outcomes for customers. I'll pass you to Imran now to talk guidance.

Imran Nawaz: Hi Andrew. Look, maybe just I'll tell you how I'm thinking about it. So we had a really good first half. And you remember in April when we guided, we had said broadly flat. Now after the first half, as you see, we basically upgraded, if you wish, from £2.5 billion to £2.6 to £2.7. So a sizable step-up. And essentially the way I'm thinking about it is we are locking in that outperformance.

As we go into the second half, what we're trying to make sure is that we remain competitive, we continue to invest in quality, and we protect the flexibility and the firepower so that we can react to whatever we face into the second half. It is really, really important that we have all we need to continue to win Christmas. Now clearly, we'll see where that takes us, but I'm feeling very good about the first half and I want to maintain that flex into the second half and continue to control the controllables, which we've been doing all year, well, actually the last 18 months, if you wish, in this environment.

Andrew Gwynn: Are we right to conclude it, it is very, very prudent? Or is it as a very, very honest assessment of where we could land?

Imran Nawaz: Well, look, it's an honest assessment of where we are. I mean, obviously as we then, I think, we intend to win Christmas and then we'll give you an update as to how that goes. But we've got another six months to go and I just want to continue to do what we've been doing. And setting ourselves up for success tells me that 2.6 to 2.7 at this stage is the right number.

Ken Murphy: Okay, all very clear. And having covered Tesco for many, many years, one thing I would say, almost a total absence of one-offs, which I think it does show the journey, so well done. Thank you very much.

Imran Nawaz: Thank you.

Ken Murphy: Thank you, Andrew.

Moderator: Thanks, Andrew. We now take our next question from Clive Black at Shore Capital. Clive, please unmute and go ahead.

Clive Black: Good morning, gentlemen. I hope you can hear me.

Imran Nawaz: Yes.

Clive Black: Very nice jacket by the way, Imran. Just a couple of questions from me. Firstly, Ken, thanks for the presentation particularly around the digital achievements. To what extent did digital significantly contribute to the profit performance in the first half? It is something you've alluded to in recent years, but maybe you've been a little coy. And then just secondly, again, well done on not just the operational delivery, but the financial delivery, at the bottom end of your net debt-to-EBITDA range now. I just wonder with maybe interest rates being higher for longer that you may adjust that leverage range. Or if you go below it, where would you signal the allocation of capital preferences? Thank you very much.

Ken Murphy: Thanks, Clive. I'll take the digital question. I'll pass to Imran to talk about debt. So digital plays, I think, an increasingly important role in our total proposition, but I would start by saying that really our success is predicated on doing the basics really well. So our very strong pricing position, very strong investment in product innovation and product quality, and then the shopping trip improvements over the last six months have been really notable. And we've seen progressive improvements in our shelf-based availability in both in store, but particularly online. And that really has shone through such that we're gaining share both in physical stores but also in our online proposition. So it is that combination.

In the background, we are increasingly using personalised propositions to help customers access value more relevant to them. And so, we issued about 86 million personalised coupons to about 6 million customers over the period. But I wouldn't want to overstate it, Clive. It's an integrated part of the offer. And I think as we get into the conversations around retail, media income, et cetera, I really want to stress the importance of we only really make inroads with things like retail media income when it's giving customers ads and offers that are relevant to them and it's actually decluttering their lives and making it feel like the Clubcard's working harder for them rather than bombarding them with advertising that isn't relevant. And then conversely, suppliers only value it when they're getting a focused audience that gets a higher conversion rate.

So what we don't do is we don't hitch our wagon to a retail media number. What we do is say, "How do we broaden customer engagement? How do we get higher conversion rates because we have higher relevance? And how do we convert that into an income stream from suppliers because they can see the value of what they do?" And then we look at it in the round. And really what we try and measure is, are we growing the number of high value customers? And that's been a real underpin of the performance in the first half of this year, is that we've seen our high-value customer base grow meaningfully over the period. And that's really the internal metric we're using to drive that kind of initiative.

Imran Nawaz: Hi, Clive. On the net debt, look, I mean, we had a really strong cash performance and we brought down debt, to your point, £600 million or so from the beginning of the year to now. And as you point out, it's now at the lower end of the range, the 2.3 to 2.8.

Personally, I'll say I like having a strong balance sheet. It gives you flexibility, it gives you firepower to deploy when needed or if needed. At the same time, I have no real plans to change the allocation. I'm happy with the capital allocation policy we set out. To your point, with high interest rates, it's no bad thing to be at the lower end as well, but no plans to change. I mean, remember our net debt, if I look at it, ex-lease liabilities is £2.2 billion. So I feel we're in a really good place on that front anyway.

In terms of cash allocation priorities, we continue to invest in capital. You'll have seen we upgraded our capex a bit, 100 million. We saw some good opportunities to deploy cash in the right way. So we're doing that. We continue looking at store buybacks, other properties and all that's clearly, the recurring buyback programme, it remains a key priority and as does the dividend. So I feel like even though we've done a really strong job on cash, we need to continue down the path of our disciplined consistent framework that we set out two plus years ago.

Clive: Okay, look, well, thank you for that and very well done.

Ken Murphy: Thanks, Clive.

Imran Nawaz: Thank you.

Ken Murphy: Thank you very much.

Moderator: Thanks, Clive. We'll take our next question from James Grzinic at Jefferies. James, please go ahead.

James Grzinic: Thank you very much. Good morning team. And I second my colleagues' comments, very well done on a great performance. Given that context, it just feels if there are more durable changes happening in the industry right now. Do you feel that the 1.4 to 1.8 billion retail free cashflow guide rail may start looking a little bit obsolete in light of what is going on structurally in the industry?

Imran Nawaz: Well, you talk about the cash mid-term sort of outlook?

James Grzinic: Yeah. Exactly.

Imran Nawaz: Well, look, I mean, the reality is, so first I feel really good about the focus that the business has on cash. It really goes well with the focus on absolute profits. Granted, and I'll take it in the sense that we've over delivered sort of the last two years in a row, and again this half year we're doing sort of better. But also fair to say that in addition to strong profit growth, we do have working capital benefits driven by inflation. If I look at the first half, it benefits us to the tune of around 360 million. That's not immaterial in the context. And as inflation starts to move sort of to disinflation, if you wish, that number will clearly get smaller. We do also, a technical matter here, but we do get some tax benefits at the moment or call it the tune of 120 million or so a year, which will end at the end of this year from the pension contribution that had been done four years ago.

So when I look at the cash range, 1.4 to 1.8 in a normalised world, feels like it's the right place. Having said that, you could imagine, we'll always try and beat it where we can because it's a matter of importance for us and the equity story that we continue to demonstrate strong, sustainable cash flows to also keep investing into the business and have the recurring buyback programme that we've laid out.

James Grzinic: Great, thank you. Thank you, Imran.

Imran Nawaz: Sure.

Moderator: Thanks, James. And our next question will come from Izabel Dobreva of Morgan Stanley. Please go ahead.

Izabel Dobreva: Hello, good morning and thank you for taking my questions. I also have two. So in the presentation, one of the upside factors, which was called out was the resilient volume performance. Could you give us a little bit more colour of what drove that? Is it the underlying consumer getting better? Is it the rotation of food? Is it your own market share resilience? Any colour on that would be useful. And then my second question is on your pricing outlook, because as of late there has been increasing debate whether we're going to see deflation next year, but I suppose that doesn't happen by itself. We would need to see an irrational level of price competition. So my question is, do you see any signs of that? And in general, what is your expectation about pricing as we go into next year?

Ken Murphy: Thanks, Isabelle. I think I'd start by saying that we have seen so far and I think we'll continue to see a very rational market. The effects on the industry of the various inflationary pressures, whether that be energy, wages or commodities have been felt right across the piece. And so you're seeing a certain uniformity in the behaviour of our competitor set. That said, it remains a very intensely competitive market. I think in terms of our performance, we take a lot of comfort from the fact that we continue to sharpen our value position and you see that we've done that and being the cheapest of the full-line grocers over six months, pretty continuously has been a big factor in that. I think the fact that we have between one and a half and 2,000 products on an Everyday Low Price promise, that are all the essentials that customers need and the fact that many of those products have been coming down in price and you're seeing a consistency also in pricing, so you're starting to see less volatility, is really helping reassure the consumer and allowing them to plan. And that I think is what's helped the volume stay more resilient. So I would say also the fact that we're in a full employment market helps a lot as well. And these factors combined have meant that you've seen what I would see a gradual improvement in customer sentiment. I wouldn't want to overplay that, but you are seeing a movement in the right direction. Clearly there are still parts of our society really struggling on a day-to-day basis and we have to work very hard at making sure that they can afford to feed themselves and their families.

But we are seeing a little bit more upside and we're seeing more trade from eating out to eating in and we're seeing strong growth in our Finest range, which has also helped from both a kind of a mix effect and a volume perspective. And clearly we've had a fantastic performance in our Booker business where we've seen strong market share gains as well. So I think it's a composite of a number of things. And as I look forward, I would expect the market to continue to behave in a rational way. I don't expect it to get less intense from a competition point of view, but I don't see either, any of the actors behaving irrationally.

Izabel Dobreva: Thank you.

Ken Murphy: Thank you.

Moderator: Thanks, Izabel. We'll now take our next question from James Anstead at Barclays. James, please go ahead.

Clive Black: Yeah, good morning, Ken, Imran. A couple of questions please. Firstly on Hungary, appreciating it's not an enormous part of the group, but it sounds like there's short-term profit turbulence. How quickly do you think Hungary will return to a more normal level of profitability? And a second question on capex, it sounds like you're talking of 1.3 billion this year. Just following on from that, are you doing more than you expected or is it just costing more? And should we be expecting that as a reasonable source of guide for capex going forward? Because I think the longer term guidance is more like 900 to 1.2 billion. Those would be my two questions please.

Ken Murphy: Thanks, James. I'll address the Hungary question. I'll pass to Imran to talk about capex. So Hungary I think is suffering probably from three different effects. One is it's lapping some stimulus that the government put into the market last year, which I think will anniversary soon and that will help. The second thing is that there are a number of temporary regulatory measures and tax measures that are impacting profitability across the industry and the market in Hungary. And they are also due to unwind over the next 12 months. So I think that, let's say two thirds of the issue we expect to unwind.

There are also a couple of temporary effects in that both energy and FX is more challenged in Hungary than you're seeing in other markets. And again, we'd expect a normalisation of that over the next six months. So I would say on balance, James, we expect the majority of the issues in Hungary to be temporary. That said, it is a volatile country with an unpredictable government in terms of future regulation. So I can't give you any certainty that all of these factors will wash through and we won't be faced with new ones.

Imran Nawaz: So I'll take the capex question. So to your point, we have a guidance within our framework of 900 million to 1.2 billion. We've been pretty clear that we expect to spend at the upper end of that, so more 1.2 billion than the 900 million, and you've seen that the last two years. Look, the reality is we're doing a bit more this year. We've delivered more cash and we see more opportunities to invest, whether it's in our stores, whether it's to deliver some extra savings by automation and frankly store openings. Inflation will always play a bit of a role because clearly like everyone, capex is also impacted by inflation. So clearly as I look ahead, that will not go away either. My personal view at this stage is I'd continue to expect us to spend at the upper end. And honestly, if I see opportunities with the strong balance sheet that we have to spend a bit more every year, then I would do so. And I'll clearly let you know as we do these updates.

Clive Black: Perhaps one quick follow up on the capex. The work you were doing on the store refresh, are you seeing a noticeable difference in customer traffic in the stores that have had the money spent?

Ken Murphy: Yes, but it is really a consequence of our need to replace the refrigeration and other fixtures and refresh that store just to maintain the brand and the shopping trip. The other thing, James, is it has a meaningful impact on our sustainability goals. So, when we replace the refrigeration, we eliminate any CO_2, and the eco-friendliness and the sustainability, in fact, the energy efficiency of the new refrigeration is dramatically better than the old.

So, there's probably three reasons we do these refits. One is we're at end of life and we start to see a lot of fridge breakdowns and other issues. Therefore, we need to do it from that point of view. We need to do it from a brand point of view, so the shopping trip is maintained to a high standard. And then we do it from a sustainability point of view to make sure we can hit net-zero by 2035.

Clive Black: That's very helpful. Thank you.

Ken Murphy: Thank you.

Moderator: Thanks, James. We're going to take our next question from Sreedhar Mahamkali of UBS, please go ahead.

Sreedhar Mahamkali: Hi, good morning. Thank you for taking my questions. I've got three, if that's okay? First one is cost inflation. Imran, I think if you can talk through your views on the second half and going into 2024, please, what you see if you get the crystal ball out. Specifically within that on energy, can you talk about if it still remains a headwind into second half or it is starting to become a tailwind? Relative to the first half, what do you see in the second half? And if you're starting to hedge already for 2024.

Second one, I think, can you talk about strong improvement in pricing versus discounters? The UBS data shows the price perception is still 12-13% versus Aldi and Lidl gap. What does your data say? Do you have any numbers you can share with us in terms of actual price reality? And that'll be super helpful. And I guess, if I can very briefly go back to Clive's question on leverage. Imran, you talked about wanting flexibility on leverage. I guess, if I can push you back a little bit on it and go, how much flexibility is right flexibility? Is it starting to look a little too much flexibility? If you see what I mean? Thank you.

Imran Nawaz: Okay. Let me take maybe the cost inflation one first and then I'll take the leverage one and then pass on to you. Look, I mean, cost inflation clearly is the biggest challenge we had this year. We've talked about it in April, we talked about it in Q1 and we're talking about it today. The two big ticket items that I'd call out, payroll and energy.

The great thing, Sreedhar, is we have a very good hedging programme and it helps us to avoid the peaks and therefore get in a fairly good level. And as you can see that in the results. And more importantly than that, we had a really strong Save to Invest delivery, right? So, a productivity programme that delivers close to 300 million in the half is a helpful programme. Energy into the second half, it's still a headwind, but it's a lower headwind in the second half than it is in the first half. If I could say it like that, if that gives you the answer to the question?

But look, overall, the way we're approaching it is we continue to work on identifying opportunities to be as productive as we need to be, and therefore, the Save to Invest programme, we are now going to do 1.1 billion or so for two years. We want to continue into the next outer years as well, including next year, because you never know where commodities go. I would expect next year when I think ahead, payroll will continue to be a headwind, it's an area, and then energy ought to be a bit of a benefit. But again, I'm not going to disclose now our hedging strategy, as you wouldn't expect me to take that on.

Then in terms of balance sheet strength, look, I get there's always going to be people that will say, "Give us back more." Or, "Give us back less." I get that, right? But ultimately from where I stand, it is better to have a really strong balance sheet at a time like this. The world where we are at, 2.3 puts us into the right place where we discussed before, it allows us to take care of capex and increase it. It allows us to take care of the dividend on a progressive basis and continue our recurring share buyback programme. And that flex is important, right? It is important that if we ever needed to react that we can. So, I don't really see a need to change that, especially where times are.

Sreedhar Mahamkali: I guess where I was going with it is, what would take you for you to reassess if 750 million pounds of buyback is the right number? Or should it be-

Imran Nawaz: I mean, as a business, we continue to always look at what are the best uses of cash? Right? And the way I think about it is you have opportunities to invest in capex, you have opportunities to invest in store buybacks, you have opportunities to buy third-party stores. And frankly, tag on M&A and then of course, the dividend and the buyback.

As long as we make sure that we're investing into the business for growth in the right way, in a disciplined way, we're in a good place. And as I said, with interest rates where they are, this doesn't feel like the right time for me to say, "Let's change it and make it less strong."

Sreedhar Mahamkali: Understood.

Ken Murphy: And Sreedhar, if I address your question around pricing relative to the discounter. So, if I cast my mind back to 2009-10, we halved the gap between 2010 and 2020, between 2020 and today we've halved the gap again. Just to give you a sense of context. And of course, on the most important lines to our customer base. So, those 650 everyday essential lines were matched pound for pound. And then of course on a lot of brands on household items, that you can't get at a discounter, we've locked the prices now for nearly a year. In fact, coming up, we're just lapping our one-year anniversary and we've announced a lock of another thousand prices through till January.

So, if you think that a discounter has a range of about 4,000 SKUs, on somewhere between 1,500 and 2,000 SKUs at any given moment, we're going toe to toe. So, we feel that our value proposition is as strong as it's ever been, in fact, stronger than it's ever been. And when you add the other 15 to 20,000 SKUs on top that we stock, we give that customer that beautiful sweet spot between the total range they need to do everything in one place and great value in all those everyday essentials. And of course, then you complement that with they can have it delivered to their home or they can pick up their phone and order it and get it to their door in 30 minutes through our rapid delivery service. So, I think it's the combination of all those factors is really giving us the impetus that you've seen over the last six months.

Sreedhar Mahamkali: Thank you. Thank you both.

Ken Murphy: Thank you.

Moderator: Thank you. And just as a brief reminder, any analyst who would like to ask a question should click on the raise hand icon in the reactions button at the bottom of your screen. We'll now take our next question from Nick Coulter at Citi. Please go ahead.

Nick Coulter: Hi, good morning. Two quick ones, if I may, please. Firstly, can I ask what a more normalised run rate for savings might be in future years? Or, is it a case of trying to offset a more normalised level of cost inflations? In essence, how should we think about that? And then secondly, could I ask about the level of promotions that I think are beginning to come through and whether you expect greater support for the industry from CPGs in the coming quarters? I guess as they seek to drive growth and re-establish some sort of volume momentum as things begin to normalise. Thank you.

Ken Murphy: Thanks, Nick. I'll take the promo point and then Imran will cover the normalised savings run rate. So we have seen an uptick in promotional participation over the last six months, somewhere between a 5 and 6% uptick in promotions, but they are supported by the CPGs. I think what is happening is you're seeing a reaction to the increased participation of own brand over the last 12 months, and therefore the CPGs are trying to recover volume and hence you're seeing promotional participation go up. So from an investor point of view, the positive thing is this is completely funded by the suppliers and it's a great way of us being able to deliver better value back to customers on those brands that the customers love and which of course aren't typically stocked in the discounters. So it's not all bad from that point of view, Nick.

Nick Coulter: No, I'm calling it out as a positive, but do you think that we're probably only part way through on the beginning of that journey of trade dollars coming through?

Ken Murphy: Yeah, I think you're right. I think you're going to see a persistent increase in that. And I think as we get better and better at personalisation and direct kind of targeting, I think suppliers will see the value of our online platform as well. And of course that's a platform that's 60% bigger than it was two years ago.

Nick Coulter: And do you think about this differently versus other cycles in terms of trying to manage the flow of promotions to try and make sure that you get best unit price and manage the flow through the supply chain?

Ken Murphy: You're absolutely spot on. So one of the things that we've been very, very almost evangelical about actually is protecting that base file price, that unit cost price because we think it's essential for us to be able to maintain consistency of everyday value and competitive pricing and then the promotional funding can come on top when it's relevant. So you're absolutely right, we don't want to trade one off against the other.

Nick Coulter: Thank you.

Ken Murphy: Thank you.

Imran Nawaz: On savings. Look, I mean the good thing is savings productivity, it's in the DNA of Tesco and the people that work here. Now, clearly the last two years we had to really step it up and I think the scale of the savings, 1.1 billion in two years, is testament to that. The reality though also is certain structural headwinds, be it payroll, some of the energy, they're not going to go away that fast. So the reality is we need to continue to leverage that DNA and continue to look for opportunities and savings.

Now the question you asked me is the one I ask internally as well, what can we do? How much do we need to go after? And the reality is certain capex investments, technology automation can always help you find that next sort of opportunity that you couldn't get to before. So my view is it'll be less than the last two years for sure, per year, but look, it'll be something that we need to deploy to continue to help us offset the headwinds.

Nick Coulter: Okay. So it sounds like you expect sizable cost saves in future years?

Imran Nawaz: I think we never do... The philosophy we have on cost savings is we should always protect the customer's shopping experience and we should only go after the stuff that actually aids the customer in us being a better business. So you can do a lot of things without touching that, but there's certain rules we do follow to make sure that we never break that sort of principle. But look, we need to continue to look, I'm not going to give you a number or a normalised run rate today because that's something we continue to work and truthfully every year will depend on is it the right time to press the button on something or not? And that's where I'm really counting on Tesco's DNA to get that right judgment right.

Nick Coulter: That's helpful. Thank you.

Imran Nawaz: Sure.

Moderator: Thank you. We'll now take our next question, which is currently the final question from Paul Rossington at HSBC. Please go ahead, Paul.

Paul Rossington: Good morning, gents. Well done on the numbers, just a brief one from me. You've talked about Booker performing very well, but the rate of growth in both the retail and the catering business did slow over the second quarter. I'm just wondering if that slowdown was kind of in line with what you'd anticipated and with regard to catering where you see that going forward given your own position to benefit from customers eating in rather than shutting down or your outlook on the eating out market. Thank you.

Ken Murphy: Well, look, I think the first thing to say is that Booker has been exceeding our expectations pretty much for the full half. The slowdown in growth you saw over the summer was actually largely weather related because we had such a rough July and August, which makes the Booker performance all the more impressive because it speaks to what available business there is out there Booker is winning, and I think it's winning it because of a combination of a real renown now for great product quality but also fantastic pricing.

We have put a lot of effort into what we describe as menu management. Effectively, how do we reconfigure our proposition to allow our catering customers put together menus that are really hitting the note with customers from an affordability point of view? And I think that has really helped us. And of course we're also looking to expand our network capacity to be able to build out the catering business even further. So even though we are seeing that trend of more people eating in than eating out, what we are seeing is Booker winning share in that available catering market and doing so through that great combination of quality, value and service. So we're feeling pretty optimistic about the capacity for Booker to continue growing.

Paul Rossington: Thank you. And just a quick follow up, if the weather was a factor for Booker, should we anticipate seeing a improvement in convenience sales into the second half as well based on the same? Thank you.

Ken Murphy: Well, we have made a significant investment into our convenience business and from a value point of view, you'll have noted there recently that we've put 50 really competitive entry level products and own brand products into our convenience range. And in many cases there's like a 40% price reduction in the product just to make that convenience shopping experience more affordable.

And I think as winter kicks in and as we continue to improve availability and the quality of our proposition in convenience, we would expect the convenience business to maintain its very strong performance.

Paul Rossington: Thank you, gents. Thank you.

Ken Murphy: Thanks very much, Paul.

Moderator: Thanks, Paul. We have no further questions at this time, so I'd like to hand it back to Ken Murphy for some closing remarks.

Ken Murphy: Thank you everyone for joining us today. We really appreciate the time, the effort, and all the great questions that you've given us. We're really pleased with the first half performance. We think it demonstrates our clear commitment to really strong value, and that's been reflected in how customers are responding. With the market share gains we've seen over the half, a really strong commitment to quality and product innovation. You've seen that coming through over the first six months, something which we want to build on as we go into quarter three and into Christmas where we think that we're really well set up to win. We are very excited about both the product proposition and the shopping trip, and so we look forward to seeing you all again to talk about Christmas trading. In the meantime, I hope you have a wonderful Christmas and New Year, and I look forward to seeing you in January. Thank you.