Tesco PLC LSE:TSCO

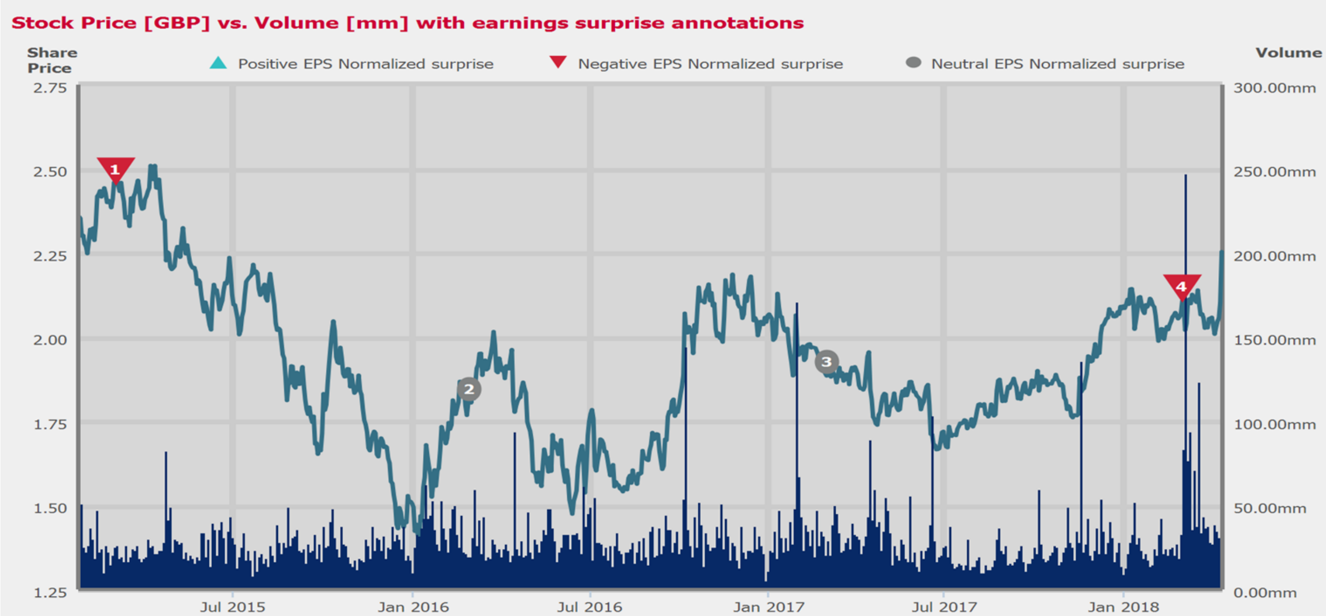
FY 2018 Earnings Call Transcripts

Wednesday, April 11, 2018 8:00 AM GMT

S&P Global Market Intelligence Estimates

	-FY 2018-			-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	0.11	0.10	(9.09 %)	0.13
Revenue (mm)	57340.72	57491.00	0.26	63264.36

Currency: GBP
Consensus as of Apr-09-2018 9:45 AM GMT



- EPS NORMALIZED -			
	CONSENSUS	ACTUAL	SURPRISE
FY 2017	0.08	0.08	1 0.00 %
FY 2018	0.11	0.10	2 (9.09 %)

Table of Contents

Call Participants

EXECUTIVES

Alan James Harris Stewart
CFO & Executive Director

Charles Wilson
Chief Executive Officer of UK & Republic of Ireland

Dave Lewis
Group Chief Executive & Executive Director

Jason Tarry
Chief Executive Officer of UK & ROI

Tony Hoggett
Chief Operating Officer

ANALYSTS

Andrew Philip Gwynn
Exane BNP Paribas, Research Division

Borja Olcese
JP Morgan Chase & Co, Research Division

Bruno Monteyne
Sanford C. Bernstein & Co., LLC., Research Division

Charlie Muir-Sands
Deutsche Bank AG, Research Division

Daniel Ekstein
UBS Investment Bank, Research Division

David McCarthy
HSBC, Research Division

Dusan Milosavljevic
Joh. Berenberg, Gossler & Co. KG, Research Division

Fabienne Caron
Kepler Cheuvreux, Research Division

James Robert Grzinic
Jefferies LLC, Research Division

James Tracey
Redburn (Europe) Limited, Research Division

Nick Coulter
Citigroup Inc, Research Division

Robert Joyce
Goldman Sachs Group Inc., Research Division

Sreedhar Mahamkali
Macquarie Research

Stewart Paul McGuire
Crédit Suisse AG, Research Division

Unknown Analyst

Xavier Le Mené
BofA Merrill Lynch, Research Division

Presentation

Dave Lewis
Group Chief Executive & Executive Director

Good morning, everybody. Nice to see you all. Thank you very much for taking the time to be here with us today.

I'm very pleased to say we have a -- we think, a strong set of results to share with you. But we're also very conscious that we are 3 years in -- 3, 4 years into the turnaround of Tesco. But it's also the point at which, if you like, it's the last time we're going to talk to you about a completely stand-alone Tesco set of results given the Booker merger. So we thought what we do this morning, as well as sharing with you the results, is share with you a little bit of a perspective of where we think we are for the 3 years in before we commence the opportunity -- the big opportunity, which is Booker.

Now I'm pleased to see in the audience, as always, at the prelims, the exec of Tesco is here. So when we do get to the Q&A at the end, with the usual rules of one question, not model-driven, strategic, insightful, entertaining questions, if either myself or Alan can't answer those, then I'll call upon members of the exec who are here to add a little color, flavor and depth, if that's helpful to you, okay?

So what we're going to do, talk about the results, and I'll pass to Alan immediately to do that, and then I'll come back and give you a perspective on the 3 years through 2 lenses, really, the 6 drivers that we shared a number of years ago but also from that stakeholder point of view that we've shared previously as well. And then I'll talk a little bit about looking ahead and particularly about Booker, okay?

So Alan, without further ado.

Alan James Harris Stewart
CFO & Executive Director

Thanks very much, Dave. Good morning, everybody.

So the full year results. As Dave said, it's been a year of progress, and I'll begin with the group results. We've delivered another strong year of progress and remained firmly on track to achieve our medium-term ambitions. Momentum in sales has continued with positive growth of 2.3% at actual rates. I'm pleased to say the fourth quarter of the year represented the ninth consecutive quarter of sales growth for both the group and our U.K. & Ireland division. We've also delivered strong profit growth, up 28.4% year-on-year to GBP 1.64 billion, with growth in every segment. The U.K. & Ireland made significant progress in the year, achieving an operating profit of GBP 1.05 billion, up 31.1%. This enabled us to finish the year strongly with an operating margin for the group in the second half of 3%. And importantly, we've had another strong year of retail cash generation, up 21.7% to GBP 2.8 billion.

If we now move to the U.K. As you know, we've played -- placed significant emphasis on fresh food as the driver of our recovery over the past few years. We are pleased to have delivered positive fresh food volume growth of 0.7% in the year, driven by continued improvements in our customer offer. As expected, we've continued to see a drag from our efforts to de-emphasize certain parts of our general merchandise business in order to shift the focus to more profitable lines, with GM volumes down 7.2%. We further refined our range, reducing the number of SKUs by 16% and reducing sales in certain categories. An example would be electronics, where it's down more than 10%. We're still focused on driving growth and profitable sustainable categories of general merchandise. The introduction of our Go Cook and Fox & Ivy ranges has been extremely successful, driving a 14% and 20% increase in customers to our cookware and home ware categories, respectively.

Overall, we've seen 260,000 more customers shopping with us year-on-year, with the average basket spend up 2.5%. This has enabled us to improve profitability, with operating margins for the U.K. & Ireland segment up 50 basis points year-on-year.

Looking now at the results for this segment in more detail. We've seen strong like-for-like sales growth of 2.3% for the year, maintaining similar levels throughout every quarter. The fresh food category is strong. And we've seen strong volume growth of 0.7% that I've just mentioned, and this corresponds to a market outperformance in fresh food of 1.7%. This is driven by a particularly strong performance in meat, fish and poultry. Our total food volume outperformance was 1.4%.

We've continued to see strong customer take-up of our own brand products, helped by the ongoing relaunch, which started last November. Own brand now accounts for 51% of total sales, up nearly 1 percentage point year-on-year.

As usual, we've included details in terms of like-for-like sales and channel analysis in your packs, from which you'll see that we've had a particularly strong performance in our large stores. Superstore like-for-like sales were up 2.6%, and extras were up 1.8%. We saw 5% -- slightly over 5% growth in Grocery Home Shopping, once again, driven by increases in both order numbers and in basket size.

As you can see from the waterfall on the right of this chart, operating margin has increased by 50 basis points to 2.3%. Despite the significant investment we made in price in the first half, as we held back more inflation for our customers than the rest of the market, we've seen a net benefit from volume, mix and price for the year is a whole. Our cost-saving plan delivered a reduction in costs in the U.K. of GBP 404 million during the year, more than offsetting the cost inflation we've seen.

While our operating margin improved significantly year-on-year, given the shape of our investments, this is even more marked in the second half, strengthening nearly 70 basis points to 2.5%. I should note at this point that the U.K. & Ireland operating profit before exceptional items includes transaction costs and fees of GBP 21 million arising from our merger with the Booker Group. This is consistent with the treatment in the prior year, where we had GBP 26 million of costs also included in the operating profit before exceptional items. In the year ahead, we see -- expect to see a similar level of transaction costs in respect of stamp duty payable on completion of the merger.

If we now move to our Central European segment. We've delivered like-for-like sales growth in food of plus 1.2%, with fresh food again being a key focus. This strong performance continues to be offset by the drag from general merchandise as we refocus our offer, similar to what we're doing in the U.K. The Czech Republic and Slovakia continued to deliver strong like-for-like growth. We've made good progress in Poland, which continues to be a very competitive market, generating positive like-for-like sales growth throughout the second half of the year. It's too early to assess the full effect of the recent legislative changes and concerning Sunday trading in Poland, and they may have some impact in the year ahead. We've seen significant progress in our convenience store format across Central Europe, with all areas contributing positively to a like-for-like sales growth of 3.2%.

We've been particularly pleased with the increase in operating profit before exceptional items in the region. Profits more than doubled year-on-year to GBP 119 million, with operating margin up 87 basis points to 1.8%. Our efforts to reduce costs have made a significant contribution to this improvement in profit, particularly the benefit of more effective stock management. The opening of a new distribution center in Slovakia serving the whole region has allowed continued progress towards operating these 4 markets as 1 business.

Moving now to our Asia segment. As we've mentioned throughout the year, the headline sales numbers are significantly impacted by the strategic decision taken in Thailand to remove unprofitable bulk selling and mass couponing activities in order to focus on sustainable, profitable sales growth. This change will annualize during this quarter of this year -- this year we've just started. The change to bulk selling has driven around a 6% negative impact, with the reduction in couponing driving around another 3% negative impact. When stripping out this impact, Asia's like-for-like sales were down around 1%, largely reflecting our investment in price across the region.

You can see the positive impact the strategic decisions have had by turning to the profit waterfall. We've continued to invest in keeping prices low for our customers and have seen the benefit in both volume and mix. We've also in Asia made significant progress in our cost-savings program, saving a total of GBP 120 million during the year. Throughout the year, we've seen further improvements in profitability. Despite the full year deflation of around 1%, our operating profit margin is up nearly 1 full percentage point to 6%.

If we now turn to the bank. Tesco Bank celebrated its 20th year of serving Tesco shoppers during the year we just ended. We've continued to strengthen our product and service offering to customers, delivering meaningful little helps along the way, driving the growth in active customer accounts of 4.1% across the primary products in the bank.

Operating profit before exceptional items was up 10%, and our headline lending balances have grown 16%. We continue to build the mortgage base, with total mortgage lending up 39%. Secured lending now accounts for 26% of the loan book, up 440 basis points year-on-year.

Tesco Bank recently won the Best Direct Lender Award for the third year running as, again, a focus of our commitment to customer and value for our customers.

The balance sheet remains strong with a risk asset ratio of 19.3%. As you may be aware, IFRS 9 financial instruments has come into effect for all accounting periods beginning after 1st January 2018. As a result, the opening retained earnings for Tesco Bank for the '18, '19 financial year are expected to be reduced by GBP 166 million. Although the impact of the new impairment requirements in our retail business is immaterial, there may be some increase in bank volatility -- the profitability of the bank and volatility of that as we go forward as the new business is accounted for on an expected losses basis and as we fully understand the implications of IFRS 9. Shouldn't make any impact on the long -- on the overall results of the business, but the timing of recognition of losses changes as a result of this standard.

If we now move to the next slide, you can see the standard bank metrics we always share. I'd like again to draw your attention to the differing rates of growth between the secured and the unsecured lending, reflecting the bank's greater focus on secured lending. The improvement in our cost-to-income ratio to 59.7% follows the restructuring changes we made in the bank last year.

If we now move to the sources and uses of cash. And again, this is the way we think about cash within our business, represented on this waterfall. If we begin on the left-hand side, we start with GBP 2.466 billion of cash from retail operations, driven by continued improvements in the profitability of the business. Following this, we've had a very positive working capital inflow of GBP 499 million. I should note that this includes GBP 102 million timing benefit driven by trade payables arriving from the -- arising from the Palmer & Harvey administration towards the end of the financial year. We expect this to reverse in the '18, '19 year. Aside from this, the key benefit to working capital is from a variety of stock management initiatives across the whole business.

Our exceptional cash items results in an outflow of GBP 192 million. These are made up of GBP 149 million of payments in relation to the deferred prosecution agreement with the SFO and the shareholder compensation scheme payments. There are GBP 122 million of restructuring costs and GBP 92 million of onerous lease utilizations. These are offset by GBP 160 million recovered from HMRC regarding the treatment of VAT on Clubcard benefits. HMRC has appealed this decision, so there is the possibility of a cash outflow in the future should their appeal be successful. Overall, this leads to a retail operating cash flow of GBP 2.7 billion, an increase of 21.7% year-on-year.

Our cash capital expenditure of GBP 1.2 billion is up year-on-year and includes around the GBP 200 million impact from the payment this year of prior year accruals.

Net interest and tax payments of GBP 428 million were GBP 113 million lower than last year, largely as a result of a maturing debt and the 2 liability management exercises we undertook during the year. I'll discuss these in more detail shortly.

Our net property transactions include 10 store buybacks in the second half of the year, following on from our transaction with British Land at the beginning of the financial year. This is offset by GBP 253 million of proceeds from property sales, including the sale of our Hackney store in the first half and a number of other sites in the U.K. and in Central Europe.

We raised GBP 362 million through disposals and dividends received, primarily driven by the sale of our remaining minority stake in Lazada online business and our opticians business division Express as well as the GBP 50 million dividend we'll receive from Tesco Bank. The results in the overall free cash flow for the year of GBP 1.377 million -- GBP 1.377 billion.

Moving to capital expenditure. CapEx for the full year was GBP 1.1 billion, in line with our guidance and continues to be largely made up of maintaining and replacing essential assets. In the U.K., within the GBP 677 million, we've allocated CapEx to repurposing in 20 Extra stores and a small amount of new store openings, primarily in our Express store format. Within the year, we opened over 50 concessions within our stores in the U.K. with Arcadia Group, Holland & Barrett, Dixons Carphone and Next. The GBP 133 million in Central Europe relates mainly to repurposing of existing stores. And in Asia, the GBP 239 million relates to 69 new stores we've opened, mainly in Thailand, and repurposing in 34 stores. And just to reiterate, we continue to expect CapEx to remain between GBP 1.1 billion and GBP 1.4 billion per annum. Based on our current plans and at this early stage in the year, I'd expect to see our spend towards the top end of this range in the current '18/'19 financial year.

We covered pensions in a lot of detail at the half year. And to recap, the most significant update was the conclusion of the triennial actuarial valuation confirming the deficit of GBP 3.0 billion. We also, at that stage, confirmed the small increase in the annual contributions of GBP 15 million to GBP 285 million from April 8 -- 2018 with our long-term funding framework unchanged. We also covered the significant reduction in pension deficit as calculated by IAS 19. I won't repeat all the detail here again, but you can see from the waterfall on this chart that it reduced from GBP 6.6 billion to GBP 3.2 billion pretax and to GBP 2.7 billion post-tax over the course of the year.

I'm pleased with the significant progress we've made over this year towards strengthening our balance sheet, with net debt reducing to GBP 2.6 billion. This chart shows the progress over the last 3 years, where we've seen significant improvements. We've also seen a GBP 509 million in the year reduction in our lease commitments, which includes the benefit of the buyback of the 17 stores over the course of the year. And total indebtedness now stands at GBP 12 billion, a GBP 9 billion reduction from 2014, with lower net debt driving around half of this reduction.

This slide on debt reduction gives some more color on our progress on gross debt within the year. During the year, we've repaid a total of GBP 2.7 billion, consisting of debt maturities of GBP 1.4 billion and the 2 bond tenders I've previously mentioned. The first tender took place in July 2017, complete -- concluding with the repurchase of GBP 500 million of debt. Following this, in October, we repurchased a further GBP 800 million of debt. As you can see from this slide, we've targeted bonds with high coupon rates to maximize the return. The exception to this was our Eurobond maturing in 2019, which we repurchased to help smooth our debt maturity profile. The tenders alone results in annualized interest savings of around GBP 50 million.

We're really pleased with the progress we've made on the balance sheet. Our intention remains to return to an investment-grade credit rating, with our key threshold metrics being fixed charge cover in excess of 3x and total indebtedness of less than 3x EBITDA (sic) [EBITDAR]. These graphs show the significant progress we've already made on both of these metrics, which are our internal metrics and measurable against our internal financial results.

Our EPS has improved significantly, up 62.7% to 11.88p. In addition to the strong increase in operating profit I mentioned earlier, which resulted in the tax charge increasing, we've also had a large reduction in finance costs, primarily driven by the reduction in debt that I've just discussed.

With the continued strengthening of free cash flow that we've delivered, we formalized a commitment that any future dilution from the issuance of new shares to satisfy the requirements of share schemes will be offset by matching repurchase of shares in the market. Put simply, we want to ensure that the total number of shares in issue stays constant going forward. We expect this will utilize around GBP 150 million of cash per annum, with the exact amount dependent on our performance each year.

We're pleased to propose the final dividend of 2p per share to be paid on the 22nd of June 2018. This results in a total cash cost of around GBP 164 million, which will be payable during the course of this financial year. We continue to target cover of around 2x earnings in the medium term. Our full year dividend of 3p reflects our continued improvement in performance and the board's confidence in the plans that we've set out.

Before I conclude, I have a slide summarizing our guidance for the key financial metrics and how we see our continued progression. The margin cost-saving and cash-generation targets are directly linked to our 6 strategic drivers. The remaining guidance for pension contributions, CapEx, finance costs, tax and the dividend remain unchanged from October. We expect the current year's tax charge to be around 24%. I've also included here our debt metrics for total indebtedness less than 3x EBITDA (sic) [EBITDAR] and the fixed charge cover of greater than 3x. And finally, just to remind you that we'll be consolidating 51 weeks of Booker in the current financial year following completion of the merger on the 5th of March.

So in conclusion, the year represents continued strong progress, leaving us firmly on track to deliver our medium-term targets. We've delivered another year of growth in sales, profit and cash. We continue to increase profitability across the group, with our operating margin reaching 3% in the second half. We've also made substantial progress across the group on our cost-saving target -- program, with total cost savings of GBP 594 million in the year and GBP 820 million of savings to date, well in excess of half of the target we've set ourselves. We continue to strengthen the balance sheet with GBP 2.7 billion of debt repaid during the year. And finally, the dividend represents the board's confidence in our ongoing recovery.

Thank you for your time. I'll now hand back to Dave.

Dave Lewis
Group Chief Executive & Executive Director

Thanks, Alan. Okay. So as I said by way of introduction, what we thought would be both appropriate and helpful is to spend a little bit of time talking about the last 3 years. We do that obviously to give you sights of the progress that we're making but also recognizing, as Alan says, going forward, we'll obviously incorporate Booker. And whilst we'll continue to give you clear sights of what the Tesco performance is against the aspirations we've set for ourselves, this is the last time we'll be presenting a full set of results that are Tesco stand-alone, so we wanted to make sure that we give you the best update of that before we move into the Booker play.

So it starts with 2 lenses really. First is the drivers that you're familiar with. So the first of those is to rebuild the brand, a more differentiated brand, you've seen this chart from me before, starting in January '14 all the way up to February of '18. And I'm pleased to say that the performance of the brand continues to strengthen.

If you look at the metrics on the right-hand side, the 3 that I picked out, again, are the ones consistent with how we've reviewed them over the period: net Promoter Score, up 15 points; the quality perception of the brand has doubled over that time period; and the value perception of the brand has tripled over that period. So when I measure the brand, there's still more that we can do, there's still more opportunity for Ali, the team and everyone to add more value to the Tesco brand. But over the last 3 years, we have definitely seen some progress in rebuilding a more differentiated proposition for Tesco.

As Alan says, we're well on our way in terms of the operating costs, so GBP 820 million so far, the trajectory ahead of that we shared when we shared the guidance a couple of years ago. And on the right-hand side, I've given you a little update in terms of the progress that we're making in the buckets that we shared at that time. So store operating model, lots and lots of change, as you would. We've shared with them -- them with you as we have gone through the last 3 years. But GBP 540 million of that GBP 820 million coming out of the operating model; more than GBP 100 million in terms of logistics and distribution; GBP 174 million in that goods not for resale. So really very happy with the progress that we're making in terms of cost savings and still an opportunity for us to continue and accelerate what it is the team had been doing.

Generation of cash. Alan talked about it in the year. If you look across the 3 years, the GBP 9 billion that we talked about, well on track to deliver, very happy with the way that, that is coming through. On the right-hand side, we were trying to give you a little more insight in terms of cash. It's so easy to say than it is to do. I suppose it's significant, but it shouldn't be a surprise, but 80% of that cash improvement has come from the profit recovery. So that rebuilding of the profitability of the business comes through in cash very strongly. But also, 20% of it has come from a real improvement in working capital performance, and we continue to see opportunities for us to do that even better going forward.

Everybody remembers this matrix from October of '16. The bit that I'll update is the bottom right-hand corner at this point, which is we -- second half of '14, '15, the margin for the group was 0.8%; full year was 1.8%; and you've seen stable first year, 2.3%, 2.9%; exit the year just above 3%. It's the trajectory of total group level of total margin.

I thought I'd give you 2 other examples about how it is we think about mix geographically. So what you see here is by half year, the 3 business units that we have. On the left-hand side, the U.K. & Republic of Ireland. Then you'll remember as well as I do that in the second half of '14, '15, the U.K. & Ireland was negative in terms of its profitability and is at 2.5% in the second half of this year. We've made lots of changes in Central Europe during the period of time we've been here. Really, really, really pleased with the plan that Matt and his team have put in place and the performance of the business in the last year in Central Europe, doubling the profit and getting the growth that we want and with some really strong plans for how we go forward. And as Alan says, the profit performance in Asia has been very good indeed but required us to do some strategic management of the mix that we were selling. And I suppose that's the thing that I think, when we talk about managing the mix, being prepared to walk away from unprofitable sales. Once we've first taken out the costs of delivering those unprofitable sales is something we've been prepared to do in order to enhance the quality and the sustainability of the business model. And Asia probably is the biggest single example of that, whilst we've been doing quite a lot of it in the U.K. around certain categories of general merchandise as well.

Thought the other thing I'd do is give you a sense of mix. We talk about food, and we've talked very clearly, I think, for 3 years about the importance of food in terms of the turnaround of the business. What I've done here is break down, back to the U.K., what's driving our growth versus what's driving growth in our competitive set. So the dark blue is food. And whether you take the 4-week ending to the end of February or the 12-week ending, you see that our focus is on food, and our outperformance versus the market continues to be in food. And that's deliberate, no surprise. But actually, when people ask me am I happy with the performance in the U.K. as prices move and other things. I'm very happy with the performance in the U.K. We continue to outperform the market in terms of volume over the period and regained food market share in the U.K. in the year, and that's because that's where our focus is. But the mix of growth in the U.K. market across the competitive set is actually quite different.

Anyway, moving on. Steve and the team have done a remarkable job in property, released more than GBP 1.4 billion worth of value, lots and lots and lots of activity, really very impressive. You -- the things that you will have seen over 3 years, freehold proportion has gone above 50%, so we've been quite active in buying back property that we felt were part of the sustainable future of the business. We've released that GBP 1.4 billion and, at the same time, repurposed more than 2.6 million square feet of space. A lot going on in the property world in Tesco.

And finally, innovation, which is where I never say anything, which is on the left-hand side, but we're happy to talk about things that are on the right-hand side. Look, I suppose the one, if I think back over 3 years, that whilst there's an awful lot, there's one that stands out as being quite a pivotal moment for us, the decision to invest in the farm brands with a big deal. It was an awful lot of money at the time against the strategy that was at that time not proven. So if you look at the top there, the picture of the farm brands, just give you a little insight, in the 12 months that we're just reporting, sales of the farm brands in the U.K. were GBP 550 million. We sold more than 750 million units, i.e. packaged or loose. It's been a phenomenally successful activity for us in the way that we've repositioned not just the category but the value perception of the total brand. But there's been a lot of innovation, and dare I say there's an awful lot more to come.

The 3 that I pick out that you should be watching out for now is in own brand. You would have -- hopefully, some of you saw on the way in if you've not been seeing in store. Some of you came to the launch of what we call [Project Atlas], which is the relaunch of Tesco's own label across all 3 tiers of the brand. We're about 1,300 SKUs into, a total that Ali and the team have to manage, which is more -- and Jason, of more than 10,000. We'll get about 95% of the way through by the end of Q3, and you'll see some of that thinking and that execution play out in other parts of our International business through the course of this year.

So far, we've launched 5 more exclusive brands that replaced the value tier, and you would've seen some of those in the foyer as we go. A lot going on, on Tesco on label. Alan said 51% participation in the U.K., growing more than 4%, really very happy with the work that is going on, on brand.

Clubcard relaunched in the year to be contactless, it gives us a lot more capability going forward. It's reinvigorated engagement with Clubcard. There's been some work around partnerships and how we use it for reward. We've got some more plans for Clubcard going forward.

And that link also to what is we've got going in Pay+. Pay+ now has gone through at the half -- the 500,000 users of that Pay+ app within the Tesco business, really very successful launch, recognized by the finance institute as the best payment and loyalty app available. So just some examples of what's current, if you like, in terms of that 3-year trend on innovation.

So that -- those were the 6 drivers that brings you up to date in terms of where we are with each of them. But we've also tried to always, through that 4 years -- 3 years, share with you through the lens of the 4 stakeholders we consider in our business.

So if I start with customer, the promoter score I've touched on already, a very significant improvement in the feedback and the recommendation that we're getting from customers who we're visiting, prepared to recommend others to come back to Tesco, very significant. If I go back to August of '14, i.e. the period before we started here, our market share was declining by a little more than 1.5%. And if I come all the way forward to February of '18, actually, we're gaining market share again. If you -- for those who remember, in October '14, we said there were 3 priority -- immediate priorities for the U.K. business, which was to regain competitiveness. I think we can safely say, whilst it's definitely not done and there's always a challenge, we're more competitive now than we were 3 years ago.

If I take the Kantar measure of loyalty, and this is sort of heavy loyalty, we see a strong improvement in the loyalty profile of Tesco shoppers also across that 3-year period. And if you encapsulate that all in the 6 factors that go together in the YouGov brand survey on brand perception, we have more than tripled the positive perception of the brand across -- if you see down at the bottom, quality, value, reputation, satisfaction are all the things that drive brand perception. And there's a threefold -- more than threefold improvement in the brand as judged by the customers over that period.

If I talk about colleagues, look, there's been an awful lot of change for Tesco colleagues over the 3 years, not all of it easy by any stretch. Interestingly, through that period, as fed back by our colleagues, a great place to work, has gone from 70% to 83%. A great place to shop has doubled, right, still lower than I would like it to, but it's doubled. And anybody in retail knows that your colleagues are by far and away your harshest critics. They're also your most knowledgeable customers. Listening to colleagues is really, really helpful in terms of the things we have to do. So getting recognition back from our colleagues as a great place to shop and a place they recommend was very important to us, and there's been strong, strong progress in that over the 3 years.

Try to give you an insight into transformation, what's really happened, because I'm very conscious that when we make a change, everybody talks about that one particular change. If we go back to -- this is looking at colleague hours, right, been a lot of change. But between August of '14 and now, with all of the changes that we've done, we have more than 18,000 more customer-facing roles, right, as we've made lots and lots of changes around what we've been doing, if you remember in those early presentations, how did we increase the amount of Tesco talent and resource which is serving customers, we have increased the percentage of our people who are serving customers really quite significantly. At the same time, though, if I look at the management numbers, and for us, that's sort of, well, level 3 and above, and the management changes we've taken, the number of management roles in our business, same time period, is 6,000 less. It's been really quite a dramatic shift. If you look at the structure of our business now and if I think about what Matt and Tony and others drove in the U.K. and what we did in our head offices around, it's really quite a radical transformation. But the interesting thing is -- and not often reported is, actually, the number of colleagues who were serving customers has increased 3 years in, net-net. And actually, it's in other structures that we've taken roles away from the business in order to simplify.

The investment in colleagues, right -- the investments in colleagues, we had a pay freeze 3 years ago, no investment in the pay at all given the situation the business found itself in. And what you see there is the trajectory in terms of base pay. There's also been bonus based on performance introduced for colleagues in the U.K. We have a 10.5% pay deal agreed for the Next, which covers this year and next year. So we've continued to invest in that colleague relationship with Tesco as the business has improved.

Suppliers, obviously, a very difficult place a little over 3 years ago. I have nothing but admiration for what Jason and the team have done in rebooting, if you like, the relationship that we have with our suppliers. We stepped back and said we want to do this really very differently. Now has responsibility for end-to-end product life cycle.

The supplier viewpoint in terms of satisfaction 3 years on has moved from 51% to 78%. We have 10,500 users of the Supplier Network that we've put in place. This is all about helping suppliers understand how it is they should work with Tesco, how it is they can best extract value and work effectively with us. And externally, you see that, that change in the way that we approach has come through in the Advantage survey, where we were definitely middle of the pack in '14, '15 but have been first, as voted by our suppliers for the last 2 years. And it -- obviously, we talked about a volume-led recovery. You see on the right-hand side, we had 7 years of volume decline in our business. That really affects the relationship we have with our suppliers. Arresting that decline, getting ourselves back to competitive levels of growth is something that our suppliers clearly appreciate. And always remember that 1% of growth from a Tesco point of view is significantly more than 1% of growth elsewhere given the size of our business. So quite a fundamental change in the way that our relationships with suppliers has seen.

And I suppose, finally, obviously very importantly, our shareholders. We started from a place where we were losing share to everybody. Those charts, if you remember, about where everybody said you had a particular problem coming in, actually, our problem was bigger because we were losing share to everybody. We're now gaining share in food full year U.K. We were loss-making in the U.K. The margin -- group margin is now exiting the year just above 3%. We're generating a significant amount of free cash flow and can see that improving further. And as Alan touched on, net debt was GBP 8.5 billion 3 years ago. We finished the year at GBP 2.6 billion. Total indebtedness is down from GBP 21 billion to GBP 12 billion.

The capital discipline. The last 3 years, we've been very, very, very tight with capital, changed the metrics that we use, changed the payback periods that we look for and actually been very tight in the way that we look at capital across. If you look at the 3 years before that, the level of CapEx was nearly 3x higher. And really interesting, Alan and I, before Charles arrived, we sat down with the U.K. business and looked through that detail in their capital plan. One thing that was really interesting for me was that a little bit more than 80% of the capital that was being proposed for investment in this year had a return of less than 2 years. Now I tell you already, I think Charles may sharpen that payback period even tighter. I think Booker was 18 months. I'm quite happy for that challenge to come in. But I suppose from a Tesco perspective, getting that percentage under 2 years hopefully gives you an insight into the discipline and the respect that we have for capital investment in the business.

EPS, Alan has touched on; and dividend, you're familiar with. So that was just trying to put together through those 4 stakeholders what we think has happened over 3 years.

So that's done. That's 3 years. We are where we are, pleased with the progress, much more to do, challenges and opportunities, but motivated by what comes next. And what comes next, I suspect, is dominated by what it is we've done in the merger of coming together with Booker.

I suppose what I would do, it was in the release this morning, the Booker results from Charles and his team, finished only on the 31st of March, they're not fully audited. At this point, we have to make sure that that's closed off properly. So please, they're not fully audited, but we've obviously got pretty good sear. And I'm pleased to say that a very strong performance from the Booker team and that trajectory that you saw through last year carries on.

Customer satisfaction, the most important metric, continues to strengthen, up again to 85.7%; like-for-like, just under 10%. And a very strong performance in terms of GBP 195 million of operating profit and GBP 120 million of net cash. The performance of the Booker business has been fantastic over the long period, but it's also been fantastic as we've gone through the merger process. More customers, the retail club is working particularly well, but actually, just the level of satisfaction that is within Charles' customer base is impressive, and we hope to build on that yet further.

As you know, we have a small -- we've had a small team of people working across the 2 businesses. We call it Joining Forces, looking at how it is we get the complementary skills of both businesses and how we could try and get fast out of the gate in terms of realizing some of the opportunities. We delivered the merger on time, exactly as we proposed it, even though it was more than a year earlier. I'm very pleased with the way that both teams worked together on that merger, and I see the benefits of that as we start operating together.

We have GBP 175 million at least of significant cost synergy potential, and we've put in GBP 25 million of growth synergy opportunity. That was in the prospectus. We've said that all the way through. We're 5 weeks in, all right? We're 5 weeks into the merger, and we are focused on delivering that.

I think what are we doing? Trying to give you a little bit of flavor. What have we actually been doing over 5 -- those 5 weeks? We know we're really clear that there are some opportunities in the complementary nature of the 2 ranges across the 2 businesses.

So a little insight into what does that mean. So we identified in Tesco what might be the 30 SKUs that Booker customers would really like to have but they don't have access to now and vice versa. So what are the 30 things in Booker that might be very good for Tesco customers that they currently don't have access to? Now it was easier for us to make Booker a customer of Tesco, so we actually started in a couple of stores, right, right out of the bat, having 30 of those lines in a few of our stores.

5 weeks in, really very happy with the sales performance. That range, as Jason was telling me only yesterday, justifies itself from a sales density point of view already, and there's very little, if any, communication about that. It's very early days. We'll now put the Tesco SKUs into the Booker offer, and we'll see how that builds. But when we look at range optimization, we see some really complementary opportunities. And before you ask me the question later, it really is in that sort of catering opportunity, catering pack sizes of brands that people know or catering executions that actually Tesco customers in large stores seem to instinctively find appealing. So when we talk about range optimization, that's one of the things that we see as an opportunity.

Some of you may have visited Cambridge in the last sort of 5 weeks in our store in Bar Hill, right? We launched a Chef Central at the very end of February. Now why Bar Hill? I have to say partly from customer and market opportunity but partly on a very practical basis. For those who have ever been to Bar Hill, don't know how many have, we used to have a Dobbies in Bar Hill. When we sold Dobbies, there's a part of the store which is already completely cordoned off and separate. So as part of Joining Forces, on a tenancy basis, we started to prepare for Booker to become a tenant inside a Tesco store in order for us to test this proposition. And that's what we opened as Chef Central right at the very end of February. It's been running now for 6 weeks. We'll do the full review at the end of this week with Charles and the team. And if you walk in there, that's a professional offer, right? It's a professional offer that doesn't exist in that neighborhood, and you can see the sales begin to grow. It's also an offer that Tesco shoppers can avail themselves to if they want to come out of our Extra store and go into the Chef Central proposition, okay? Now really very interesting for us.

The other thing that's been interesting about this is it's allowed us to have the conversations that we've been having with our supply partners about the growth opportunity that we see bringing together the country's leading retailer and wholesaler in one place by physically walking. So all of the conversations that have happened with the first sort of 39 supply partners about the opportunity of working together with the new group have been taking place in Bar Hill around Chef Central. So we can talk about it live and with reality in terms of what it is we're thinking about the opportunity going forward.

The other -- and again, we touched on this in prospectus -- is we do see a big opportunity for us to expand our delivery offer. If you think about that Chef Central example I've just given to you, we haven't done this yet, okay? So just be really clear, haven't done this yet. But would it be possible for our Grocery Home Shopping delivery vehicles to pick up from Chef Central and deliver to professional customers from that site? Yes, it would. Yes, it would. And that would allow us to utilize those delivery vehicles at the time of day that they currently stand idle. We haven't done that yet, but that's one of the expanded delivery options, by putting those ranges together, that we see as an opportunity.

And we see huge opportunity in terms of Click & Collect network, be it with independent retail customers that come with the Booker operation or, indeed, some of the businesses that Booker serve, how do we expand our Click & Collect reach and how do we use some of the mobile and banking apps that I've talked about for the Booker customers and, indeed, the customers of Booker's customers.

So that's what we're working on. It's -- we're 5 weeks in. We're -- I think we're pretty fast out of the gate in terms of the range and Chef Central and the relationships with suppliers, but it's the start of what we think is really quite a big opportunity.

To scale that for you and just to help in terms of how we think about it, the GBP 200 million of synergies we've talked about is over 3 years. We've also said it's going to be -- our aspiration is GBP 60 million in the first year, GBP 140 million in the second and GBP 200 million in the third year. So we're giving you the aspiration and we're giving you the breakdown of how we see it across the plan so that you've got transparency. We included in the prospectus an exceptional cost of up to GBP 145 million over those 3 years to deliver all of those benefits.

The bit that wasn't in the prospectus, because you have to obviously prove everything in terms of any growth that you put in, is the number that's on the right-hand side. The GBP 2.5 billion of revenue opportunity is what we see. As management, we see a GBP 2.5 billion growth opportunity of these 2 businesses coming together. This is the number that we've shared with our supply partners.

This is where those growth opportunities start to move us towards. And I suppose if you want my simple view on this, because everybody does ask me and I understand why you ask me about synergies is, look, our first job is to deliver the GBP 200 million and if we identify any of that or more than that, please be rest assured, we'll go after them, right? Will we try and do it quicker? We will try and do it quicker. Will we try and do it for less than GBP 145 million? We will try and do it for less than GBP 145 million. And we have an aspiration of growth which is GBP 2.5 billion, and if there's more to go for, you can be rest assured we'll go for it. But if we hit GBP 2.5 billion, we should all be very happy about that. That's the result of, just to be clear, strengthening the core offer to our existing customers, and you can see that already in parts of the business, and some of the new growth opportunities that I've mentioned and other plans that we've got, which, as usual, you're going to have to wait to see them before I'll talk about them. But that's the way that we're thinking about coming together in the merged entity.

The other bit of insight I thought I will give you, people say how are the 2 businesses going to work together? Now we had a long time to talk about this merger between ourselves, and one of the things we talked about is fit, cultural fit, how does it work? And actually, the thing that's really interesting there's a longer presentation for employees but actually some of the language that the 2 businesses use are ever so slightly different. When you look at the intent, it's amazing, amazing how actually aligned they are in terms of priorities values and wishes. So what we chose to do for our own employees is share and I've simplified for you here, if you think about the combined business, the idea of serving Britain customers a little better every day fits perfectly. If anybody who's visited Charles, he's a Booker investor over the last 10 years, he would have told you about health safe and legal, customer satisfaction, customer profitability, same thing. What do we talk about? Customer at the heart at everything we do, magnetic and offer every decision we take, healthiest place to work and shop, safest place to work and shop. So serving Britain's customers little better every day is the magnetic north of the combined organization. Really very happy that the 3 values, as articulated currently in Tesco, apply almost exactly to Booker. So we adopt that language for both.

And if you like the operating principles, we use ever so slightly different language, but health safe and legal, we think is the better articulation so we adopt that across the business.

Customer satisfaction is there for both. Cash profitability is there for both and has been throughout. This idea, and again, we pick up the Booker expression of that, which is how do you get maximum benefit from minimum change? How do you do 20% of the investment for 80% of the result? How do you do it in 20% of the time and get 80% of the way there? This idea, we're really very clear. People always ask me about integration, it's 1 team, it's exactly how we've been running the others parts of Tesco, which is built with very special channel expertise. Booker is a brilliant wholesaling business. We don't want to change that at all. We just want to try and augment it. And likewise, Tesco is not a bad retailer either. So we have large stores, small stores, online, wholesale, [fortunate] 1 team, 1 team, but with specialist capability in each of those outlets.

And for those who are long in the tooth or have read the history of Tesco and Jack Cohen, he had this little acronym at the bottom that some of you will know. The thing that Charles and I wanted to and the team wanted to put forward to the operations of the business was get on with it.

Speed, we're not spending a lot of time integrating businesses. Actually we want to get to the growth quickly. So for those who are not familiar, we bring back and putt in to the operating principles of Cohen edict, which means if you are not familiar, the letters mean you can't do business sitting on your a**, right, which seem like a very good way of encapsulating the need for speed.

I think in terms of shareholders, we've -- you've heard us talking Tesco about medium-term ambitions of 3.5% to 4%, GBP 9 billion of cash, GBP 1.5 billion of cost, you've had all of that. That's been our articulation of what it is philosophically we wanted to be doing. I think if you ask us what our underlying philosophy is, and again we've touched on this a couple of times, but it's also manifested in the Booker business, is an absolute focus on cash profitability. And I know that when we come and when we talk to the city, we convert it into a margin. But again, just let me repeat, in Tesco today, nobody, nobody has a percentage margin target. Never have had, never will have. It's an outcome. The only time we calculate it is when we get ready to share it with you, all right? All the things that set a quantum cash profitability, we'll carry on doing that. It's very consistent with how Booker works and that's what we will do going forward. So our underlying philosophy is cash profitability.

Then how do we grow the earnings? And how do we generate free cash flow? Now hopefully over the 3 years, you've seen that from Tesco, you've seen it for longer after Booker, if you put the 2 businesses together, and that's what you're going to see for us. We'll continue to report on the Tesco number so you can see our performance in the way that I've tried to give you a 3-year update. But if you want to know how it is we're going to think as a leadership team about driving the whole business going forward, it's cash profitability quantum, it's earnings growth, it's free cash flow generation, okay?

So that's it. We're delivering against the 6 drivers. We're happy with the momentum in terms of the performance. Sales, profit, cash are all up. Thankfully, debt is down. We continue to shift the mix, and we will continue to shift the mix as we think about what the right offer is. The balance sheet is significantly strengthened. Very happy and confident with the opportunity that's now afforded to us in the U.K. by coming together with Booker. We talked about a volume-led recovery that was then helped by cost effectiveness and management of mix in terms of margin recovery. To that, we now add significant growth opportunity as the other lever.

So -- and with that, we're managing to generate an improving shareholder return.

So that was all I was going to say by way of presentation. And now we'll open it up to questions. As I said, at this point I should say, there are 2 people in the audience who have never from a Tesco point of view been in the audience before. One is obviously Charles, but he's not a stranger to any of you or to this sort of forum, but Charles, officially, welcome. And then Iain, who's sitting at the back. So Iain Clink, you may not know. Iain is the Interim CEO for the bank. And so if there are any detailed banking questions, I'll be calling on Iain to help. But I think you also know all the other Tesco exec colleagues who are in the room. So we'll move to questions. But again, based on the feedback I've had before, can we keep it to one question each? And if it is a question about sort of detailed modeling assumptions or technical accounting, then I'm probably going to push it into Chris' direction to solve and answer after the meeting. And for the questions, I'll -- Alan and I will try and answer them but if we need some help or we think we can give you better color with the exec, I'll call on the exec to augment on that to the answers. Is that okay? So if you want to put up a hand, we'll get some microphones going. Why don't you go?

Question and Answer

Stewart Paul McGuire
Crédit Suisse AG, Research Division

Stewart McGuire from Crédit Suisse. Just one question for me. If -- the little dot chart on Page 34, you actually show your food like-for-like volumes. And if that's accurate, it looks like it's 0. So you've been able to generate your improved profitability without any food like-for-like volume growth, which was traditionally a key part of your strategy. Can you continue to grow profitability in a 0 growth volume?

Dave Lewis
Group Chief Executive & Executive Director

So the short answer to that question is yes. As Alan said, he talked about it in the U.K. in particular, the volume outperformance versus the market in the full year was 1.7%. So the critical thing for us is do we outperform the market in food volume in order to have the conversations with suppliers that we've had in the past? And we continue to do that. But the other thing that your question allows me to talk about, as I said at the end, as we talked about a recovery which was led by volume then augmented by mix, cost effectiveness and then new growth. So there are 4 levers by which we can recover margin, not just 1, all right? So the critical thing for us was to arrest the decline. We did. We've put in growth over the 3 years we have. And then we need to outperform the macro environment and volume is the way our suppliers understand it. And I'm really quite happy that there's still opportunity for us to do more of that going forward. Okay? Yes, pass it on.

Robert Joyce
Goldman Sachs Group Inc., Research Division

Rob Joyce, Goldman Sachs. Just on the number you put up there, the GBP 2.5 billion in terms of additional revenue hoping to get, with the original perspective, I think you had GBP 25 million of your cost-saving synergies coming from revenue. What revenue number was that based on?

Dave Lewis
Group Chief Executive & Executive Director

We didn't give one. And so I think, Rob, the distinction here is between what you can put in perspectives and you have to be able to demonstrate and prove versus actually what is an aspiration for us as there. And now all we're trying to do is now that we're not in that stage is share with you a little bit what is management aspiration for growth, right? And the management aspiration for growth that we set for ourselves over the medium term is GBP 2.5 billion. But you shouldn't try and translate that too much to what is that element that we put in because that was a known item that was very discreet, the GBP 2.5 billion is business we've still got to build.

Robert Joyce
Goldman Sachs Group Inc., Research Division

Okay, so I may follow on quickly on that. Just to -- does that mean we should look at that as incremental revenue? Does that drop through at a pretty healthy margin? How do we think about it?

Dave Lewis
Group Chief Executive & Executive Director

No, look, I think the hardest bit, what you should think about is the GBP 200 million that we talked about and we can see and how it is we might sort of choose to invest that in enhancing the offer versus dropping through to the bottom line, we're really clear about that. And we've given you a 3-year view about how we see it. The opportunity on top of revenue growth is depending which of those initiatives work will depend on the margin profile. So at this point for me to say it's going to be x, would be premature, right? I just want to give you a sense for the optimism that we have for the coming together. Okay. Why don't you just pass it, should we pass it down the line? That efficient?

Unknown Analyst

A question for Alan actually. Two for me. And thanks for the help on the Booker numbers in terms of last year in synergies and whatever. Could you give some indication of how you see the group balance sheet being this time next year after the equity issue, maybe a comment on working capital, free cash from Booker so we get a better feel just at this stage rather than throwing darts in the dark as usual as to how the group's going to look?

Alan James Harris Stewart
CFO & Executive Director

Yes. So the -- as Dave said, we are absolutely focused on free cash flow as the measure by which we want to be judging, and that's something which then creates the opportunities for us as a business. And that's after the CapEx, et cetera. In terms of the Booker impact, the GBP 120 million which comes onto our balance sheet at the time that of the merger is a number which is after paying away the dividend, the final dividend for Booker, so it's really augmenting our cash. We still have cash in our balance sheet and we'll continue to look at the balance sheet efficiency of that cash, obviously being conscious of the fact that we want to run a business which is secure and strong and stable. So it's a bit we'll continue to look at that. The -- going forward then, we get to the debt metrics that we've set out as threshold metrics beyond that. We are not there yet, we'll see where we get to. But critically, the focus on capital discipline, free cash generation, paying a dividend which over time is twice covered, we are just under 4x covered today, so there's a lot of growth potential within that dividend putting aside earnings growth, which equally gives us the potential to increase the dividend. And we then end up I think with a balance sheet which is a strong balance sheet, sustainable with the business which is generating very strong cash. The GBP 195 million of cash which Booker generated, which isn't again an underlying number, is something which as we've seen from Booker's track record, operating profit translates pretty closely into cash from a Booker perspective. In our business, there are some timing elements around the actual year-on-year net debt. And I'm really clear that we've got about GBP 200 million per annum of working capital benefit on top of the free cash flow generating from the business. Put that with the tax interest reduction from liability management exercises we've done, and we have a very strong cash generation in our business. Don't know if that helps, Clive.

Unknown Analyst

Sort of.

Dave Lewis
Group Chief Executive & Executive Director

Sort of putting together a little bit, Clive. Do you want to pass, why don't we just logistically go that way.

James Tracey
Redburn (Europe) Limited, Research Division

James Tracey from Redburn. One question for Charles if I can. I don't know if he's answering questions or maybe if you could do that, Dave. But what do you intend to do differently as CEO of Tesco U.K. retail?

Dave Lewis
Group Chief Executive & Executive Director

Definitely can answer that one, Charles?

Charles Wilson
Chief Executive Officer of UK & Republic of Ireland

James, I'll answer a question that I got asked during coffee. First of all, and then come onto your -- first of all, what did I see in Tesco which was a surprise that was bad, okay? We did a lot of due diligence before we joined forces, visited 200 stores before we came together. And actually what you see with Tesco is pretty much what you get. What was the pleasant surprise, okay, me joining Tesco because I might be here about 5.5 weeks, is actually the people. The Tesco people tend to keep themselves to themselves.

And so I had a good understanding of the business but I didn't really know Jason, I didn't know Matt, I didn't know Ali, I didn't know the rest it, the leadership team is really strong. When you're in stores, we've got some very, very strong store operators. And Jason and I have had the privilege of working together with some of the buying teams and the Booker buying teams and the Tesco buying teams getting on very well in Bar Hill because we're winning together. And also, what I saw when I came was the great work that Dave, Alan and the rest of the leadership team had done on culture, because the culture in Tesco is really, really good progress, and that's the great -- so when you asked me what am I going to do different is an evolution. There's some great work going on in this company and building on the good people that we've got, building on what we do, so really you're seeing in credits Matt Davies is good handover, I'm very grateful for the business we've received of making sure we trade business as usual. So as Tesco does a good job for Tesco, Booker does a good job for Booker customers, 5.5 weeks and we've made good progress on that. And then we're starting to say how we've build on that good work to deliver what Dave and Alan had been articulating. So James I hope that answers.

Dave Lewis
Group Chief Executive & Executive Director

Pass. I'll just -- is that okay?

Charlie Muir-Sands
Deutsche Bank AG, Research Division

Charlie Muir-Sands from Deutsche Bank. You showed a chart showing how you deliver cost savings ahead of your original dotted line plan. I just wondered whether you could sort of reflect on how much do you think is sort of a pull forward as opposed to finding more opportunities than you had initially hoped that were there? And whether you reinvested more or less of that than you'd originally planned either as well?

Dave Lewis
Group Chief Executive & Executive Director

So what I saw and you can in that if that's the case. I think, look, the -- we were very clear about where we thought the GBP 1.5 billion was going to come from. We gave 3 buckets of that. I think what we're seeing now is actually our progress on stores has been ahead of what we had originally thought, and we have seen some opportunities there that we didn't see at the start, and we've realized them and got on. I think, in other parts, there are some of the opportunities we saw actually were harder to get to them, always the nature of these things, is never lands the way that you do. So in logistics and distribution, actually because of principally because of Palmer & Harvey and now obviously with Booker, we're having to think again a little bit around what the changes in distribution logistics are. And I'm happy with where we are on goods not for resale. So I think the only thing I can say to you is we are happy with the GBP 1.5 billion target. It's largely in the way we thought it would be, but there have been some changes within. If the question is will we try and get that sooner? We'll always try and get it sooner. Will there be other opportunities after we have done that? Yes, we think there will be, but we're not at a place where we can articulate those for you. We need to concentrate on delivering the other half of what we've got. In terms of reinvestment, I think this is where it gets difficult because we need to put some of the volume leverage, some of the cost and some of the other things and the mix changes into that investment. But we have invested back. The most significant was the investment we made in farm brands. We made it ahead of, but you could -- actually if you were quiet at the time, it was -- in the end it was more than a GBP 300 million of investment. And that was paid for through a number of ways, not least of which a significant part of it was volume leverage and the cost savings. So that's where we are. That's how we see it. Slightly different from what we planned. We'll try and do it quicker. We're not at a place yet where we're going to raise the guidance because we've got to get on and get from GBP 820 million to GBP 1.5 billion.

Alan James Harris Stewart
CFO & Executive Director

The only thing I'd add is that what we set out and what we showed when we first spoke about that was a plan to which we'd been working for some time. And clearly, the world has changed since that time. Dave mentioned this Palmer & Harvey inflation is certainly a lot higher than anything that was anticipated, and that flows through into our cost base. And -- but no change. And the graph we were pretty clear was indicative and shouldn't be plotted. It's nice to be ahead of the one that we plotted because, clearly, there was some thought behind the plot that we gave -- did. But we are really confident that the 3.5% to 4% margin, despite all the changes, is something which we are well on track to deliver in the time frame that we set out.

Bruno Monteyne
Sanford C. Bernstein & Co., LLC., Research Division

Bruno Monteyne from Bernstein. Given your scale, given your reach, given your own background as your previous consumer group companies, is it right that your branded index is below your peers? If not, what you're doing about that? And what would the business look like financially and as a shape if you're able to get your brand index ahead of your peers?

Dave Lewis
Group Chief Executive & Executive Director

It is a great question. I think it's -- I've talked about the progress from where we were to where we are. I think I would, I know Ali would, I think we all still see there's still significant opportunity for the brand in total to your point and that's why it was the first of the drivers we talked about. The way that I would see it, but these -- as I know with brands, it's always very easy to talk about improvements, it's not always easy to deliver improvements and that's why I think what the team have done is so significant over 3 years. But look, the theory of marketing is such the more value you add to a brand, the more engagement and loyalties you have, allows you more discretion in terms of pricing. If you add value to a brand then it's repaid in that way, we're not at that place yet because of the things that you mentioned. But do we get to a place where actually as we continue to add uniqueness and relevance to the brand, that can change the economic model of Tesco. But we're not there yet. You would have seen on the way in, right? So if you didn't look at the own-label relaunch activity, would have also seen the naked kitchen activity, completely exclusive, unique to Tesco, bringing 44% new people into the category, something they can't get anywhere else, absolutely bang on trend. That is something exclusive that's relevant to Tesco that actually customers value. And ultimately a marketing theory that plays into price positioning. And that's the opportunity for adding value to the brand, and that's why it's so important to us. But it's a big brand to improve. So that's where we are. Do you want to pass back behind you and then we'll come...

Xavier Le Mené
BofA Merrill Lynch, Research Division

Xavier Le Mené from Bank of America. I'd like to go back to the Slide #5 actually at the U.K. and ROI profit. If I look at what you are printing today versus what you printed in the first half, we saw significant reversal of these prices, it was a negative impact in H1, it's a positive for the full year. For the mix, actually, it was significant positive in H1 and it seems to be a small positive for the full year as well. I know the scale is different, but can you elaborate on the trends in H2 versus H1 or the significant changes that the charts are highlighting?

Alan James Harris Stewart
CFO & Executive Director

So I think that the biggest driver, clearly, which we have highlighted, is our price positioning in H1 relative to price positioning in H2. And in H1, we took a very active decision in terms of the, as inflation came through into the market, a number of us -- of participants had hedged to a certain degree, that hedge began to unwind, and we saw inflation coming into the market and it was pretty strong, we held back, we worked with our suppliers to try to absorb that for as long as possible. And frankly, we absorbed a lot of it ourselves so what we couldn't work with suppliers. And that impacted very positively in terms of our perception. But clearly, there was some cost to us in terms of the business. We got a volume benefit from that, and that played through. As we then moved to the second half of the year, the price positioning and the inflation, we didn't hold back on as much. And as some people have commented, some of that was passed through into the market. Important there, this is what Dave spoke about, is the relativity. Because as a customer I'm buying today relative to what else I can buy today, the fact that 6 months ago it was different is interesting but I can't buy it. So it's really important how am I relative to what else of my choices in that day. And that's what we've seen. So to the point of second half, first half, we definitely had, we were more aligned with the market in terms of the inflation, but we continued to grow the volumes relative to the market over the full year, that 1.7% that Dave spoke about. Then you have some timing impacts in respect of when cost saving initiatives happened, when they didn't. But overall, that's I think the biggest trend I'd call first half, second half.

Dave Lewis
Group Chief Executive & Executive Director

Pass to your right and then we'll come forward and then we'll just...

Fabienne Caron
Kepler Cheuvreux, Research Division

Fabienne Caron, Kepler Cheuvreux. So we have got a boring question for Alan, IFRS 16 will be implemented in January '19. Have you decided yet which method will you use. And can you give us a feeling of the increase of the NPV of the operating lease following IFRS 16?

Alan James Harris Stewart
CFO & Executive Director

I can answer part of that question. Yes, we have decided. Very deep in the detail of the press release, we've confirmed that we will adopt the fully retrospective basis for IFRS 16. We feel that this best aligns the future with the past and gives the best reference point for the comparison as we go and we restate. It's effective in the '19, '20 year, so the year we've just entered will be the comparative year. We will be restating. There's a huge amount of work across the Tesco group to do to understand all of that. We are well on track on that, but we don't -- we are not able to quantify that yet. But as you know, it will impact our assets, our liabilities, our depreciation, our interest. No cash impact. But as soon as we are able to quantify and give more color on it, that's what we'll do. But we have confirmed that we're going the fully retrospective route.

Fabienne Caron
Kepler Cheuvreux, Research Division

Okay. But we should still go find increase in your operating lease commitment and when you will use IFRS 16 compared to what you published today?

Alan James Harris Stewart
CFO & Executive Director

The way we disclose our -- yes, there are differences. And under the current lease obligations, the standards require that we take the lease obligations and discount them to lease breaks. IFRS 16 puts the asset on to the balance sheet effectively forever, and that will be a change. Within our notes, we do have the -- what we capitalize on the balance sheet and we show discounted, that and then we also have the future lease commitments shown in our notes. So if you add the sums together, you can begin to get to that. Obviously, the rating agencies have their own metrics which try to get to it as well. But it's pretty technical, pretty complex. Fundamentally, cash doesn't change.

Dusan Milosavljevic
Joh. Berenberg, Gossler & Co. KG, Research Division

It's Dusan from Berenberg. I just had a question for Charles. It's kind of a bit of a hypothetical question. But what is the operating leverage effect in the Booker business for incremental unit of growth that you've seen over the years?

Charles Wilson
Chief Executive Officer of UK & Republic of Ireland

It's not a hypothetical question because it's easier to draw off history. So we -- where we were converting was pretty much 10% growth in earnings would -- 10% growth in sales would equate to about a 12%

growth in earnings, which would come through to the cash bottom line pretty hard and fast. And that's what you've seen over the last 5 years.

Dave Lewis
Group Chief Executive & Executive Director

Do you want to pass the microphone forward and then I'll go, go back. Here we go. [indiscernible]. Keep a hold of it.

Daniel Ekstein
UBS Investment Bank, Research Division

It's Dan Ekstein from UBS. A question around procurement. Hope it meets your expectations in terms of quality. I'm interested particularly around supply negotiations post the Booker deal. You do have a target for procurement gains and I know you hope to outperform that. Are we simply thinking about a case of going one price list versus the other and ticking off the differences? Or is it going to be more a case of starting from a position of 0 with your key suppliers and thinking more holistically about the retailer, supplier relationship with what's a very different group, particularly in terms of points of presence with the customers? And if it's the latter, then if I am the supplier, how should I think about maximizing my relationship with Tesco Booker in a profitable way?

Dave Lewis
Group Chief Executive & Executive Director

Why don't I give you an introduction and, Jason, give you 1-minute warning then I'm going to ask you to add something to it. I think, look, the -- Charles and Jason have started the conversations with 39 of the largest supply partners we have. I think it's fair to say that always, when something like this happens, there is an element of looking at the price file and looking at the relative prices between the 2 businesses and seeing where there are opportunities. That's a relatively straightforward thing to do. And then there has to be a conversation about how things like that can be resolved. And there, Jason can talk about the approach that we have to do in that. I think the -- you should know, I hope, over the last 3 years, we've talked about how it is we want to work with suppliers in true partnership. And we are going to take that principle forward, and it works even better with the enlarged group than it did even on a Tesco stand-alone basis. So the bit that I would say before I pass to Jason to give you a little bit more insight into it is if I were a supplier and I was sitting here now, I would be sitting at home saying just a second, I've got the largest retailer in the U.K. that's growing again. I've got the largest wholesaler in the U.K. that continues to grow very strongly. And I'm looking for growth in my business. And they are saying that their own aspiration is to grow another GBP 2.5 billion in revenue. I'd be sitting down thinking how it is I align my plans with the opportunity that, that full channel business affords me and actually how can I change my business to work with that more efficiently and better. I've said before, when I -- the happy days were when I was a Chairman of the Unilever in the U.K., Tesco will by far in a way my toughest partner in terms of negotiation. They got the best terms. But they were also my most profitable customer because I was able to change my business to work with them more efficiently. And that's part of where we want to be with all of our supply partners and coming together with Booker doesn't change that, it just enhances it. Is that enough warning, Mr. Tarry?

Jason Tarry
Chief Executive Officer of UK & ROI

Yes, as I have a cough you've seem to have answered the question and definitely are up to it. I think the good -- I think it's a good question. I think it's worthwhile outlining approach actually which is we met the suppliers in Bar Hill very deliberately because what we wanted to do is talk to them about growth and talk to them about speed and show them some tangible examples of that. And that was absolutely our approach. And that is what we did. We showed them around Chef Central. Charles and I talking through the growth opportunities as we saw it. And then we talked about the fact that we have found some anomalies around the price files 2 businesses, 2 price files, 1 business, 1 price file. But actually, that is -- the approach is very much to focus on the growth opportunities, the bigger, holistic opportunity, and let's get going quickly in that speed into getting after those growth opportunities together. I think your point is well around reach is very interesting. And if you actually add up the distribution points, either directly or indirectly through Charles' customer base, it does give us quite unparalleled reach in the U.K. And definitely you can see the suppliers seeing the opportunity of that.

Dave Lewis
Group Chief Executive & Executive Director

Good. Okay. Who was that? David? [indiscernible]. Yes, I'm just going to finish this row and then we'll go backwards there. Here we go.

David McCarthy
HSBC, Research Division

It's Dave McCarthy at HSBC. Just want to come back on that synergies. You've given a figure of GBP 60 million for the first half -- sorry, first year. You know the equalization of terms is going to be pretty huge, I would expect. If we take the figure you've given, it's suggesting to do the maths, I won't run you through it now, but it's suggesting that Booker was only paying about 1% more for products than Tesco was, which doesn't sound right. And what we've got from published statements and statements by competitors, that figure is actually closer to 10%. So why is that figure so low when the equalization should be so much higher?

Dave Lewis
Group Chief Executive & Executive Director

I think we will have -- and I suspect we will have a more detailed conversation about it, David. The only thing I would say to you is I think when I look at some of those publicly quoted things coaching horses that I could drive through it in terms of actually how the market works, but that's my own personal point of view, and now having seen the price file, all I would say to you, and I won't go any deeper because it would -- it gives off some sort of competitively sensitive thing, it's nowhere near as neat and tidy you think it is. Nowhere near the entirety if as you think it is.

David McCarthy
HSBC, Research Division

Equally there's going to be a number of lines where Booker was buying cheaper than you and you got 10x the...

Dave Lewis
Group Chief Executive & Executive Director

There are opportunities, there are definitely opportunities, Jason and the team have to realize the opportunities. We've got to remember, it's always with the supplier to set the price of their product, now as we can ask, but there is a subject to negotiation. And we've been very clear about, we don't set that, they set it. They have to decide whether they want to address some of the differences that might be in either part. So let's see how we go. We've got a series of assumptions. We shared with you the assumptions. And as I have said, try and beat them. Try and beat them, right? But we need to get on with it and realize some thing and then we'll share it with you when we've done it. Right. Should we go backwards.

Alan James Harris Stewart
CFO & Executive Director

Why don't you pass that one. and then we can try and pass to the next person who's going to get this one.

Sreedhar Mahamkali
Macquarie Research

Sreedhar Mahamkali from Macquarie. One question and a very short follow-up, if I'm allowed. The question is, you've talked quite a lot about first half, second half shape of last year in the U.K. the puts and takes. As you look forward, does the second half that you've just finished, does that represent more accurately the year ahead? How do we think about it in terms of puts and takes? Or do you see slightly greater need for reinvestment back in the offer? That's the first one. And the follow-up is the GBP 2.5 billion, is there any way you can give us some kind of magnitude, Booker versus presumably you'll report Booker sales as Booker. How much of that we should be looking to see in Booker and how much in Tesco, for instance?

Dave Lewis
Group Chief Executive & Executive Director

Right. So take the follow-up first. At this stage, I can't break that down, I won't break that down, it's going to be as a combined business, because I absolutely want to keep the businesses together, it's a new opportunity that comes from both being together, so it's GBP 2.5 billion for the combined group. When we come to report actual performance, we'll give you the insight, but there's no breakdown of GBP 2.5 billion because it's only facilitated by both businesses being together. In terms of...

Sreedhar Mahamkali
Macquarie Research

How you should -- just absolutely the profit from that isn't in the GBP 200 million? Whatever profit you generate out of GBP 2.5 billion...

Dave Lewis
Group Chief Executive & Executive Director

GBP 25 million of that is in the GBP 200 million, right. We've now got to get a growth trajectory above, we think it's GBP 2.5 billion.

Sreedhar Mahamkali
Macquarie Research

Okay. So GBP 25 million profit out of GBP 2.5 billion...

Dave Lewis
Group Chief Executive & Executive Director

Yes, so we're GBP 175 million of cost, GBP 25 million...

Sreedhar Mahamkali
Macquarie Research

You're putting in that 1%...

Dave Lewis
Group Chief Executive & Executive Director

Exactly. To your earlier question, what do we see? We see inflation getting -- being lower going forward than we saw last year at a consumer price and when we look at commodities and we look at -- I think the last month was 0.8 versus net 3% for last year. So you can see that. That's partly competitively driven as much as just so the cost price is driven. So I think the market stays competitive in that sense. I think the other thing that we should say and we see is there are some challenges in terms of some of the cost sides of the business. And for us, that's one that's most on our minds at the moment is distribution. As we go through Palmer & Harvey, bringing Palmer & Harvey into Tesco is definitely an oncost for us. We had it where it was for a reason. And we need to work that through, thinking through the Booker network, Tesco network, once -- to find the right way to do that, because it's very clear that, that complexity does affect our operation and we need to find the right way to do this. So that's a challenge that we have. I think that's exacerbated and you will have seen this elsewhere by, particularly in the transport sector, there's pressure in terms of transportation now in terms of drivers and cost. So that's a feature, that's a new headwind, if you like, that will -- the industry will see a little bit of as we go forward and we've got plans to sort of mitigate that. So the only new feature I see going forward is that unique dynamic we have about what the right distribution and logistics make a business as we bring the groups together and there's a lot of detailed work going on, on that.

Sreedhar Mahamkali
Macquarie Research

Specifically, in terms of your pricing position versus your competitors, you're happy with the way you...

Dave Lewis
Group Chief Executive & Executive Director

As Alan touched onto that, we're very happy. So people will talk about points of inflation, if I look at where we are in terms of price relatively as we exited our financial year, happy where we were. Is there more -- is there a competitive activity in the marketplace? There is, and as always, we'll decide how it is we choose to react. I think the most important thing and the thing that's worked so well for us over the 3 years is we've decided what it is we want to do for our shoppers, right? And so actually most of our pricing decisions are based on the conversation with our shoppers. And we've got away from reacting to all little initiatives and big initiatives that go everywhere else, and that's what we'll continue to do. And that's exactly how we see it. Inflation, we don't see it being as big as it was last year. There's still some pressure there, so we'll be in the usual game of deciding actually how it is we can manage, invest, deliver the profit. That's just our normal -- but there's nothing new that I would talk about in that offer going forward at this stage.

Alan James Harris Stewart
CFO & Executive Director

But in terms of shape, first half, second half, what we've done is we've grown and we've grown. We're exiting with 230 -- 2.3% margin in the U.K. business, group at 3%, and that's a firm base to which to start this year.

Dave Lewis
Group Chief Executive & Executive Director

That's right.

Borja Olcese
JP Morgan Chase & Co, Research Division

Borja Olcese from JPMorgan. One for Alan. Your retail free cash flow, GBP 1.4 billion in the year, included GBP 500 million working cap and almost GBP 400 million from disposals. These are big numbers, obviously. How do we think of these 2, in particular, going forward?

Alan James Harris Stewart
CFO & Executive Director

The -- and there are some timing impact in that which we highlighted. We spoke about the Palmer & Harvey administration. We also spoke about and highlighted or tried to highlight in our release, the fact that there is still GBP 60 million to pay in respect of the compensation scheme. So there were some and there's potential outflows in relation to the HMRC. So there are moving parts. And one of the difficulties about Tesco is that the numbers are very big and they can be quite lumpy and we just have to recognize that equally the timing of when some of our coupon payments and our bonds might well impact year-on-year. But overall, I think the way that I think about it is grow the operating cash from the business; manage the cash flow on CapEx, which we had a bit of an outflow last year, the GBP 200 million that I mentioned. But generally, I would expect and hope that, providing our CapEx is stable year-on-year, our cash utilization should be pretty much the same year-on-year. And that was this year GBP 1.1 billion, indicated a little bit more is what we're targeting now. But generally, in year, that should be about the same level. And then the other impact that we -- as I look forward, obviously, as we make more profit and we utilize past tax losses, we pay more cash tax. And then just again a flag, this is going to impact everybody in the market, HMRC and the U.K. are bringing forward the payment on account regime, and we will impact -- and that's effectively a payment outflow from a working capital perspective and that will impact over the next couple of years. But broadly, the way we think about it is generate the cash from the business, spend it wisely within it and then get to the free cash flow. I think this year was -- in fact, there were some favorable elements in it. And then the lumpy elements also will be some of the property and other items which we don't have a huge amount of control over but we choose to invest to make money or invest it as the circumstances arise.

Dave Lewis
Group Chief Executive & Executive Director

Very good. Go ahead.

Andrew Philip Gwynn
Exane BNP Paribas, Research Division

So it's Andrew Gwynn from Exane. I'm going to be the person that asks about Asia again. So you've flagged the 2 factors, so 6% wholesale, 3% from lower vouchering if we look at the Q4 performance, minus 14%, obviously it's about 5 percentage points of like-for-like. So I'm just wondering what's happening there, because obviously the profit is growing, forget the margin, as absolute currency adjusted profit is growing and there you've got some very, very weak underlying like-for-like unless something else going on there that I'm missing.

Dave Lewis
Group Chief Executive & Executive Director

Go ahead.

Alan James Harris Stewart
CFO & Executive Director

So yes, the key drivers that I would talk or the highlight are the ones we've spoken about, the 6%, the 3% and the 1% deflation. There is -- and again, we've tried to be as clear as we can be in terms of the numbers. As we looked around the group and the way that we were accounting for some small elements of sales, particularly in the Asian business, to a lesser degree in the European business, an element of previous wholesales are now being accounted for as a consignment basis, again no change to the cash that we are receiving but there is an element of that, and if you look at the specifics in the numbers. In the back of the deck, we've highlighted the adjustments we've made. And Chris and the team can take you through that, but that's probably part of what you're pointing at.

Andrew Philip Gwynn
Exane BNP Paribas, Research Division

So I suppose a simple question. What's the underlying like-for-like within Asia?

Dave Lewis
Group Chief Executive & Executive Director

If you strip out the numbers, I'm looking at Tony if he wants to add something as we talk, I think we see at the moment and again, if I look at the last month, which is on my mind, I think our food sales are up over 3% like-for-like in Asia as we come out the annualizing of that, the market is deflating. So if you look at the Thai market, not just ourselves but everybody else, there's deflation in the marketplace, there's some government couponing that we need to understand in terms of what the impetus of that is going to be on the marketplace. But in the core bits of the turnaround of the Thai business and the restructuring of the whole proposition, if I look at core food, last 4 weeks, 3.2% like-for-like gives you the best indication, stripping out all the bulk and the couponing and was that -- Tony, do you want to say anything else on top of that?

Tony Hoggett
Chief Operating Officer

Like before I think you've answered it, but I think it will be just to reiterate, this is a volume recovery volume growth and quality of growth going forward, big traditional market which is about half the market. And part of that sale that you've seen come out was driving that market was going into that market and wasn't profitable. So as you see the year ahead growing profits, growing sales in a profitable way.

Dave Lewis
Group Chief Executive & Executive Director

Okay. Want to go?

Nick Coulter
Citigroup Inc, Research Division

It's Nick Coulter from Citi. Just a point of clarification, if I may. Similar to the GBP 1.5 billion target that you have out there, can I clarify that the GBP 175 million target is your gross savings target from the Booker merger, which, of course, you will probably beat and you'll probably retain, but just to check that, the GBP 175 million is gross rather than the net?

Dave Lewis
Group Chief Executive & Executive Director

Correct. Please?

James Robert Grzinic
Jefferies LLC, Research Division

James Grzinic from Jefferies. Very quick question, strategic question really. As the free cash flow profile of your U.K. business really improves, does that open up options, strategic options, for the more cash-generative businesses outside the U.K. I'm thinking particularly Thailand?

Dave Lewis
Group Chief Executive & Executive Director

Can you say some more about what -- I'm not sure I got the last bit of what you said. Does that provide opportunities for?

James Robert Grzinic
Jefferies LLC, Research Division

Strategic options in terms of international businesses, the more cash-generative international businesses?

Dave Lewis
Group Chief Executive & Executive Director

I think -- so look, I think what we think is getting ourselves back to is what I tried to say is our intention through driving cash profitability, the earnings growth and the free cash flow enhances again the balance sheet and gives us all sorts of optionality as we do that. I don't think you should at this point take that trajectory to, in any way, infer that there will be a change in the international strategy that we've laid out. We're still in a place which as we see big growth opportunity in Thailand that returns very well and we continue to invest and we continue to open stores in Thailand. In Central Europe what Matt's doing is reshaping that portfolio. We've closed unprofitable stores, we're thinking about different propositions that can work better in a couple of those key markets. That keeps us absolutely busy, all right? And what we've got going on in Ireland, that keeps us absolutely busy, so I wouldn't at all infer on how it is we philosophically see the improvement about not just the U.K. but the group into a change in international strategy at this point, not at all.

James Robert Grzinic
Jefferies LLC, Research Division

Very clear. And are you working on a new discount chain for the U.K?

Dave Lewis
Group Chief Executive & Executive Director

Never ever comment on any innovation ever. And I'll give the qualification to that because people always -- you get into a no-win situation, which is while he didn't say this or he did say that and people second guess and you get yourself into all sorts of thing. So flat no on anything that's in the innovation book

whether it's a good idea or bad idea, yes or no, no comment. So you can't read anything into it ever, all right? And at least I've been consistent about that for 3 years, I'm not just starting now, all right?
Is that it? Don't see any more arms in the air. So hopefully, we've answered all of your questions. I'm sure we'll talk more over the days and the weeks to come. Thank you very much for listening. As I say, 2 things for me: Strong set of results, very pleased with the Tesco colleagues and what they've managed to deliver together over the last 12 months. But hopefully, you'll see that, over 3 years, that's the consistent trajectory and we're really, really very excited to have Booker and Tesco U.K. together and the opportunity that, that can bring in terms of new growth, new thinking to our largest business in the group. So thank you very much for your time and your attention. Cheers.