Y 2022 Earnings Call

Company Participants

- Imran Nawaz, Chief Financial Officer
- Ken Murphy, Group Chief Executive Officer

Other Participants

- Andrew Gwynn, Analyst
- Andrew Porteous, Analyst
- Borja Olcese, Analyst
- Clive Black, Analyst
- James Anstead, Analyst
- James Grzinic, Analyst
- Maria-Laura Adurno, Analyst
- Nick Coulter, Analyst
- Rob Joyce, Analyst
- Sreedhar Mahamkali, Analyst
- Thomas Davies, Analyst
- Victoria Petrova, Analyst
- William Woods, Analyst
- Xavier Le Mene, Analyst

Presentation

Ken Murphy {BIO 18844208 <GO>}

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

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

I'm delighted that in agreement with Asda and the UK, we've been able to agree a substantial new pay deal for our UK store colleagues, as well as a further thank you payment in recognition of colleagues amazing contribution last year. Our future success depends on our colleagues and our commitment to them has never been stronger.

Before I reflect on business performance, I wanted to take a moment to speak about the war in Ukraine. All of those affected are in our thoughts. We were really quick to respond together with our colleagues and customers doing whatever we could to help. Our teams in Central Europe started to transport donations of food and other essential items to the border within hours of the conflict starting, as well as supporting with logistics and supply chain capability at the border.

To-date, we have supplied nearly 1,000 pallets of food for humanitarian organizations and are helping in other ways too, such as making it easier for refugees to access job opportunities and removing all the charges from calls and money transfers to Ukraine. As always, the generosity of Tesco colleagues and customers is incredible. Together, we have raised almost GBP4 million to support the vital work of the Red Cross, as well as more than GBP500,000 for humanitarian organizations in Central Europe.

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

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

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

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

Over to you, Imran.

Imran Nawaz {BIO 20578333 <GO>}

Thank you, Ken. Good morning, everyone, and thank you for joining us. I'll start with an overview of performance, followed by some more color on trends and drivers. Throughout my review, percentage growth rates will be expressed in constant currency, unless stated otherwise.

In the year, we have delivered a very strong performance in all of our key metrics across the Group. Group sales grew by 3% on a one-year basis and by 10.2% on a two-year basis with a strong performance across all regions on top of exceptional sales last year. Group profit increased by 58.9% to GBP2.8 billion. This reflects the strong sales performance across the retail businesses, a reduction in COVID-19 costs and a return to profitability in the Bank; partially offset by inflationary pressures in the cost base and ongoing investment in the customer proposition.

You will remember that at the half, we introduced a simpler retail free cash flow measure. And on this basis, retail free cash flow was GBP2.3 billion, up GBP0.9 billion on last year. This was driven by higher retail operating profits, the elimination of the UK pension contribution, following our one-off contribution last year and a working capital benefit from higher sales; partly offset by an increase in capital expenditure.

Net debt at the end of the year was GBP10.5 billion, GBP1.4 billion lower than last year, primarily driven by the strong free cash flow generation. In line with our targeted payout ratio of circa 50% of earnings, we have proposed a final dividend of 7.7 pence per ordinary share, taking the full-year dividend to 10.9 pence per ordinary share, an increase of 19.1%. Our headline earnings per share of 21.86 pence represents an improvement of 88.8% with the recovery in Retail and Bank profits more than offsetting the higher tax charge.

Total retail sales for the year were GBP53.8 billion with profit of GBP2.6 billion. Both our UK and Ireland and Central Europe segments delivered a strong profit recovery with quantum profits exceeding '19-'20 levels for each segment. Tesco Bank generated GBP176 million of profit compared to a loss of GBP175 million in the prior year.

Over the next few slides, I will cover the performance of each of our segments in more detail starting with sales before moving on to profit. Sales have shown good momentum in each of the UK, Ireland and Booker businesses. You'll see the exceptional growth on a two-year basis with substantially higher sales than before the pandemic.

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

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

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

As anticipated, with some of our customers choosing to return to shopping in our stores, we did see a decline in online sales, especially as we lapped last year's peak demand in the second-half. Our online business remained significantly larger than before the pandemic with two-year like-for-like of 66%, which equates to GBP2.3 billion of additional online sales. We were pleased that our convenience stores returned to growth in the second-half with a particularly strong growth in our on-the go stores as City Center footfall started recovering from Q2 onwards.

Turning to performance by category. Food, obviously, reflects the majority of our business; and for the year as a whole, delivered sales that were slightly down, reflecting elevated levels of in-home consumption in our base. Looking across the year, we saw food sales declines in Q1 as we lapped the start of the first lockdown and the period of stockpiling followed by growth across both Q2 and Q3. In Q4, food sales did decline year-on-year, reflecting very strong comparators.

We saw strong growth in both GM and clothing in the first half of the year, which reflects lower discretionary spend in the first lockdown last year and a benefit this year from the continued closure of non-essential retail. Growth in clothing was particularly strong especially in kids and leisure wear as we continued to evolve our ranges to reflect changing customer demand. As a result, we were able to achieve a higher proportion of full price sales, supporting our profitability.

Our non-food performance also benefited from rebalancing our space in 116 stores over the last couple of years, making our clothing more of a destination and our GM ranges simpler and easier to shop. On a two year basis, we delivered growth across all three categories: 8.1% like-for-like in food, 1.6% in GM and 15.1% in clothing.

Turning to Ireland, where sales were 10.6% higher than pre-pandemic with a strong performance across all categories and all channels. On a one-year basis, our sales declined by 2.9% as we traded over a strong performance in the prior year, reflecting the market impact of stockpiling in Ireland and the longer period of restrictions on hospitality. We continue to see strong growth in our online business where we have increased geographic coverage and expanded Click & Collect locations from 28 to 65 stores. Online now represents 8% of our sales in Ireland. We've announced our intention to acquire 10 Joyce's stores in Galway, providing us with a platform to reach more customers and to bring online to more locations in the west of Ireland. Subject to regulatory approval, we expect to complete this transaction this year.

In Booker, sales have grown strongly on both a one-year and two-year basis. Performance versus last year was driven by the sharp recovery of catering sales, which grew by 56.1%, as the hospitality sector reopened for outdoor dining in April and indoor from mid-May onwards. Given the level of COVID-19 distortion, I have included some quarterly charts here on a two-year basis. You will see that our retail business has delivered very consistent growth on a two-year basis, maintained increased sales from last year. We are really encouraged by our strong customer retention supported by maintaining our keen focus on pricing. Our catering business recovered strongly from Q2 onwards. And we worked hard to mitigate the impact of significant supply chain challenges. Growth in Q4 was lower than in Q3 due to the emergence of the Omicron variant and its impact on the restaurant industry.

In Central Europe, like-for-like sales were up 2.9% on a one-year basis and 2.5% on a two-year basis, with growth across all channels and categories. In addition to some benefit from inflation, we saw a strong one-year performance from non-food. We were able to offer our full range following non-food sales restrictions last year, and so our customers returning to our large stores. In addition, we've doubled the size of our online business over the last two years, albeit from a relatively small base.

Moving on to profit. As you can see on this graph, Retail operating profit improved by GBP686 million year-on-year to reach GBP2.6 billion, driven by our UK and Ireland segment. In the UK and Ireland, profit growth of 35.4% was driven by a number of factors. In the UK, COVID-19 cost reduced from GBP892 million last year to GBP220 million with this year's cost primarily relating to absence for those colleagues who were sick or self-isolating. We benefited from a sales recovery in categories that were particularly impacted by COVID-19 last year, including margin-accretive categories such as clothing. We invested in customer shopping trip, in price and service. Our efficiencies across the year mitigated the operating cost inflation that we saw coming through, especially towards the end of the year.

In Central Europe, profit was up 41.1%, again, reflecting lower COVID-19 costs. Non-food sales grew strongly following the restrictions last year and we benefited from higher mall income. As in the UK, we continued to invest in our customer offer and our operating efficiencies and largely mitigated cost inflation.

Turning to Tesco Bank. We have seen some recovery in volumes this year, driven by an increase in new business although lending balances still remained below '19-'20 levels. The Bank's return to profitability was predominantly driven by the year-on-year movements in bad debts. The profit also included a GBP13 million contribution from Tesco underwriting, which is now fully consolidated following the acquisition that we completed back in May. As you can see from the ratios on the slide, the balance sheet remains strong. As a result of the stronger performance this year, the Bank paid an GBP87 million dividend to Tesco Group, consisting of the usual GBP50 million, plus a catch-up of GBP37 million in relation to the dividend paid last year.

This slide gives you more detail on the components of our statutory profit performance, which increased by 186% as higher adjusting items and tax charges were offset by a reduction in finance costs. Formerly known as exceptional items and now as adjusting items, we incurred GBP265 million of adjusting charges in the year. As mentioned at the half, this was driven by GBP193 million settlement, relating to historic shareholder litigation claims, which was paid in full in the year.

Net finance costs were GBP542 million, including a fair value remeasurement credit of GBP123 million, primarily relating to the mark-to-market movement on inflation-linked swaps, which was a significant change to the prior year. Before fair value remeasurements, net finance costs were GBP58 million lower than last year at GBP665 million, driven by lower net pension finance costs and a lower interest charge on lease liabilities. Our tax charge was GBP510 million, up from GBP104 million in the prior year. This reflects the growth in operating profit, both in our Retail business and in Tesco Bank. We also incurred a one-off charge due to revaluation of our deferred tax liability, following the increase to the UK corporation tax rate from 19% to 25%.

Moving now to our cash performance. Based on the simplified definition that we introduced at the half-year, we generated GBP2.3 billion of retail free cash. And I'll talk you through the major components and year-on-year movements. Before working capital, you'll see that we generated GBP4.3 billion of retail free cash from operations, an increase of just over GBP1 billion. This reflects higher sales and lower COVID 19 costs, as well as the benefit this year of GBP351 million from no longer making contributions to the pension scheme,following our one-off contribution last year from the Asia disposal proceeds.

Our total working capital inflow was GBP501 million, mainly driven by a sharp recovery in fuel volumes and the recovery of Booker's catering business in the first-half. Working capital in the second-half was then broadly neutral with the typical seasonal unwind after the summer peak being offset by strong sales in the UK and higher fuel payables, reflecting both volume and cost price inflation.

Capital expenditure was GBP1.1 billion, in line with our guidance range and we have provided the usual breakdowns by region and type in the appendices. This was GBP148 million higher than last year's CapEx, reflecting more store openings across the UK and a continued expansion of our online proposition in both the UK and in Ireland. We paid GBP641 million of interest costs; of which, GBP402 million related to finance charges on lease liabilities and GBP239 million to interest paid on bank debt.

Cash tax paid was GBP195 million, benefiting from three factors. First, a benefit of GBP120 million from the one-off pension contribution last year, following the disposal of our Asia business. Second, a benefit of around GBP80 million from the new super-deduction for certain capital investments, which was introduced in March 2021. And third, a benefit from the utilization of prior year losses. We expect the first two of these factors to recur in the coming year. We received GBP109 million in dividends from Tesco Bank and property joint ventures and purchase GBP144 million of shares in the market to offset dilution from share schemes. Finally, capital repayments of leases was GBP571 million.

I have included this next slide to describe the performance of items now outside our simplified definition of retail free cash flow. The net business acquisitions and disposals line here includes GBP122 million of proceeds from the sale of our business in Poland to the Salling Group, which completed in March. Net property proceeds and purchases of GBP228 million relate to GBP308 million from the sale of properties, partially offset by an GBP80 million outflow related to property buybacks. The property sales included a disposal of our Fenny Lock distribution center, along with the sale of properties in Poland that were not part of the corporate transaction with the Salling Group. Partly offsetting this, we bought back one extra store in Barry and a full stake in The Tesco Sarum Limited Partnership, bringing 11 stores into full ownership.

Adjusting items principally covered the historic shareholder litigation claims that I mentioned earlier, which were fully settled in the year. On the previous definition therefore, we generated GBP2.3 billion of retail free cash flow compared to GBP1.2 billion in the prior year. In the coming year, subject to regulatory approval, we expect our other cash items to include the cash consideration for Joyce's, as well as a circa GBP200 million proceeds from the sale of 17 malls and one retail park in Central Europe that we agreed this month. We also exercised the option in February to buy back our partners' equity in the Tesco Dorney property joint venture, which we expect to complete in the fourth quarter of this coming year.

Turning to the balance sheet. Total indebtedness was GBP10.8 billion, down GBP2.2 billion with all three components of indebtedness reducing year-on-year. Due to the impact of market movements on our pension assets, we carried a GBP2.1 billion IAS 19 pension surplus at the end of the year, in comparison to a GBP1 billion deficit last year. In line with our definition, this surplus has not included indebtedness, so the GBP0.2 billion deficit that you see on the slide reflects only the pension schemes that are in a net deficit position. We also saw a GBP0.9 billion reduction in net debt before lease liabilities, driven by our strong cash generation. Finally, lease liabilities themselves reduced to GBP7.9 billion, following the purchase of our partner's stake in The Tesco Sarum Limited Partnership that I mentioned earlier, as well as the sale of our Polish business.

Our total indebtedness ratio was 2.5 times compared to 3.6 times last year. Our new leverage ratio, net debt to EBITDA was 2.5 times compared to 3.3 times last year, and is midway in our target leverage range of 2.3 times to 2.8 times. Our fixed charge cover was 3.5 times, up from 2.9 times. Along with higher retail EBITDA, the reduction in lease interest payments and lease capital in prepayments more than offset a small increase in net finance costs.

I wanted to close by talking about shareholder returns. We have delivered a strong performance this year across sales, profit and cash generation. And this does, of course, flow into shareholder returns. First, in line with our targeted payout ratio of circa 50% of earnings, I'm pleased that the proposed full-year dividend is an increase of 19.1% at 10.9 pence per ordinary share. This increase reflects the growth in Retail and Bank operating profits, partly offset by the impact from last year's dividend policy exception. As I mentioned in October, we intend to pay a progressive dividend going forward. Second, having launched our ongoing buyback program in October, we have already purchased GBP300 million worth of Tesco shares to-date. I'm pleased to be able to confirm today a commitment to buy back a total of GBP750 million worth of shares over the next 12 months.

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

Ken Murphy {BIO 18844208 <GO>}

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

Price is a critical component of Magnetic value. And we have been unwavering in our commitment to keep prices as low as possible for our customers. Although we could not have foreseen all of the increasing pressures the consumers are starting to face, our efforts over the last 18 months or so have put us in a really strong position to help.

You can see from the chart that we have strengthened our competitiveness throughout this year, reaching our strongest relative price position for many years. As a result, we are much better placed than we were the last time the market experienced significant levels of inflation. Importantly, customers are recognizing this too. Our value perception has gone from strength to strength. Over the last couple of years, you can see a meaningful gap opening up between ourselves and the rest of the big four supermarkets over five full percentage points.

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

Clubcard Prices have also landed really well with customers. From the initial trials back in September 2020, we have now moved all of our promotions on to the scheme, as well as providing customers with a really clear sense of how much they are saving, it also enables us to negotiate the very best discounts for them with our suppliers. The most recent addition to Clubcard Prices was our iconic lunchtime meal deal. This allowed us to keep the price at an inflation-busting GBP3 for anyone using their Clubcard; at least 50p cheaper than most of our competitors and at the same price as it was 10 years ago.

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

Magnetic value was also about ensuring that we are offering our customers fantastic quality. I'm delighted that we've been able to step forward on this front too, particularly in a year with so many supply chain challenges. On the product development side, we launched over 300 new products in the year, including, adding a significant number of new seasonal lines to our Christmas range. We have also continued to work on reformulation, improving the quality of over 500 lines.

Finest is a key focus for us as it offers customers the chance to trade into more premium products without needing to shop elsewhere. At a time when customers are recalibrating their choices as to whether to eat in or out, it's really important to have a great offer to suit every meal occasion. The Finest range includes around 2,000 products and grew by 9.3% this year; generated sales of GBP1.7 billion, making it the UK's largest premium food own brand.

As a result of our efforts so far, you can see from the chart that we delivered an improvement in quality perception this year against the market trend. You may remember that we launched ambitious new health commitments across all of our markets a year ago. Over the course of the year, we have continued our reformulation program looking at ways to improve the nutritional characteristics each time we touch a product, either reducing the fat, sugar and salt content or increasing dietary fiber. In total, we have removed a further GBP7.7 billion calories from our own brand ranges this year.

Demand for plant-based products has remained high. Since our 2018 baseline, we have now grown sales of plant-based meat alternatives by 130% in the UK. In December, we launched a range of Wicked Kitchen vegan products through our Booker retail partners. And we have introduced Plant Chef to all of our three Central European markets.

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

The final component of magnetic value is sustainability. Increasingly, customers see this as a given for whomever they choose to shop with. We launched our ambitious new climate commitments in September, bringing forward our net zero commitments for our own operations across the Group to 2035 and launching a new Scope 3 target of 2050.

We were proud to launch the UK's first electric HGVs in January and to be the first to pilot them in Hungary and the Czech Republic. We're also making good progress on electric.com vans. For customers, our network of EV charging points is now in 500 stores, providing over 2 million free charging sessions to-date. On plastic, we have now removed over 1.6 billion pieces of plastic from our operations. And we're the first retailer to roll out a nationwide soft plastic recycling program in the UK. We are also supporting innovations such as our trial with a peel on citrus fruit, which aims to minimize both plastic and food waste.

Our community efforts always get great support. Under our Buy One to Help a Child campaign, we made a donation for every piece of fruit and veg that customers bought over a period of three weeks. This enabled us to donate the equivalent of 3 million extra meals on top of the 53 million donated through our usual food redistribution programs.

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

You can see on this chart how the number of regular app users has increased more than fourfold over the last two years to 9 million. It is also worth noting that we have been leveraging the same capabilities across the Group with Clubcard Prices launching in our other markets, in Tesco Mobile and in Tesco Bank. As a result, Clubcard penetration has continued to increase. Customers are swiping, tapping or scanning their Clubcards on three-quarters of all UK Tesco transactions. And we expect this to further increase over the coming months. This greater level of engagement is allowing us to improve the customer experience of Clubcard 2, with personalized coupons and increasingly relevant rewards.

Our third priority is easily the most convenient; serving our customers wherever, whenever and however they want. It's about keeping our existing estate relevant for customers, while seeking out capital-light growth in convenience and online. Tesco has emerged from the pandemic a much stronger business, and nowhere is this more true than online.

As expected, we have seen some normalization, but we are still seeing around 1.2 million orders each week, over 60% higher than pre-pandemic. Basket sizes are up too, and online grocery still represent nearly 14% of the total UK sales, about 5% more than two years ago. This is testament to the brilliant work the team did to open up our capacity when customers needed us most in the first few months of the pandemic, and their continued efforts to maintain an outstanding service to our customers over the last two years. As a result, we gained 1 million new customers to Tesco and around 67% of those are continuing to shop with us either online or in store.

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

While we are expecting further normalization in the current year, we see online as one of our key medium-term growth opportunities. We now have four fulfillment centers open, and our fifth in Rutherglen open next month. We've seen the two most recent sites following a faster ramp-up trajectory than either West Bromwich or Lakeside. In addition to providing extra capacity to allow our grocery home shopping business to grow, UFCs also improve the economics. Our UFC pick rates are around 4 times the rate of manual picking.

Another area we are focusing on from an economic point of view is Click & Collect. Having peaked at around 25% of orders during the pandemic, we are still seeing around double proportion of Click & Collect than we had two years ago. This year we have rolled out an additional 102 locations for customers to be able to pick up their groceries and are continuing to refine the customer experience.

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

We have pushed on what our convenience opening program, opening 40 new Express stores and 59 new one-stops. In the coming year, our opening program will take us to a total of over 2,000 Express stores and over 1,000 one-stops. In addition, we continue to seek opportunities to make our larger stores even more compelling for customers with concession partners including Decathlon, YO! Sushi and Homebase.

Booker's catering business has coped brilliantly with the challenges of the pandemic and is emerging a stronger business. Over 37,000 new catering customers were added in the last year alone. It is also continuing to build on this partnership with Just Eat and the retail business is performing well too.

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

Our final strategic priority is save to invest. You've already heard from Imran, the cost efficiency is not new to Tesco. It's in our DNA to ensure that everything we are doing and every pound we are spending is in the service of our customers. That's more critical now than ever. We set ourselves the goal of being able to offset the impact of cost inflation on our business each year and ideally create additional headroom that will allow us to invest in competitiveness and growth. We identified GBP1 billion of savings over three years broadly evenly phased with the key areas of opportunity being goods and services not for resale, property, improved operational efficiency and central overheads.

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

I wanted to close by talking about the current market environment. We know that this is a really challenging time for many of our customers, facing the biggest increase to the cost of living that we've seen in decades. Over 70% of customers say that inflation is a serious concern for them and real incomes are forecast to fall by almost 4% this year. As you would expect this has impact shopper confidence, which has fallen sharply since the start of 2022 on top of any uncertainties around the emergence from the pandemic.

You can see from this chart that many customers are already planning changes to the way they shop and we will make sure that we are there to support them. Own brand will play an important role, and we continue to make sure that we have the strongest range and the best possible prices across every tier and every category.

We need to stay close to our suppliers too with the crisis in Ukraine straining availability and adding to the cost of ingredients, particularly in commodities such as wheat and sunflower oil. The strength of our supply chain and our strong supplier relationships put us in an excellent position relative to others, but we do need to recognize and respond to the challenges being faced by the industry.

Against this backdrop, it's essential that we keep listening to our customers. Value is going to be critical and I see three immediate priorities as we look to the year ahead. We will stay laser-focused on price. We will not allow price to become a reason for customers to shop anywhere else than Tesco. We will also make sure we have a compelling offer for those customers looking to save by eating in instead of eating out. Feeding the family out of home can be a big expense and we will make sure that we can provide a brilliant alternative, a great value.

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

So what does that mean for next year? Given the significant external uncertainties, we have given our profit guidance in the form of a wider than usual range. Our current best view is therefore that we will deliver between GBP2.4 billion and GBP2.6 billion of retail adjusted operating profit next year. We've highlighted in the release the three main factors that are likely to influence our actual performance, as we don't want to pretend we have any certain how they will plan out.

Clearly, there are levers we could pull to land on a certain level of profit, but that's not what we're about. We are running the business to generate sustainable value for all stakeholders for the long-term. If we can do better, we will; or if we think it needs to change, we'll let you know. What we can tell you with certainty is that we will stay focused on our customers throughout, as that's the best way to deliver the medium-term growth and the strong sustainable cash flows that we have set out. We are confident that we can keep this level of cash generation sustainable into the future and are therefore pleased to commit to a further GBP750 million capital return under our share buyback program to be completed by no later than April 2023.

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

Thank you for your time so far. Imran and I are now really happy to take your questions.

Questions And Answers

Operator

Thank you. (Operator Instructions)

A - Ken Murphy {BIO 18844208 <GO>}

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

Operator

Thank you. And our first question comes from the line of Andrew Porteous at HSBC. Please go ahead. Your line is open.

Q - Andrew Porteous {BIO 16735821 <GO>}

Yeah. Good morning, team. A couple from me. I guess, this morning the market has been spooked by the outlook statement a little bit. I just wanted to, if you could reflect on to what extent outlook (Technical Difficulty) sort of some of the industry headwinds you flagged and to what extent perhaps does it reflects you being able to continue to hold back inflation and go after market share?

And then second around Clubcard (Technical Difficulty) stand out for you over the (Technical Difficulty). To what extent is that a sustainable competitive advantage? I mean, does your scale really help you in that regard and do you think it's something the competitors could look to replicate or would they find that difficult?

A - Ken Murphy {BIO 18844208 <GO>}

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

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

Q - Andrew Porteous {BIO 16735821 <GO>}

Thank you.

A - Ken Murphy {BIO 18844208 <GO>}

Thanks, Andrew.

Operator

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

Q - Andrew Gwynn {BIO 15089439 <GO>}

Yeah. Good morning, Ken. Good morning, Imran. Just one question actually for me, which is where prices are needing to go up? Where you got sufficient level of cost inflation. Are they going up in the market at present? And kind of connected that, I suppose, a second question forge [ph] but when the discounters are? Are they leading the market or would you anticipate that Tesco would be leading the market in the coming year? Thank you very much.

A - Ken Murphy {BIO 18844208 <GO>}

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

Q - Andrew Gwynn {BIO 15089439 <GO>}

Great. Thank you very much.

A - Ken Murphy {BIO 18844208 <GO>}

Thank you.

Operator

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

Q - James Anstead {BIO 5201112 <GO>}

Thanks very much. My two questions; firstly, you talked, Ken, a little bit about some of the trends you expect to see in the year ahead with, for example, own brand being an important area, and making sure you have a great alternative to eating out. But could you just be clear you starting to see already significant changes in customer behavior in the early part of the new financial year or is this an understandable expectation given the disposable income pressure that we can stay ahead? The first question.

Second one would just be, I imagine, a lot of people like me would be trying to do a back-of-the-envelope profit bridge from the number you've just delivered at 2.65 to, say, the midpoint of the new guidance range for the year ahead, 2.5. I think you put in the statement there is a benefit of COVID costs hopefully being GBP140 million less year-on-year, which means that at least at the midpoint of the new guidance, everything else that adds up to a roundabout GBP300 million. I just wondered perhaps Imran whether you can give us any granularity on any of the individual elements in that movement you're expecting for the year ahead? Thank you.

A - Ken Murphy {BIO 18844208 <GO>}

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

A - Imran Nawaz {BIO 20578333 <GO>}

Okay. Let me try and avoid giving you a line-by-line bridge, but I'll give you assessment of how I'm thinking about the range. And as Ken said, the key term there is, there are three uncertainties of the COVID normalization, what do we think happens, the price level of investment that we need to have to continue to do what we've been doing the last 18 months and where does inflation end up. And the way I'm thinking about it is if you think on the topline we'll have at the moment there'll be some level of normalization. So I would expect volumes to go back 2 to 3 points. Let's see how that plays out. As customers go back to work and rather than staying at home or do the traveling outside, then clearly there's going to be a bit of a mix down trade as well. I do see also some of the inflation will offset that.

On the cost line, I think you have -- you are aware we are facing significant cost inflationary pressures, right. So you've seen our recent investment in colleagues, GBP200 million. Think about energy around that scale as well. And then, clearly you have the same types of increases on property, on store, on distribution. But at the same time, we are doubling down on our Save to Invest program. Now clearly within the year, I don't expect to be able to offset that. In terms of the COVID costs, as you well know, we spent around GBP200 million or so this past year. I think GBP80 million or so will stick, because of the continued elevated demand for online, which was part of that stickiness and that's actually a good investment. So net-net, when I look at it and I think, okay, some lower volumes, a bit of mix down trade cost is clearly going to be the thing that we need to manage well and therefore you have the range and the 2.4 to 2.6 is if you wish to different realms of possibilities as we see it right now.

A - Ken Murphy {BIO 18844208 <GO>}

And as regards the trends from a customer perspective, I think what we have seen over the past few months is clearly a reversal of some of the behaviors that we were seeing during the pandemic. So we are seeing more people eat out and that's reflected in the incredibly strong performance from Booker. And we are seeing people travel more. And you'll see the well-publicized issues that have been shown on airports et cetera. And we're also seeing people shop less frequently.

What we're really trying to do is understand and anticipate how customers may choose to shop as we progressed through the year, and make sure that we're ready with a really compelling proposition whatever those trends may be. And they will include the staycation, can we make sure that people can entertain at home really cost effectively with really great quality product. If they choose to shop on a tighter budget, can they do so effectively through Tesco, making sure that we have a really strong Aldi Price Match range together with our exclusive a Tesco proposition. So we're really working on the premise that whatever the customer chooses to do, we will be there for them.

Q - James Anstead {BIO 5201112 <GO>}

That's very helpful. Thank you.

A - Ken Murphy {BIO 18844208 <GO>}

Thank you.

Operator

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

Q - James Grzinic {BIO 4004104 <GO>}

Yes. Good morning all. I had two quick ones. I guess, first a clarification. So what you're saying is that there hasn't really been a change in behavior as far as your behavior within stores, mix dynamics, good, better, best growth is concerned, despite the fact that we had by your own survey four months of very elevated concerns on inflation. And we had essentially eight, nine months of very elevated levels of inflation that consumers have had to cope with. I think that's the first question in terms of clarification.

And the second one, I guess, for Imran specifically. So that GBP1.42 billion to GBP1.8 billion reiterated Retail free cash flow guidance for the year you had Imran, that includes food online there'll be GBP0.5 billion benefit from working capital. So you would see things like the Booker recovery that we saw last year, the fuel recovery that we saw last year unwind to some extent. So if you could help us on that free cash flow bridge that would be very helpful as well. Thank you.

A - Ken Murphy {BIO 18844208 <GO>}

So, James, in terms of the trends -- and you're absolutely right, we see exactly the same thing. So we see a dramatic increase in customers being concerned about the cost of living; there's no doubt about that. And we are seeing some behavior shifts associated with that. It's hard to separate them from the kind of unwinding pandemic trends, which, if you like, go in the opposite direction. But we are really pleased with the fact that, because of our incredibly strong value positioning, because of the great experience availability that you get and because of the flexibility of our proposition, i.e., you can order it online, you can click and collect it, you can go to a large store or small store, we have outperformed the market. And our ambition is to make sure that no matter how those trends shift customer behavior, we'll be able to anticipate and respond to those really, really quickly. Let me take the cash question. To your point, we delivered a fantastic performance in cash. I think, there is no doubt that GBP2.3 billion is even slightly ahead of our own expectations. And I actually think if I could just add this, I think it's actually demonstrates when we get it right on pricing proposition, all the mechanics we have, it actually generates a lot of cash. And the thinking we have is, if we continue to do that, we will continue to generate that cash. Now, as we go into next year, clearly, the key drivers that will drive the cash generation are going to be one, the level of profit where do we land. The second big piece is on the working capital. Now, the view is I think some of the working capital work that we've done will stick, some will unwind. As you well know, it happens to be falling at the half-year and the year-end as to what was the trend at that month before, so that you get a sense of the unwind. My view is, maybe -- I don't know. My current central plan is maybe GBP100 million to GBP200 million unwinds, the rest will stick. But again, we have to wait and see how volumes trend throughout the year. And it's linked, again, to the topline assessment that we've made. What I would say to you is, in October, we laid out a range of GBP1.4 billion to GBP1.8 billion. And that did include in our view an assumption that the one thing that will swing around more than normal would be working capital. So that's kind of why I feel comfortable with the range that we have.

Q - James Grzinic {BIO 4004104 <GO>}

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

A - Ken Murphy {BIO 18844208 <GO>}

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

Q - James Grzinic {BIO 4004104 <GO>}

Great. Thank you.

A - Ken Murphy {BIO 18844208 <GO>}

Thank you.

Operator

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

Q - Rob Joyce {BIO 16540401 <GO>}

Hi. Good morning. Thanks for taking my questions. Just a couple of follow-ups and then one new one. In terms of the guidance, Imran, is it fair to say volumes back two to three ongoing out a bit of down-trading but inflation running mid-single digit. We should think of the sort of broader topline like-for-like you're expecting to be sort of zero to plus 2%-ish.

And then on the operating cost side, I think back in January you said they were running around 5% inflation. Wondering if you help us understand where that's got to and whether there is any help from those volumes declining within that.

And then the final one, possibly one for Ken, I guess you said the strategy to price to be a little bit less and a little bit later than the market on pricing. Does this mean -- necessarily mean margin investment for you or just your scale advantage, particularly in the UK allow you to do this without seeing any relative squeeze on margins? Thanks very much.

A - Ken Murphy {BIO 18844208 <GO>}

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

A - Imran Nawaz {BIO 20578333 <GO>}

Okay. If I take your two questions in turn, so one topline growth, yeah, I mean, the central case assumes between 0%, 1% to 2% topline growth. Essentially, the drivers I laid out, volume going back, some inflation and some mix down-trade offsetting each other in that way. We have to see, of course, how it plays out, but that's what, I think, we're going for internally.

When I look at the operating costs, I mean, you'll have seen especially now with the unfortunate situation in Russia, Ukraine, that's clearly exasperated a lot of the cost lines. The way I think about it is, the GBP200 million that we're seeing on the payroll investment we've made for our colleagues, you see similar increases on energy, we're seeing similar increases on across a few of our key lines. Now the question that you would also ask me then is what are you going to do to offset that, right? You know we've got our Save to Invest program. We called out GBP1 billion over three years. The original plan was we were going to do it, call it a-third, a-third, a-third. Now, clearly, we're going to try and do better; we have to, without impacting the shopper experience, which is also important. And I think we're trying to work that through still. My gut assessment at the moment is in this case as part of the guidance that we will not mitigate the full cost increases in year, but certainly over the horizon that the GBP1 billion applies.

Q - Rob Joyce {BIO 16540401 <GO>}

Okay. Very clear. Does the -- do you get any help -- volumes are down a bit this year. Do you get any offset there? Can you -- does that sort of naturally take some of your OpEx down?

A - Imran Nawaz {BIO 20578333 <GO>}

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

Q - Rob Joyce {BIO 16540401 <GO>}

Very clear. Thank you.

Operator

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

Q - William Woods {BIO 22004993 <GO>}

Good morning both. Two questions; the first one on the relationship with the suppliers. I suppose you mentioned kind of keeping those supplier relationships strong. And how much pressure are you seeing from them to pass on inflation and how well are you able to push back? Do you think the kind of relationship has changed there?

And then second one, you mentioned kind of strained availability and we've noticed some kind of patchy availability online. How much are you being disrupted by some of the lumpiness in the supply chain and how much seasonal effect for next year? Thanks.

A - Ken Murphy {BIO 18844208 <GO>}

Thank you, Ali [ph]. So our supplier relationships, in my view, have never been more important. They are what has carried us through this pandemic, what does carried us through the pingdemic last summer, all the supply chain disruption we saw in late-summer and coming into Christmas. And the latest challenges we have with the dreadful war in Ukraine and the latest issues in Dover, et cetera. So we count on those relationships. We're very pleased that for the sixth year running, we were voted by the independent advent survey as the number one supplier to deal within the grocery industry.

And that I think is placed to the fact that we are very long-term in our thinking. We build long-term relationships with our suppliers. We are fair and reasonable to deal with, but clearly, we're also very, very objective about making sure that we work together to minimize the cost impact on our customers. And that's something they get. They are as committed to it as we are. It dials up the need for us to be more efficient in the way we think to be really focused on simplification of range and a focusing on making sure we optimize every stage of the supply chain.

We have a great sourcing team, but no commodity prices inside-out. And so we know what's true inflation versus what's added on top. And that's really where we derive our strength. It's something suppliers get and understand and they work with very effectively. So I think that those relationships will get even stronger through this period. And also, of course, we are offering them growth. As we're winning in the market, we become the go-to place to offer them growth. And I think that is a further factor that's helped us with our suppliers.

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

Q - William Woods {BIO 22004993 <GO>}

Great, thank you.

A - Ken Murphy {BIO 18844208 <GO>}

Thanks, Ali.

Operator

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

Q - Clive Black {BIO 1757474 <GO>}

Good morning, gentlemen, and well done on last year. And continuing the theme around inflation, could you give us an indication of where you think food inflation in the UK may peak?

And in that respect, does that change the way you think about your business, particularly around the involvement of automation and digitization in the operating model to the extent that you bring forward to make bigger decisions about the operating platform of the business in future, please? Thank you.

A - Ken Murphy {BIO 18844208 <GO>}

Thank you, Clive. Great questions, as always, which of course, I'm not going to answer. We really aren't in the business of trying to forecast what food inflation is going to do over the next six to 12 months. What we are doing is working incredibly hard to minimize that impact on our customers, no matter what it is. And that's really the focus of the Company. So we're not really speculating on the projected food inflation. We're really working on managing all of the inputs and optimizing them, so that we can be incredibly competitive for customers. And that really is the job at hand.

And raising costs, by definition, make automation solutions more feasible, but actually don't change fundamentally our trajectory. Because, I think that we need them to work and work really well for the business before we invest in them. The good news is that things like urban fulfillment centers are working well. And we're seeing no productivity levels from our latest two investments and we've gone from two to four in the last couple of weeks and we'll add a fifth in the coming weeks that are hitting productivity levels that we forecasted in the business case and the latest ones accelerating towards that business case level of productivity on a much faster arc than the first two, which really gives me great confidence that we've learnt the lessons and we've really refined the model and we're in good shape at it. And that really will help as much in terms of increasing our capacity online as it will in reducing the cost to fulfill and of course it also accelerates our ability to capture and process an order, which means we'll be able to fulfill a full grocery order much, much faster, particularly on a click and collect basis than we would have been able to do historically, and so that's really pleasing.

Q - Clive Black {BIO 1757474 <GO>}

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

A - Imran Nawaz {BIO 20578333 <GO>}

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

Q - Clive Black {BIO 1757474 <GO>}

Thank you very much, guys. Well done.

A - Ken Murphy {BIO 18844208 <GO>}

Thanks, Clive.

Operator

Thank you. Our next question comes from the line Victoria Petrova of Credit Suisse. Please go ahead. Your line is open.

Q - Victoria Petrova {BIO 15425421 <GO>}

Thank you very much. I'll be short and quick. First of all, have you seen any first signs of price elasticity of your customers' demand in the current environment? And you've mentioned GBP200 million investment in your employees. Could you quantify the cost pressures on any lines obviously cost of goods sold, energy, supply chain disruption in the first quarter or at least something you're seeing right now just to give us some additional color on current inflationary trends? And the very last, do you expect the next wave of cost of goods sold price increases towards the end of second quarter or is it happening already now? Thank you very much.

A - Ken Murphy {BIO 18844208 <GO>}

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

And I'll pass over to Imran now just to address the two cost questions.

A - Imran Nawaz {BIO 20578333 <GO>}

Sure. So, look, I mean, I'll tell you one thing. I'll tell you what Tesco is really good at is driving out efficiencies. And you saw that last year, and we're going to continue to do that. So as we're seeing cost increases and I called them actually on the payroll piece for our colleagues, I actually see there is an investment and I see as the right type of investment given who we are and given the importance of the colleagues that we have. We do continue to see increases on energy of a similar nature, distribution costs are going up. Similarly, you saw recently we had announced a payroll agreement back off of Christmas.

When you add those up, there is significant, but at the same time and that's I think equally important question that we ask the team, what are you going to do to offset that. And I think I'll come back to Safe to Invest, which is a key program for us to drive out those efficiencies, such that we minimize the impact. So the challenge of calling out a percentage cost increase that you're seeing on the operating costs is that it takes into account or it assumes that we're just going to be bystanders, but we're actually going to be actively working that and that's what we've been doing last year and we're definitely going to be doing that this year. So the net of where that comes out, that we'll keep you posted. But that to me is the focus point of when I look at cost increases.

As to the COGS question, look, I'll -- you can imagine -- and look, it's a fair question, but you'd never expect me to talk on a call like this about our supplier commercial agreements and the conversations we're having and the negotiations. What I can say to you is, for sure, there are live dialogues that are taking place over the last months and will continue.

Q - Victoria Petrova {BIO 15425421 <GO>}

Thank you very much.

A - Ken Murphy {BIO 18844208 <GO>}

Thanks, Victoria.

Operator

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

Q - Sreedhar Mahamkali {BIO 15121206 <GO>}

Yeah. Hi. Good morning, guys. Thanks for taking my questions. Two as well then, please. And the first one is to just follow up on James Anstead's questions earlier on the EBIT bridge, maybe slightly differently with the GBP2.4 billion to GBP2.6 billion. I'm more interested in trying to understand the lower end and wait -- probably splitting hairs here a little bit to be honest, but is the driver to get to GBP2.4 billion, a larger sort of proactive investment absorbing more inflation relative to a GBP2.5 billion scenario or GBP2.6 billion scenario, are you assuming something different. So just trying to explore the lower end of the range? That's the first one.

Secondly, I think you both talked about strategies on shareholder returns and I realize and appreciate the you're returning over GBP1 billion on a two-year basis to shareholders. But in the context of, I don't know, GBP3.7 billion or GBP4 billion free cash flow on a two-year background, why do you think that is with the right level? Could it be higher if you sort of see the shares remaining as attractively valued as they are now? Could you step it up through the year? Those are the two questions. Thank you.

A - Ken Murphy {BIO 18844208 <GO>}

Thanks very much, Sreedhar. I'll pass to Imran to address the range in a moment. Just specifically, the reason we have a larger range is because we are not certain about what it's going to take in terms of price competitiveness. But you should read it as more reactive than proactive. So it is -- we believe that we need to stay focused on customers.

We believe we needed to invest in our colleagues. We've done both of those things and we maintain that focus. We think it's the right thing for shareholder value and we think it's going to deliver a strong performance for Tesco in the context of the market. It's just hard for us to predict what that's going to take as we look into this 12 months and therefore we've given ourselves a wider than usual range as a consequence. Imran?

A - Imran Nawaz {BIO 20578333 <GO>}

Yeah. If -- I'll just build on that very quickly, because I don't have that much to add to that point. If -- here's how I look at it. We are continuing to do what we said we would do, and it worked really well for us last year. Aldi Price Match, Clubcard pricing, Low Everyday Pricing, continuing to put the customer first. It creates a virtuous cycle. You continue to win in the market, you outperform and you drive cash and bingo you return it. There is no need to change that model. It's the core of the strategy we're trying to run.

Now the problem, Sreedhar, is we've got a lot of uncertainty out there at the moment in terms of how customers are reacting, how inflation is going to go and frankly what will happen from a competitive stand. We're rational is one thing that -- it may be obvious to say, but we're not -- this is not like trying to do something crazy out there. We're very rational in our thinking on delivering the profit levels that we've set out and that's kind of how we want to continue to run the business, because we do believe that virtuous cycle and protecting the competitive price position that we have created is important. And that's why it's there and that's why you see a wider range.

In terms of the way to think about the lower end, I mean, the reality is, with the uncertainty could be the lower end, could be the midpoint, we don't know yet. It really does depend on how customers react to the higher cost inflation environment that they're living in. What we are clear is, we will not waver away from it and we will continue to leverage the strength we have today, because we are convinced it will drive the cash that we need to generate.

As it comes to the buyback itself, your question. Look, cash was really strong and the philosophy we laid out in October and I think that we're continuing to sort of demonstrate to you here today is that, if we are within our range of GBP2.3 billion to GBP2.8 billion and if we are in the cash range that we want to generate, the GBP1.4 billion to the GBP1.8 billion, then we should have the rolling buyback program that we've announced. And now what we're doing is, we're just building on that. Now, I think the right thing to do in an uncertain environment is to make sure we get that number right and GBP750 million to us felt like the right step. It's a step up from where we were on the GBP500 million and -- but, overall, as you pointed out, cumulatively it will be GBP1,050,000,000 by the time we get to April, which I think is a strong number.

Operator

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

Q - Maria-Laura Adurno {BIO 17983382 <GO>}

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

The second question that I have, so we have started to see cost inflation coming through last year already and labor was definitely one of the categories that was mentioned, but of course there were some others. Just wondering, this GBP1 billion in over three years of cost savings that you have, how come at no point was this rate -- is there no more headroom from a cost saving standpoint to actually see further increases coming through. Just trying to understand here, well, basically the execution on cost savings and the optionality? Thank you.

A - Ken Murphy {BIO 18844208 <GO>}

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

And with regard to the cost savings program, I'll pass over to Imran to address that.

A - Imran Nawaz {BIO 20578333 <GO>}

Yeah. I mean look, you sound like me, you're pushing the right buttons and it sounds can you do more. We announced the GBP1 billion only in October and we're building the program and we feel really good about it. As I said, it's in the DNA and as I also said we need this fuel, because the pressures that we have are significant.

But, look, right now, I want to get through the year, I want to continue to look for what else can we do in efficiency terms that doesn't impact the customer or the customer experience. And that balancing act is important and that's what we're going after.

Do I think we will need more than the GBP1 billion in the midterm? Yes. I think, given the cost pressures we have, I'd be wrong to say no. So we'll -- obviously, we'll continue to look, but it's too early to officially come to you today and say and here's the another chunk. We first need to do the work and find it, which we are working on as we speak.

Q - Maria-Laura Adurno {BIO 17983382 <GO>}

Thank you. That's very clear.

A - Imran Nawaz {BIO 20578333 <GO>}

Thank you.

Operator

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

Q - Nick Coulter {BIO 16493605 <GO>}

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

A - Ken Murphy {BIO 18844208 <GO>}

Okay, Nick. I think what I'm really pleased about is actually substantively what's happening right now. So the pandemic clearly has been unwinding for the last few months. We've seen some normalization of customer behavior and that would or should in theory favor the discounters and we are seeing some trade back into them. But what we're not seeing is switching losses against the market. We are continuing to win against the market week-in, week-out and that trend has maintained itself right the way through the first six weeks of the new year. And what's really pleasing is, it's even stronger on a volume basis than on a value basis.

So my personal view is that, no matter how the market trends evolve, Tesco is in a really strong position to respond and we plan to continue winning with customers regardless.

Q - Nick Coulter {BIO 16493605 <GO>}

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

A - Ken Murphy {BIO 18844208 <GO>}

Thank you. I mean, you're talking about the Urban Fulfillment Centers?

Q - Nick Coulter {BIO 16493605 <GO>}

Yes, yes, absolutely.

A - Ken Murphy {BIO 18844208 <GO>}

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

Q - Nick Coulter {BIO 16493605 <GO>}

Okay. Thank you.

A - Ken Murphy {BIO 18844208 <GO>}

Thank you.

Operator

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

Q - Xavier Le Mene {BIO 3181750 <GO>}

Thank you very much, and good morning. Two questions on my side. The first one, first is on the exceptional item that you had this year, for fiscal year 2022 --as well as for fiscal year 2022 [ph], which was about GBP240 million. So what should we expect going forward, because that the exceptional -- and that exceptional, so just to get a sense of what we should expect?

The second one is more longer-term. So we understand that for fiscal year 2023, it could be challenging because of inflation and consumer pressure, but should we assume that fiscal year 2023 is a trough and then you can build on that and then from fiscal year 2024 onward, we should see growth coming back and what are your expectation in the mid to long-term?

A - Ken Murphy {BIO 18844208 <GO>}

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

A - Imran Nawaz {BIO 20578333 <GO>}

The question on adjusting items/exceptional items, so, look, I mean, this year, you saw GBP265 million or so, the biggest chunk of that was settling historic litigation claims, which is -- which frankly is, we can draw a line under that, we're done, which is good. Looking ahead, clearly, we want to minimize exceptional items just because it's -- I'm not the biggest fan. But as and when we incur them, we'll keep you in the loop, of course, and we'll keep reporting them as they get incurred. The one thing that sticks in my head right now, if you ask me off the bat is, as we do some of the Save to Invest programs, if we have certain provisions we need to take because they drive good savings and they are unusual, because they are one-off in nature, we would obviously come back to you and give you sort of a full accounting of that.

Q - Xavier Le Mene {BIO 3181750 <GO>}

But there is nothing we should expect specifically today?

A - Imran Nawaz {BIO 20578333 <GO>}

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

Q - Xavier Le Mene {BIO 3181750 <GO>}

Okay. Thank you very much.

Operator

Thank you. And our next question comes from the line of Borja Olcese of JPMorgan. Please go ahead. Your line is open.

Q - Borja Olcese {BIO 16853015 <GO>}

Thank you. Sorry, guys, if I'm missing something. I'm just a little bit confused here. So your profit outlook is sensible in the current context of things and the capital return outlook is clearly reflective of the solid shape of the business, yet it's the retail free cash flow guidance I'm struggling with, GBP800 million or so of a cash burn you're guiding to when the high-end of the profit guide is almost flat year-on-year and working cap you said GBP100 million, GBP200 million and one -- and that's despite a 1% to 2% sales growth. So where is that cash burn going to come from? It does seem a little bit inconsistent to me when you are saying the market is rationale, you are in a better relative position versus the market, you're not over-earning and you've done all the right things with the extra cash deleveraging and reinvesting, what am I missing?

A - Imran Nawaz {BIO 20578333 <GO>}

Yeah. Look, I mean, it's -- again, it depends on how the topline works out and how we -- when you model out how you see the working capital phase through, as I said, the central case, what I have is, is that some of the GBP500 million will unwind. The one thing I should maybe add is, we do expect to spend more at the upper-end of the CapEx guidance. So this year we spend GBP1.050 billion. I think the year that we're going to go in, I think I would expect to spend GBP150 million, GBP200 million more than that, so at the upper-end of that. That takes away a little bit of that as well. Tax, I think will be a little bit higher, just because we had some one-off benefits. So when I look at it, that range is the right range. Do I want to do more to the middle of the range than the lower range on the cash flow side? Clear, but I just didn't see the need at this point to update that range, because it's the one that we are relying on for our capital allocation framework.

Q - Borja Olcese {BIO 16853015 <GO>}

Okay. This was the same range last year, right, and yet you delivered GBP2.3 billion, am I correct?

A - Imran Nawaz {BIO 20578333 <GO>}

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

Now, as we go into the next year and we start to see, okay, look how is the volume thing going to play out, how do we see fuel playing out, what do we think about catering on the outside world? Look, I think, it's -- you wouldn't expect me -- you'd expect me to take some of that down and be a bit more cautious and stick to the guidance we gave. Look, overall, if I then look at the three-year performance on cash, it will be really strong for Tesco and it's really the confidence we have to continue on the buyback.

Q - Borja Olcese {BIO 16853015 <GO>}

Right. Now that's helpful. Thank you.

A - Imran Nawaz {BIO 20578333 <GO>}

Sure.

Operator

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

Q - Thomas Davies {BIO 19995812 <GO>}

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

A - Ken Murphy {BIO 18844208 <GO>}

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

So I look at the media monetization less as a line in the P&L and more as an integral part of a customer strategy that I think has great potential in terms of making customers feel valued, feel understood and feel like they're getting a great proposition from Tesco when it really matters to them. So we don't waste their time. And, therefore, we've been careful around setting the media budgets as a go-get for something that's just about get me as much cash from suppliers as possible, which I've seen in the past generates a kind of a supplier-led push model that works in the short term, but invariably isn't sustainable, because you end up frustrating customers and not giving the suppliers the level of return that they would expect.

So we are working on this progressively and we're getting some great results from our current media plans and we're getting increasingly sophisticated in terms of our personalization journey. It's part of the I love my Tesco Clubcard driver as a component of the strategy and, of course, converting over the last two years our customer base from 2 million digital app users to 9 million digital app users is a really key component of that, because it means you can get them those offers and those propositions in real-time.

And then when you ally that with the fact that, of course, on a two-year basis, our online grocery home shopping business is up 60%. You can see where this could go as an incredibly powerful platform.

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

Q - Thomas Davies {BIO 19995812 <GO>}

Great. Thanks a lot.

A - Ken Murphy {BIO 18844208 <GO>}

Thank you.

Operator

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

A - Ken Murphy {BIO 18844208 <GO>}

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