Strategic Report 2015

"I think the store is genuinely trying to improve performance and there is evidence of progress."
Ipswich

"When I shop in Tesco now there is an overall better feel."
Maldon

"Please keep the prices low, the shelves well stocked and the tills manned with enough staff."
Aylesbury

"The store is of vital importance to the local community, long may it continue to be so."
London

"Continue to work on customer service – it makes a big difference."
Newton Abbot

In this report:

The Strategic report 2015 is a part of the Tesco PLC Annual Report and Financial Statements 2015 and does not contain sufficient information to allow as full an understanding of the results of the Group and the state of affairs of the Company or of the Group as would be provided by the full Annual Report and Financial Statements 2015. The full Annual Report and Financial Statements 2015 is available on our website www.tescoplc.com or shareholders may obtain a printed copy, free of charge, on request.

The independent auditors' report on the full accounts for the year ended 28 February 2015 was unqualified, and their statement under section 496 (whether the Strategic report and the Directors' report are consistent with the accounts) of the Companies Act 2006 was also unqualified.

FINANCIAL HEADLINES

£69.7bn	£1.4bn	£961m	£(6.4)bn	9.42p	£(8.5)bn
Group sales	Group trading profit	Underlying profit before tax	Statutory profit/(loss) before tax	Underlying diluted earnings per share	Net debt
(13/14: £70.9bn)	(13/14: £3.3bn)	(13/14: £3.1bn)	(13/14: £2.3bn)	(13/14: 32.05p)	(13/14: £(6.6)bn)

The champion for customers

Our business was built with a simple mission: to be the champion for customers – to help everyone who shops with us enjoy a better quality of life and an easier way of living.

Over the years we've done this through lots of little, helpful differences: new stores and ways of shopping; service which saves time and makes life simpler; helping to make great food available to all.

Our mission is the same today. Our customers are hard-pressed for both time and money. They want great value and great service. They expect great products which they can buy easily. Wherever we work, they want us to do the right thing – for them, their communities and the environment. It's our job to work hard to make life easier, every day.

With our reach, our skills, our expertise, our passion and our capabilities, we have everything inside our business we need to succeed in the future. The keys to Tesco's future already exist within our business. Those keys are in the hands of every single colleague who works for us.

Around the world, Tesco is made up of over half a million colleagues. If every one of us gave one customer an experience of Tesco which was better than they expected every day, we'd change the views of millions of people every week. That is the change we want to achieve over the coming years.

Small actions, big difference. Helping to make our customers' lives easier, every day.

In other words: *Every Little Helps*.

We have changed our reporting this year to reflect our approach across the business – that is, to keep it simple. The strategic report is our top level of reporting, with signposting to further detail online at www.tescoplc.com

KEY HIGHLIGHTS

517,802	**7,817**	**Over 80m**	**£18m**	**685,000**
colleagues at year end	shops around the world	shopping trips per week	raised for Diabetes UK	children have learned about food through our Eat Happy Project

First impressions

John Allan
Chairman

It is a genuine privilege to have been appointed Chairman of this company.

I am acutely aware that this has been a difficult year for the company. This is reflected in the financial results contained in this report. As Chairman, my primary duty is to shareholders, and I believe the best way to deliver shareholder value is to regain our absolute focus on customers and on improving the shopping trip.

A key priority for me will be to ensure that the governance of the business is as it should be. Our shareholders expect their company to be run in a responsible, sustainable and transparent manner. On behalf of the Board, I would like to express sincere regret for the impact of the commercial income issue on this company, and would like to assure you that we have moved swiftly and decisively to address this serious matter. An explanation of this issue is set out on page 32. With my colleagues on the Board, I am determined that Tesco will be known for the highest standards of corporate governance and ethical leadership.

I would like to thank my predecessor Sir Richard Broadbent, who has been resolute in addressing the numerous challenges and handled the scrutiny which the company has been under with great dignity. I would also like to thank Patrick Cescau, Jacqueline Tammenoms Bakker, Liv Garfield and Gareth Bullock who have recently retired as Non-executive Directors and also Ken Hanna and Stuart Chambers who have decided not to seek re-election to the Board at the AGM. I'm delighted to welcome Richard Cousins, Mikael Olsson and Byron Grote to the Board.

Tesco is lucky to have an outstanding new management team led by our CEO, Dave Lewis, and our CFO, Alan Stewart. They are supported by a first-class team of people who have begun the hard work of putting this great business back on its feet.

As I have visited stores and other sites I have been struck by the commitment, enthusiasm and capability of Tesco's people. I am very confident that with their support Tesco will be successful in refocusing on customers, rebuilding trust and over time delivering progressively better returns.

The challenges Tesco faces remain significant and fixing them will take time. However, I firmly believe we have the right team and the right strategy to deliver the longer-term performance our shareholders expect and deserve.

John Allan
Chairman

Visit **www.tescoplc.com/ar2015** to hear more from John Allan on his first months at Tesco

A fresh start

Dave Lewis
Group Chief Executive

Tesco has always been a champion for customers. It's in our DNA. The last few years have been challenging, but we are confident that if we get back to doing an unbeatable job for customers, our best days lie ahead.

It was a huge honour for me to be asked to lead Tesco. It's a business I had worked with for 27 years. As a supplier, I always had enormous admiration for Tesco – its people, passion, and expertise. So when I was invited to come in and lead this great organisation, it was an opportunity not to be missed.

I arrived at a time of significant challenge. Clearly, for a number of years, the global retail market has been highly competitive. We were losing market share in our critical home market and the growth momentum we had enjoyed internationally had faltered. The channel shift to online and convenience presented both challenge and opportunity, but the bottom line was that we had stopped growing.

In addition, or perhaps as a result of this lack of growth, we had significant internal challenges. The commercial income issue identified in September was a significant blow and has resulted in a SFO regulatory inquiry. We have been cooperating fully with the inquiry and as we work on a programme of change across Tesco, we must ensure this never happens again.

Alongside these issues is a deeper challenge of trust. For customers to choose to shop with us, they have to place their trust in us – on price, quality, service and as a brand. But over a number of years, we've seen a gradual erosion of that trust for a number of reasons. Earning that trust back is fundamentally important to Tesco. We will do this not by any quick fix or short term initiative, but rather by continuous and lasting changes in what we do and how we behave.

Despite the challenges, at no point during these first few months has my belief in the potential of Tesco diminished. As I got to know the different parts of our business across Europe and Asia, I have found an energy and engagement by colleagues which is incredible – beyond anything I had expected. That passion to do the right thing for customers and the expertise to make it happen still beats strongly within our business.

I am extraordinarily proud of the way that colleagues have responded to the challenges we face. The business has started a long journey of renewal and change. In particular, the way colleagues from across the business worked so hard to deliver a fantastic Christmas showed me the strength and depth of retailing expertise which exists within our business.

The action we have taken so far has helped to reset the business and restore our customer focus. The reality is that it will require concerted action to get Tesco back to where it should be.

In this report we are publishing losses of £6.4bn for 2014/15. These losses were largely the result of a series of one-off charges representing our past performance. They recognise a number of issues: the value of the property we own has fallen; the cost of dealing with our excess stock levels and restructuring costs, as well as the cost of the retail sites we are no longer developing. Our reduced trading profit of £1.4bn reflects the challenges we have seen in the UK and in our overseas markets.

While these results reflect the difficulties our business has faced over a number of years, we are also beginning to see early promising signs from the changes we have made. By focusing on the fundamentals of availability, service and targeted price reductions over the last six months, we have seen a steady increase in footfall, transactions and, most significantly, volumes. Our like-for-like sales volumes are now up for the first time in four years. Every day we are seeing our customers recognise this. Put simply, more customers are now buying more things at Tesco.

Our task now is to build on this and nourish these small green shoots of recovery. We need to continue to listen to our customers and they will guide us. Tesco became a great business by putting our customers at the heart of everything we do and we shall do that again.

Customers today are hard pressed for both time and money. They want prices which are simple and stable, as well as low. Wherever they shop, they want great choice and outstanding service which makes their shopping easier. Above all they want help to make life a little simpler, every step of the way.

With our reach, our footprint, our skills and capabilities, we are perfectly placed to lead and offer this kind of service. When I look at our business, I see a sea of opportunity. What we need to do now is unlock the potential which exists within Tesco – and to do that, we need to do some key things differently.

In October, we set out our three strategic priorities:

1. **Regaining competitiveness in core UK business**
2. **Protecting and strengthening the balance sheet**
3. **Rebuilding trust and transparency**

Visit **www.tescoplc.com/ar2015** to hear more from Dave Lewis

“We firmly believe that if we give colleagues more power to choose the right actions, we’ll do a better job for customers”

Over the last six months we have taken action to deliver on each of these priorities – sharpening our focus on availability, service and selectively on price; undertaking a significant programme of restructuring and financial discipline; and launching a programme of renewal to restore trust in every aspect of the brand. A key part of our early work has been to simplify our organisation in all our markets and to make sure that customers are the absolute focus of all parts of the Group.

In many cases this has involved very difficult decisions. The consequence on our business and importantly on our colleagues has been significant. In the face of these changes they have been brilliant at all times, putting the needs of the customer and the business first, and I would like to thank them for that. Through these difficult changes we are confident that we give ourselves the chance to be great again.

The changes we are making are significant and are likely to result in an increased level of volatility in our performance over the short term. We are still in an extremely challenging market and face tough trading conditions in the UK and overseas. The benefit of at least some of the changes we are making will only be seen over time. Crucially, however, the approach we are taking now is based on a clear commitment to reinvest any savings or outperformance in the shopping trip. The better our offer is for customers, the more customers will shop with us, and the stronger our business will be over the long term.

As we continue the work of transforming Tesco, my overriding message to the business is this: work as one team and keep it simple. Too often in the past we have added in layers of complexity where simplicity was needed. The result is that we have sometimes lost focus on what our customers think and feel. This needs to change.

A crucial part of that is about giving more power to colleagues – empowering them to do the right thing for customers. We firmly believe that if we give colleagues more power to choose the right actions, we’ll do a better job for customers and achieve greater success for our business. And one of the reasons I believe this, are the stories I receive each day of colleagues going out of their way and doing exceptional things for our customers.

A few months after I arrived at Tesco, I was asked what had most surprised me since joining the business. My answer was how big its heart is. I have never met a business with so many colleagues doing so many things to help customers and communities on a daily basis. Whether it’s raising millions for charity, taking hundreds of thousands of children on food education tours, or leading the charge against food poverty, the work colleagues do is simply awe-inspiring. This kindness and spirit is also in the DNA of Tesco and I’d like us to show it just a little more.

As we embark on this journey of renewal and change, we recognise the responsibility and opportunity that comes with the choices we make. Doing the right thing for customers in a way that supports communities and the environment will be crucial to our future success.

Tesco is a great British success story. We grew into a successful business by focusing on the customer and helping him and her with both the big and the little things. These are challenging times, and we must be prepared for further volatility in the coming months, but we are emerging stronger and we believe our destiny is in our own hands. If we keep focusing on our customers, and challenging ourselves to make every single customer experience better every day, we know we can succeed.

Dave

Dave Lewis
Group Chief Executive

regain

Our starting point is the market where we serve the most customers: the UK.

The UK represents more than two-thirds of our sales. So if we regain our competitiveness and do a better job for customers in this market, it will have a dramatic impact on the performance of the Group.

We have been focusing on four things for our customers:

- Service. Our business is based on great service, but we haven't got this right in recent years. To help fix this, we have invested in 4,652 new colleagues in customer-facing roles. We have also asked everyone who works in our offices to spend time working in store.
- Range. Over the last few years, we have significantly increased the number of products in our ranges. This has put extra pressure on our store colleagues – and it's also left many customers confused. So over the course of this year and into the next we have started to review our ranges across all categories to make them simpler. As part of this we've already met with over 100 suppliers.
- Availability. Partly because of an increasing range, we did not leave enough space for the most popular products and important items have not been available at peak times. We have now given more space to the top 1,000 lines in each store, resulting in marked improvements in product availability at peak times during the day.
- Price. Along with great service and availability, we want to make those products which are most important to our customers as affordable as we can. As an example of this, we focused on the 'Festive Five', the five vegetables people most want with their Christmas lunches. Since January, we have dropped prices on hundreds of branded products and essential own-brand products. We are also committed to simpler, lower and more stable prices wherever we can.

As a result of these changes, our customers are responding. Although we have work still to do, since October we have improved our competitiveness and every day more people are choosing to shop at Tesco.

In addition, we have identified cost savings across the Group of £400m. We have also taken a difficult decision to close 43 unprofitable stores in the UK, and not to proceed with plans for 49 new stores. These decisions have been difficult but have been made to put the needs of the business and customers first.

protect

We need to protect and strengthen our financial position so that we can maintain the flexibility to invest in a better shopping trip for customers.

As a business we have too much debt with total leverage of £(22)bn. We need to reduce that, both to deliver value for our shareholders, but also to free up money to invest in the shopping trip.

In October we began an end-to-end review of all costs in the business. This has led to a number of significant decisions, including the decision not to pay a final dividend for 2014/15.

Other key areas of focus include:

- Capital spending. We are committed to stronger financial discipline around capital spending. This year, we will be reducing capital expenditure to £1bn.
- Pension fund. We have started a consultation to replace our defined benefit pension scheme for all colleagues. We are committed to protecting the pensions that colleagues have earned, and also to continuing to provide a competitive pension scheme for all colleagues.
- Property. We have undertaken a detailed review of our property portfolio, including the leases which drive our £1.5bn annual rent bill. As an example of this, we have completed an asset swap with British Land to regain sole ownership of 21 superstores, increasing the proportion of owned stores within our estate.
- Portfolio. As part of our review of the portfolio, all three Blinkbox businesses (movies, music and books) and Tesco Broadband have been sold or closed. We have also appointed advisors to consider our options for dunnhumby.

Alongside these structural changes is a cultural shift. Every pound we spend needs to be considered from the point of view of our customers. We want every spending decision to be weighed up against how many hours of store service the same investment would provide.

rebuild

Our third priority is to rebuild trust and transparency.

We rely on the trust customers, suppliers, communities and shareholders place in us. Regrettably, this trust has been undermined, following the commercial income issue identified in September.

What happened is a matter of profound regret for everyone at Tesco. We have acted swiftly and decisively to ensure that it can never happen again. Across the business, we have brought in a wide ranging programme of change and renewal, which includes:

- **New management who are transforming our commercial model to create long-term, mutually beneficial partnerships, with a greater focus on cost prices than on the commercial income we receive back from suppliers for promoting their products.**
- **A new Code of Business Conduct, supported by a company-wide training programme to help colleagues follow key policies.**
- **A speak-up culture, with a stronger focus on ethics and compliance. Code compliance and ethical leadership are now key factors in performance management and reward. In addition, we now have protector lines for both colleagues and suppliers, so any concerns with business conduct can be raised confidentially.**

Restoring trust is not just about process and structure. It's about culture and individual actions. In the same way that every colleague holds the key to better customer service, so every colleague can help us to be a better active corporate citizen.

We recognise the impact we can have on the lives of many – not just through our global reach but also in the way we run our business. For our customers, communities and the environment, we want our actions to make a big difference for everyone – and we are restless to build on the foundations we have in place.

Key highlights this year include:

- **Helping on health. In 1994 we were the first supermarket to take sweets off checkouts in our big stores. This year we became the first to do it in every UK store, including Express. We also announced our partnership with Diabetes UK and the British Heart Foundation to help tackle these diseases. It builds on our partnership with Diabetes UK which started in 2013 and raised over £18m.**
- **Helping to tackle food poverty. Over the last three years we have pioneered a national programme of food collections working with FareShare and the Trussell Trust. Together with customers we've now provided over 21.5m meals for those in need.**

Our business model

Tesco grew into a big business by focusing on the little things.

Not because we developed a highly complex business strategy. Nor because we developed a radical, revolutionary business model. We were successful because customers were our number one priority and everything we did was about doing the right thing for them.

Our aim today is to regain that total focus on serving customers. We have refocused our business under three operational headlines:

- **listening to, understanding and reaching out to customers to create the best possible offer**
- **working with growers and suppliers to make great products, and helping to deliver the best value to customers**
- **and working across different channels to get those products to customers in the most convenient way possible.**

Our aim is to make sure everything in the business is set up in the most efficient way to create value for customers.

By refocusing on these three areas – and with the capabilities, reach, insight and skills we have within our business – we are uniquely placed to deliver the best offer we can and in doing so earn our customers' loyalty. By creating value for our customers, we will create sustainable value for our shareholders too.

Customers

Tesco exists to serve customers – and our business model has customers as our number one priority.

Our scale and reach mean we have the expertise to really understand our customers; allowing us to focus on the delivery of an offer with real value in all areas of price, quality, range and service. This focus means that we will champion our customers at every level and earn their loyalty.

Reinvest

Our clear priority is to improve Tesco for customers. As we do this, we have committed to reinvest any savings or outperformance into further improvements in our shopping trip.

The reason for this reinvestment is clear: the better job we do for customers, the more we will improve our sales, and the more our sales improve, the more we can invest further in the shopping trip.

Channels

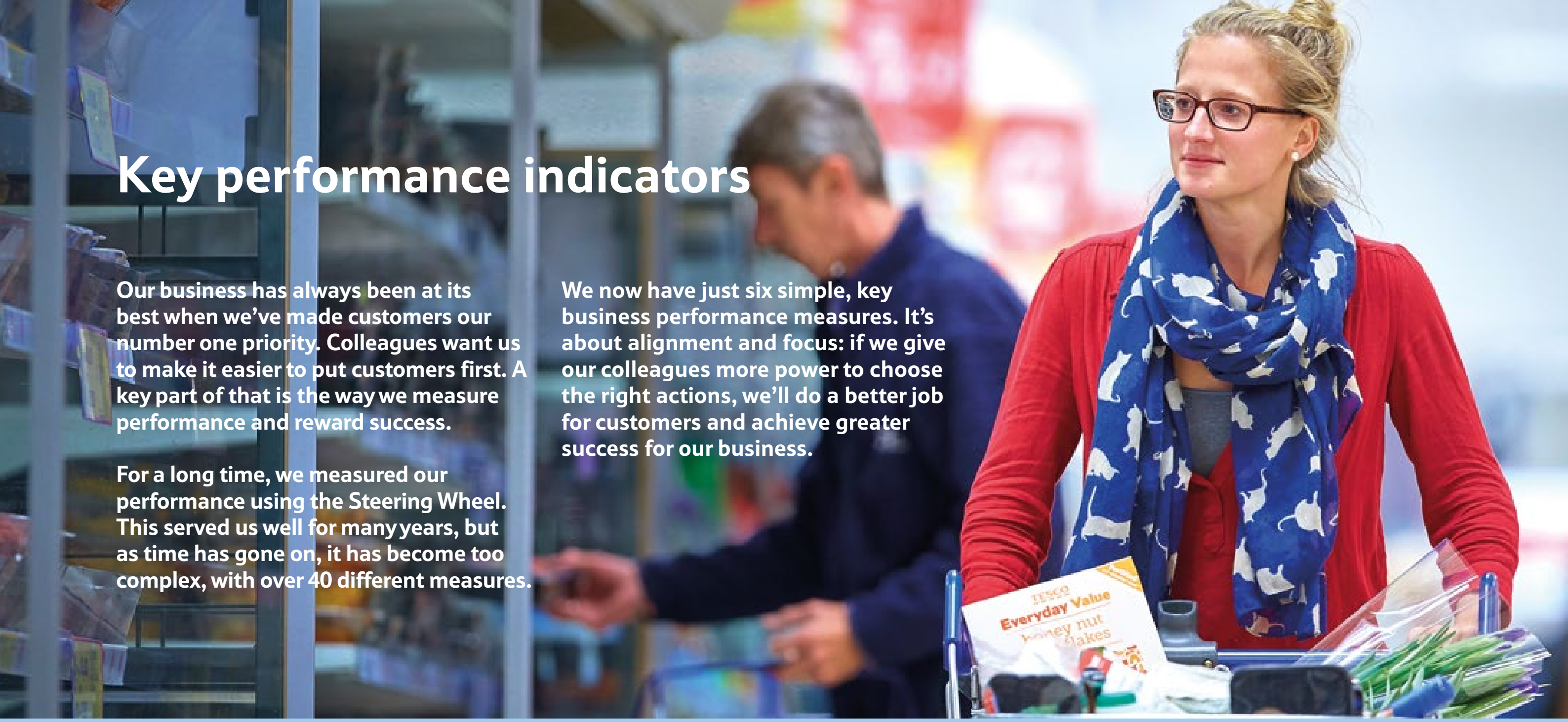
To bring the best products to customers easily, we work through a range of channels – from small shops to large shops, and through our growing online business. We were the first retailer to offer 24-hour shopping and today we have thousands of Click & Collect points across the country.

As part of improving our offer, we will invest in making our channels even more efficient and convenient for our customers.

Product

The offer we create for customers is developed by our Product team. They work with our suppliers to source the best possible range of quality products which meet and anticipate our customers' needs.

Our relationships with suppliers are crucial to delivering our customer offer. Since October, we have been reviewing our partnerships to make sure we focus on delivering the best possible value to customers.



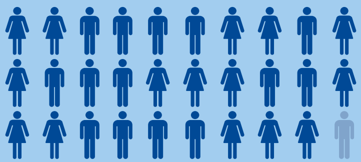
Key performance indicators

Our business has always been at its best when we've made customers our number one priority. Colleagues want us to make it easier to put customers first. A key part of that is the way we measure performance and reward success.

For a long time, we measured our performance using the Steering Wheel. This served us well for many years, but as time has gone on, it has become too complex, with over 40 different measures.

We now have just six simple, key business performance measures. It's about alignment and focus: if we give our colleagues more power to choose the right actions, we'll do a better job for customers and achieve greater success for our business.

1. Customers recommend us and come back time and again

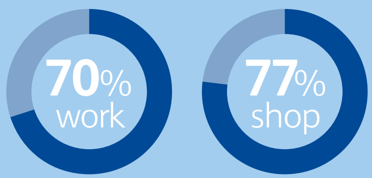


The best result we can ever achieve is that our customers are so pleased with their experience at Tesco that they recommend us to friends and shop with us again and again.

We define loyal customers based on their frequency of shopping with us and average weekly spend. Over the past year, we have seen a (2.5)% decline in this measure.

Going forward, this measure will provide a clear indication of our progress in regaining competitiveness.

2. Colleagues recommend us as a great place to work and shop

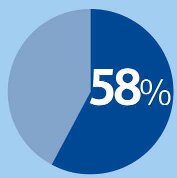


For customers to recommend us, we need to start with our colleagues and make sure Tesco is a great place to work.

In our latest survey, 70% of colleagues told us they would recommend Tesco as a great place to work, and 77% said they would recommend us as a great place to shop.

As part of our business transformation plan, we are committed to being more open, transparent and responsive to what really matters to colleagues. We are already making important changes, including new weekly calls between all store managers and senior leadership teams.

3. We build trusted partnerships



Our business is built on strong partnerships. At a national level, we need to build trusted partnerships with suppliers to provide the best offer for customers. We also rely at a local level on partnerships with communities and wider society as part of our licence to operate.

We survey our suppliers to capture how they feel about their relationship with Tesco and the latest figures indicate that 58% feel satisfied. We have already started to make significant changes to the way we work with suppliers as part of our goal of restoring trust and transparency.

4. Grow sales

Sales including fuel and VAT

£69.7bn ↓ (1.3)%*

Sales excluding fuel and VAT

£55.9bn ↓ (1.4)%*

If we do a better job for our customers, we will grow sales and achieve a stronger financial position.

Last year, our Group sales** declined by (1.4)%, reflecting a challenging backdrop and our own underperformance in the UK. While we must be prepared for further volatility, our focus will remain on our customers and we're working hard to have a positive impact on their shopping trip.

5. Deliver profit

£1,390m ↓ (57.5)%*

As customers recommend us and keep returning to shop with us, our profitability will improve and we will achieve a stronger financial position.

Group trading profit declined to £1.4bn in 2014/15, driven by a challenging year for the UK business. We have taken action to start to restore our competitiveness and have committed to reinvest any savings back into the shopping trip to help our business be stronger over the long term.

6. Improve operating cash flow

£1,860m ↓ (59.6)%*

We need a strong cash flow so we can keep the business running and invest in our customers and the shopping trip.

In 2014/15, our retail cash flow declined to £1.9bn, reflecting both an extremely challenging year for Tesco and a year in which we began a process of considerable change.

* Growth is on a 52 week basis – see the Glossary on page 40.
** Excluding VAT, fuel and IFRIC 13.

Financial review

Alan Stewart
Chief Financial Officer

The reported year has been both an extremely challenging year for Tesco and a year in which we began a process of considerable change. Against this backdrop we delivered sales of £70bn in 2014/15, (1.3)% below last year on a 52 week basis at constant currency. Trading profit declined by (58.1)% to £1.4bn principally as a result of a fall in like-for-like sales, the accumulated costs of inefficiencies within our operations and the changes we have made in the second half to stabilise the business. Our statutory loss before tax was £(6.4)bn, after charging one-off items of £(7.0)bn. Of these one-off items, £(0.6)bn will result in a direct cash outflow, with the remaining amounts being non-cash adjustments to balance sheet carrying values.

Group results 2014/15 (on a continuing operations basis)

On a continuing operations basis	2014/15	52 week % change** (actual exchange rates)	52 week % change** (constant exchange rates)	*53 week % change (actual exchange rates)*
Group sales (including VAT)*	£69,654m	(3.0)%	(1.3)%	*(1.7)%*
Sales growth excluding fuel		(3.2)%	(1.3)%	*(1.9)%*
Group trading profit	£1,390m	(58.2)%	(57.5)%	*(58.1)%*
–UK	£467m	(78.8)%	(78.8)%	*(78.7)%*
–Asia	£565m	(18.4)%	(15.3)%	*(18.4)%*
–Europe	£164m	(31.9)%	(31.1)%	*(31.1)%*
–Tesco Bank	£194m	0.0%	0.0%	*0.0%*
Underlying profit before tax	£961m	(68.4)%		*(68.5)%*
Statutory loss before tax	£(6,376)m	n/a		*n/a*
Underlying diluted earnings per share	9.42p	(70.5)%		*(70.6)%*
Diluted losses per share	(70.24)p	n/a		*n/a*

* Group sales (inc. VAT) exclude the accounting impact of IFRIC 13 (Customer Loyalty Programmes).
** 52 week growth rates exclude week 53 (the 7 days ended 28 February 2015) for the UK and Republic of Ireland.

Protecting and strengthening our balance sheet

Upon our arrival as a new management team we identified protecting and strengthening the balance sheet as one of our three priorities. This resulted in a number of steps to begin to address our balance sheet leverage of £(21.7)bn, which we define more broadly to include net debt, discounted rent or lease commitments and our IAS 19 net pension liability:

- **Liquidity and funding:** We have underpinned our liquidity and funding position with access to £5bn of credit facilities, which remained undrawn at the year end. These facilities are secure, multi-year credit lines ensuring we have the flexibility to address our three immediate priorities over an appropriate timeframe.
- **Capital expenditure:** In 2014/15 we reduced our capital expenditure from £2.7bn to £2.0bn. Based on a comprehensive analysis of the Group's requirements we expect to further reduce our capital expenditure to £1.0bn in 2015/16, net of disposals, without adversely affecting our business.
- **Dividends:** Following the reduction in the interim dividend, the Board has recommended not to pay a final dividend.
- **Pension:** A plan to fund the deficit has been agreed with the Trustee with a payment of £270m per annum and we are consulting with our colleagues to replace our defined benefit pension scheme with a defined contribution scheme.
- **Property:** We have undertaken a detailed review of our property portfolio, including where appropriate to review our lease commitments. In addition we have taken the difficult decision to close 43 unprofitable stores and not to proceed with 49 new store developments. In March 2015 we also announced an asset swap with British Land, regaining sole ownership of 21 superstores and reducing our exposure to indexed rent reviews.
- **Portfolio:** In October we said that we would review our portfolio. To date, this process has resulted in the sale or the closure of Blinkbox and Tesco Broadband and the appointment of advisors to review our options for dunnhumby. This process is on track.

In 2015/16, we will retain our focus on financial discipline.

Enhanced disclosure

Restoring trust and transparency is also one of our three priorities and part of this objective will be met by progressively enhancing our disclosure. In this review we provide greater clarity around commercial income and the valuation and ownership of our property. The Notes to the accounts in the Annual Report and Financial Statements 2015 also include enhanced disclosure of segmental assets (in Note 2 on page 94), net debt (in Note 30 on page 135), JVs and associates (in Note 13 on page 110) and operating leases (in Note 34 on page 137).

Importantly, for 2015/16 we will also move to a simpler profit measure based on operating profit adjusted only for large and distorting impacts.

Visit **www.tescoplc.com/ar2015** to find PDF and Excel downloads of our financial statements

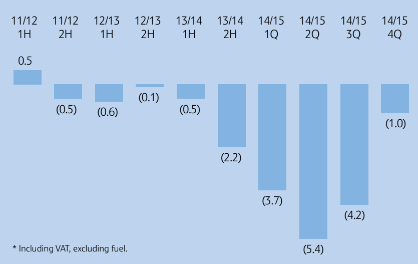
Segmental results
UK

		52 week % change
UK sales* (inc. VAT)	**£48,231m**	(1.7)%
UK revenue* (exc. VAT)	**£43,573m**	(1.8)%
UK trading profit	**£467m**	(78.8)%
Trading margin (trading profit/revenue)	**1.07%**	(394)bp

* Excludes the accounting impact of IFRIC 13.

Full year UK sales declined by (1.7)% on a 52 week basis. This included a 1.8% contribution from new space. Following the year end we completed the closure of 43 stores which we expect to impact our 2015/16 sales by around (0.4)%.

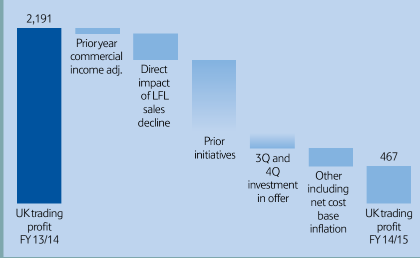
UK like-for-like sales performance* (%)



Like-for-like sales, including VAT and excluding fuel, fell by (3.6)%. This reflected a challenging and deflationary market back drop – and our own underperformance.

We've seen some improvement recently with fourth quarter like-for-like sales performance of (1.0)% driven by positive volumes which represents an encouraging response to the customer-focused initiatives launched in the third quarter.

UK trading profit (£m)



Our full year UK trading margin was 1.07%, a reduction of almost four percentage points year-on-year. The decline principally reflected the combination of the deterioration in like-for-like sales and the impact of previous initiatives. The fundamental change to the way we do business with our suppliers, with significantly less focus on commercial income, further impacted profitability. The investment we have made in service, availability and, selectively in price in the second half is also a contributing factor.

Financial review continued

Asia

		52 week % change at actual rates	52 week % change at constant rates
Asia sales* (including VAT)	**£10,501m**	(4.1)%	(0.9)%
Asia revenue* (excluding VAT)	**£9,884m**	(4.1)%	(0.9)%
Asia trading profit	**£565m**	(18.4)%	(15.3)%
Trading margin (trading profit/revenue)	**5.72%**	(100)bp	(97)bp

* Excludes the accounting impact of IFRIC 13.

Sales in Asia declined by (4.1)% including a (3.2)% impact from foreign exchange. Like-for-like sales were (4.4)%. In South Korea, the impact of the DIDA regulations has remained significant whilst in Thailand the recovery in consumer spending has been slower to materialise than initially anticipated. Our trading performance in Malaysia has been impacted by protests against some Western-owned businesses and a challenging economic environment. Our trading profit in Asia was (15.3)% lower year-on-year at constant rates, primarily due to the operational gearing effect from the impact of negative like-for-like sales performances in all three markets.

Europe

		52 week % change at actual rates	52 week % change at constant rates
Europe sales* (including VAT)	**£9,898m**	(8.5)%	(0.6)%
Europe revenue* (excluding VAT)	**£8,515m**	(8.5)%	(0.7)%
Europe trading profit	**£164m**	(31.9)%	(31.1)%
Trading margin (trading profit/revenue)	**1.93%**	(66)bp	(64)bp

* Excludes the accounting impact of IFRIC 13.

Sales in Europe reduced by (8.5)% on a 52 week basis including a (7.9)% foreign exchange effect as the Euro fell to seven-year lows against Sterling by year-end. Whilst we saw some improvement in the fourth quarter, the like-for-like sales performance was mixed over the course of the year. We have seen strong competition from discount retailers and this held back our sales performance, particularly in Ireland which saw a like-for-like sales decline of (6.3)%. The profitability of our Central European businesses continued to be under pressure and in Turkey included a £(30)m charge relating to the write-off of a fuel debtor.

Recent legislative changes in Hungary, including mandated store closures on Sundays and the introduction of a 'food supervision fee' from 1 January 2015, will have a material impact to ongoing market profitability.

Consultation started in March 2015 on a significant restructure of the leadership team for Czech Republic, Hungary, Poland and Slovakia to move from operating as individual country teams to one regional team. This restructuring will create substantial buying and operational synergies, helping us to unlock more opportunities to invest in the customer offer.

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Tesco Bank

	TY	LY	YOY Change
Revenue	**£1,024m**	£1,003m	2.1%
Trading Profit	**£194m**	£194m	0.0%
Lending to customers	**£7,720m**	£6,915m	11.6%
Customer deposits	**£6,913m**	£6,079m	13.7%
Net interest margin	**4.2%**	4.4%	(0.2)%
Underlying cost: income ratio	**65.0%**	64.0%	(1.0)%
Bad debt asset ratio	**0.7%**	1.0%	+0.3%
Risk asset ratio	**18.8%**	17.7%	+1.1%
Loan to deposit ratio	**111.7%**	113.8%	+2.1%

In highly competitive market conditions, Tesco Bank's revenue was up 2.1% to £1,024m driven by strong growth in lending to customers. We have expanded our range of mortgage and loan products and, in June 2014, we launched our personal current account. Our motor and home insurance business has seen 3% growth in accounts having expanded our underwriting providers and implemented digital improvements to enhance the customer experience. Trading profit was £194m, in line with the prior year, with strong underlying growth offset by our ongoing investment in personal current accounts.

One-off items

	TY	LY*
PPE impairment and onerous lease charges	**£(4,727)m**	£(636)m
Goodwill and other impairments	**£(878)m**	–
Stock	**£(570)m**	–
Restructuring	**£(416)m**	–
Commercial income adjustment		
–Recognised in 13/14	**£(53)m**	–
–Recognised in years prior to 13/14	**£(155)m**	–
Other	**£(223)m**	£(165)m
Total one-off items	**£(7,022)m**	**£(801)m**

* Last year's number is before a £(540)m write-down of goodwill relating to discontinued operations.

During the year the Group incurred £(7.0)bn of one-off and restructuring charges, largely reflecting the weak industry environment and the initiation of a number of measures to turnaround the performance of the Group. Of this amount, £(0.6)bn will result in a direct cash outflow, with the remaining amounts being non-cash adjustments to balance sheet carrying values. These charges included:

- **Fixed asset impairment and onerous lease charges:** At each balance sheet date we review the carrying value of our stores to ensure that they are supported by their value in use or their fair value less the costs of disposal. Against the backdrop of challenging industry conditions and the decline in our profit, our review resulted in an impairment and onerous lease charge of £(3.8)bn against our trading stores. A further impairment charge of £(925)m is recognised in property related items, relating to the impairment of work-in-progress balances and charges relating to the closure of stores.
- **Goodwill and other impairments:** We have booked further goodwill and other impairments totalling £(878)m. These include an impairment of £(630)m relating to our investment with China Resources Enterprise Ltd (CRE), £(116)m relating to Dobbies and other UK businesses, and an impairment of £(82)m in our investment in joint ventures which principally relates to the strategic decision to slow the roll out of Harris + Hoole and Euphorium sites.
- **Stock:** The one-off items include a £(570)m charge to the Group inventory position, principally due to the adoption of a forward-looking provisioning methodology. The charge also includes a £(168)m impact of a reduction in the level of in-store costs capitalised to inventories.
- **Restructuring:** We have described a restructuring of central overheads, a simplification of store management structures and increased working-hour flexibility, which will deliver ongoing savings in the region of £400m per year. These efficiencies will result in a one-off cost of £(350)m of which around £(300)m has been recognised in our 2014/15 results. The remaining balance includes a further £(41)m relating to restructuring in the first half and a £(20)m one-off cost relating to UK store closures.
- **Commercial income adjustment:** The commercial income adjustment refers to the impact on prior years of the commercial income issues that we announced last September. At the time of the interim results, the impacts on prior years were estimated as resulting in the profit before tax for the year ended 22 February 2014 being overstated by £70m, and for the years prior to this being overstated by £75m – a combined total of £145m relating to prior years. Subsequent to October 2014, we continued to focus on this area and identified some further amounts, bringing the total one-off adjustment to £208m for our UK and Irish businesses.

Joint ventures, interest and tax

Joint ventures and associates

Losses from joint ventures and associates were £(13)m, down from a profit of £60m last year. The movement was primarily driven by a loss from our partnership with China Resources Enterprise Ltd (CRE) which was formed in May 2014. UK property joint ventures also made lower profits.

Net finance costs

	TY	LY
Interest receivable and similar income	£90m	£132m
Interest payable on short term bank loans and overdrafts	£(101)m	£(68)m
Finance charges payable under finance leases	£(9)m	£(10)m
Interest payable on medium term notes and bonds	£(433)m	£(448)m
Capitalised interest	£44m	£79m
Underlying net finance costs	£(409)m	£(315)m
IAS 32 and IAS 39 effect	£(26)m	£(11)m
Non cash element of IAS 19 Pensions charge	£(136)m	£(106)m
Net finance costs	£(571)m	£(432)m

Underlying net finance costs increased to £(409)m from £(315)m last year. The increase in net finance costs reflected a higher level of debt and the set up costs relating to new credit facilities. Finance income reduced primarily reflecting the redemption of a medium term note and the expiry of the associated hedging instrument resulting in lower derivative income. Capitalised interest reduced by £(35)m to £44m, in line with reduced levels of work-in-progress.

Taxation

The effective rate of tax for the Group was 20.7%, with a charge of £(199)m based on underlying profit. Last year's rate of 15.4% reflected the one-off effect of a lower UK corporate tax rate on deferred tax liabilities.

Earnings per share

Underlying diluted earnings per share were 9.42p, (70.6)% lower year-on-year at actual tax rates ((70.5)% lower on a 52 week basis), driven by the decline in our trading profit performance. Statutory losses per share were (70.24)p reflecting one-off items.

Dividend

As announced in January, the Board has taken the decision not to recommend a final dividend, with the full year dividend charge solely reflecting the interim dividend of 1.16p paid on 19 December 2014. Future dividends will be considered within the context of the performance of the Group, free cash flow generation and the level of indebtedness.

Capital expenditure

	TY	LY
UK	£1.3bn	£1.6bn
Asia	£0.4bn	£0.7bn
Europe	£0.2bn	£0.3bn
Tesco Bank	£0.1bn	£0.1bn
Group	**£2.0bn**	**£2.7bn**

Capital expenditure was £2.0bn, a decrease of £0.7bn year-on-year, with lower spend in each region. As we described in January, we are planning a significant reduction in Group capital expenditure for the current year to £1.0bn.

Financial review continued

We opened 1.6m square feet of gross new space in the year, but this was offset by the closure of 1.1m sq. ft. of space, primarily in Turkey and Hungary and the repurposing of 0.6m sq. ft. of space, mainly in Asia. We continue to grow our franchise store network. In the year, we opened 1m sq. ft. of space in our franchise stores, mostly in South Korea, and are planning to open a further 0.6m sq. ft. this year.

Property

As at the year end, the estimated market value of fully-owned property across the Group was £22.9bn. This represents a reduction of £7.6bn year-on-year driven mainly by the weakening of the UK and Central European property markets. This represents an estimated surplus of £2.7bn over the net book value.

The estimated market value excludes our share of property joint ventures. Including this, the valuation would increase by £0.9bn, net of the debt in the joint ventures. Last year's disclosed property valuation of £34.1bn included £1.2bn relating to our Chinese operations now disposed to our joint venture and £2.4bn from our share of joint venture property, before deducting debt.

In March 2015, the British Land asset swap added a further £0.7bn to the value of our property as we took ownership of 21 superstores. Including this increase, our Group freehold ownership percentage is now 55% by value and 60% by selling space.

	UK	Asia	Europe	Group
Property* – wholly owned				
–Estimated market value	£10.5bn	£8.3bn	£4.1bn	£22.9bn
–Net book value**	£10.5bn	£6.1bn	£3.7bn	£20.2bn
Proportion of owned net selling space	41%	66%	75%	59%
Proportion of owned space by value***	40%	71%	74%	53%

* Stores, malls, investment properties, offices, Distribution Centres, fixtures and fittings and WIP. Excludes JVs.
** Property, plant and equipment excluding vehicles.
*** Excluding fixtures and fittings.

Retail cash flow and net debt

	TY £m	LY £m
Cash generated from retail operations before changes in working capital*	715	**4,327**
(Increase)/decrease in working capital	1,145	**280**
Interest paid	(609)	(490)
Corporation tax paid	(347)	(612)
Net cash generated from retail operating activities	904	**3,505**
Cash capital expenditure	(2,244)	(2,774)
Free cash flow	(1,340)	**731**
Other investing activities	253	66
Net cash used in financing activities and intra-Group funding and intercompany transactions	239	160
Net (decrease)/increase in cash and cash equivalents	(848)	**957**
Exclude cash movements in debt items	(1,010)	(374)
Fair value and other non-cash movements	(26)	(583)
Movement in net debt	(1,884)	**–**

* Includes both continuing and discontinued operations.

Reflecting the lower level of underlying profitability, £(0.6)bn in interest paid due to underlying finance costs and the timing of interest payments, and £(0.3)bn of cash corporation taxes, net cash generated from retail operating activities was £0.9bn. After cash capital expenditure of £(2.2)bn this resulted in a free cash outflow in the year of £(1.3)bn. This, combined with other movements led to a net debt movement of £(1.9)bn.

Pension

On an accounting basis, the Group's net pension deficit after tax increased from £(2.6)bn last year to £(3.9)bn at the year end. This was driven by a reduction of 80 basis points in real corporate bond yields, leading to a corresponding reduction in the discount rate used to measure our long term liabilities, partially offset by a strong asset performance. On an actuarial basis, the deficit at 31 March 2014 was £(2.8)bn and a plan to fund the deficit with cash contributions of £270m per annum has been agreed with the Trustee. We are consulting with our colleagues to replace our defined benefit pension scheme with a defined contribution scheme.

Total indebtedness

We define our balance sheet leverage more broadly to include net debt, discounted rent and lease commitments and our IAS 19 pension liability. On this basis our total leverage or indebtedness was £(21.7)bn, an increase of £(3.1)bn driven by increases in both net debt and our pension liability.

	TY £m	LY £m
Net debt* (excludes Tesco Bank)	(8,481)	(6,597)
Discounted operating lease commitments	(9,353)	(9,419)
Pension deficit, IAS 19 basis (post-tax)	(3,885)	(2,559)
Total indebtedness (including lease commitments and pension deficit)	(21,719)	**(18,575)**

* Includes both continuing and discontinued operations.

Our discounted minimum operating lease commitments were broadly unchanged at £(9.4)bn, whilst our operating lease expense in the year increased by £72m to £1,486m. Around £35m of this expense related to inflation-indexed rent which will not recur as a result of the British Land asset swap entered into post year end. The transaction will also result in the consolidation of net debt of around £450m.

Outlook

The market is still challenging and we don't expect this to change in the immediate future. Over the next 12 months we will continue to focus on our three priorities: regaining competitiveness in our UK business; protecting and strengthening the balance sheet; and rebuilding trust and transparency in the business and the brand.

We are already making good progress on these initiatives and on the basis of actions already undertaken they will deliver significant cost savings in 2015/16. The immediate priority for these and any other savings delivered is reinvestment in the customer offer in order to further restore UK competitiveness.

Alan Stewart
Chief Financial Officer

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Commercial income

Commercial income represents part of our overall economic relationship with suppliers. Consistent with standard grocery market practice, we negotiate a very wide range of payments to and from our suppliers including fees, contributions, discounts, multiple offers and volume rebates. Whilst we have embarked on a fundamental review which will significantly simplify our approach, in total we currently use over 20 different categories of variation in payment terms. Many of these relate to adjustments to a cost price and can be considered (and are in practice) a part of the standard unit price variations that can be expected under normal, competitive market conditions. As such these amounts are recognised in the income statement as a deduction to the cost of goods sold.

A number of commercial income categories can be conditional on the satisfaction of certain actions or performance conditions by either Tesco or the supplier in question, including the achievement of agreed sales volume targets, the provision of certain benefits such as marketing materials or promotional product positioning, and costs incurred for unplanned variations in product specification. In most instances, the arrangements that set out these terms cover periods that are within or end at the same point as our financial year.

Where agreements are in place across a period end, judgement can be required to assess if the conditions will be met, and therefore to estimate the period end amounts payable and receivable. For example, where there are volume-related allowances spanning different account periods, the Group assesses the probability that targeted volumes will be achieved based on historical and forecast performance, recognising the appropriate amounts in the period end balance sheet and income statement.

Commercial income is reflected in a number of balance sheet categories – principally due to differences in timing between recognition of income, receipt of cash and sale of goods. In order to provide greater clarity on the accounting for commercial income – including those instances where judgement and estimates are used – we are increasing our disclosure to show the effects of commercial income on the following balance sheet accounts:

- **Inventories:** The carrying value of inventories is reduced by the value of commercial income which will be earned when the associated stock is sold.

- **Trade and other receivables:** Amounts that have been invoiced to suppliers but not yet received are included within trade and other receivables.

- **Accrued income:** Any amounts earned but not yet invoiced to suppliers are included in accrued income. The majority relates to amounts outstanding under large supplier agreements or promotional allowances that run up to the period end. The balance primarily reflects amounts due under long-term agreements for volume rebates.

- **Trade payables:** Most agreements with suppliers enable income earned to be offset against amounts owed. These balances are included as a deduction within trade payables.

- **Accruals and deferred income:** Any amounts received in advance of income being earned are included in accruals and deferred income.

The impact of commercial income on each of these accounts for the years to 28 February 2015 and 22 February 2014 is shown below:

	2015 Group £m	UK £m	2014 Group £m	UK £m
Current Assets				
Inventories	(93)	(67)	(82)	(52)
Trade and other receivables				
–Other receivables	97	54	89	22
–Accrued income	158	117	230	173
Current Liabilities				
Trade and other payables				
–Trade payables	347	173	547	368
–Accruals and deferred income	(53)	(53)	–	–

Strategic report

Supplementary material

Environmental and social review

Wherever we work, we want to help make life a little easier for our customers, colleagues and communities.

Our approach
We want to help everyone who shops with us enjoy a better quality of life and an easier way of living.

We also want to help tackle wider social and environmental challenges which our customers care about and which are material to our business, for example making it easier for customers and colleagues to live healthier lives; reducing food waste and tackling food poverty; and working with our suppliers to source responsibly and sustainably.

While the last year has been challenging for Tesco, we remain incredibly proud of the efforts we have made to tackle sustainability issues, support important causes and help local communities. As we begin the process of renewal and change, we are committed to listening to and working with our customers, colleagues and stakeholders from across society to ensure that we align our approach to value creation with their expectations.

Our reporting
As we reset many aspects of our business, so we have changed our approach to reporting. This report looks at our business in the round and sets out our strategic priorities; our corporate responsibility is a fundamental part of these. Instead of a separate, printed corporate responsibility report, we now publish further details on our corporate responsibility, our policies and our key data online. In addition we are refreshing our approach to our materiality assessment as we continue listening to ensure we understand what matters most to our customers, colleagues, suppliers and stakeholders. All of this can be found at www.tescoplc.com/society.

Our governance
Our new Chairman, John Allan, has taken on the role of chair of our Corporate Responsibility Committee following the retirement of Jacqueline Tammenoms Bakker from the Board. More detail about the governance of this Committee can be found on page 40 of the Annual Report and Financial Statements 2015.

We also work closely with our Expert Advisory Panel, made up of four independent corporate responsibility advisors, who meet four times a year to provide valuable input and act as a critical voice to our activities. More information on this can be found online at www.tescoplc.com/ourpanel.

Visit **www.tescoplc.com/society** for information on:
- Our approach
- Ongoing activities
- Our latest case studies

As an example of our approach to creating sustainable value chains, take a look at our work on bananas:

We're proud to be the first retailer to publish data on food waste within our own operations, and we're working with our suppliers and customers to reduce food waste from the farm to the fork.

1. Suppliers

We want to make sure no edible part of the banana crop is wasted, so we work with dedicated banana farms to use as much as possible of the banana crops they produce. We sell small bananas in our Everyday Value and Goodness ranges, and we sell single bananas in our One Stop stores.

2. Own operations

To minimise damage to the bananas in our stores, we train our colleagues in how to treat food. A key part of that is our 'Love Bananas' campaign – this helps colleagues to understand how to handle bananas in order to minimise bruising.

3. Customers

Customers tell us they want to reduce waste within their own homes, and we're doing lots of little things to help – including adding WRAP food waste hints and tips on our fresh food packaging, and creating a meal planner on our Real Food website, which suggests recipes for customers who want to use up their food.

What's next?

Within our own operations, our overriding priority is always to minimise any food waste – but where waste does occur, customers tell us they want us to give edible food to charity. We have made great progress on this over the last year, and we will be looking at what more we can do to ensure no edible food is wasted.

Our people

Our approach

The challenges our business has faced over the last year have been incredibly difficult for our colleagues, but despite this, we are extremely proud of the focus which colleagues have continued to place on doing the right thing for customers and delivering outstanding service.

A key principle throughout the transformation process has been, wherever possible, to make sure colleagues are the first to know of any changes within the business which will affect them. This commitment to be open and transparent will continue once the transformation process is complete.

We have worked hard to do everything we can to support colleagues and offer expert advice as they face changes to their roles and the organisation. We have continued to expand our training programmes to help colleagues grow and develop. The importance of diversity in the broadest sense also remains critical to our business, and the ratio of male to female colleagues at year end is outlined below. In addition, the pay gap between men and women is less than 1%.

Our diversity	Male		Female	
Board of Directors*	**10**	77%	**3**	23%
Senior managers – Directors	**614**	76%	**195**	24%
Senior managers – Directors and managers	**3,847**	69%	**1,732**	31%
All employees	**220,257**	43%	**297,545**	57%

* Changes since year end mean that our Board is now made up of nine men and one woman.

Respecting human rights

We are determined to respect the human rights of our customers, our colleagues and our suppliers, within all of the communities they work.

We are committed to upholding basic human rights and fully support the UN Universal Declaration of Human Rights and the International Labour Organization Core Conventions. We are a founding member of the Ethical Trading Initiative and our industry-leading team of labour standards experts support our suppliers to work towards fully implementing its Base Code. We always investigate allegations of human rights infringements and take action when needed to ensure people's rights are respected.

We want everybody to have their human rights upheld and we know our customers, colleagues and suppliers do too.

- Our customers want to buy great products that are produced safely and responsibly. Only by protecting human rights can we give our customers this confidence, as well as ensuring we are a good neighbour wherever we operate.
- We have strong, consistent people policies that are designed to make Tesco a great place to work; where everyone is welcome and feels confident to be themselves in a safe environment.
- We are building even stronger partnerships with trusted suppliers so we can ensure that we deliver great, safe products that are responsibly produced.

We know that consistently addressing human rights risks and concerns across a global supply chain can be complicated. Only by being open and responsive and having strong relationships, can we find out about issues and work to solve them. We must work in partnership to do this – both with our suppliers and with experts and non-governmental organisations (NGOs) on the ground. It is also why we were strong supporters of the UK Government's new Modern Slavery Bill and the clause on transparency in supply chains, and look forward to reporting against this in future years.

Governance and monitoring

Our governance committees consider financial and non-financial risks to our business and the Compliance and Corporate Responsibility Committees in particular consider risks related to our Human Rights Policy, which are maintained on our company risk register.

This year we launched a new Code of Business Conduct, supported by a company-wide training programme to help colleagues follow key policies; this included a section on our approach to human rights.

Furthermore, we now have protector lines for both colleagues and suppliers, so any concerns with business conduct can be raised confidentially.

To review our full policy visit www.tescoplc.com/humanrights.

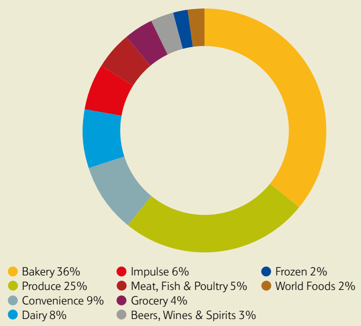
Food waste

In 2014/15 we have calculated that 55,400Δ tonnes of food were wasted in Tesco stores and distribution centres in the UK which is equivalent to 0.9%Δ of the number of food products we sold in our stores over the same period. The chart on the right shows the breakdown of this food waste by category. This has decreased by 1,180 tonnes compared to 2013/14.

Δ Independent limited assurance provided by KPMG LLP. It is important to read the data in the context of KPMG's full statement and Tesco's reporting criteria at www.tescoplc.com/foodwastefigures.

Tesco UK food waste by category breakdown

(% breakdown of total tonnage value)



55,400 tonnes
Food waste in our own operations (UK)

Greenhouse gas emissions

Our net carbon footprint in 2014/15 was 5.6 million tonnes of CO_2e.

Our overall net carbon intensity per square foot of retail and distribution floor space decreased by 4.3% compared to last year, and 40.9% since 2006/07, surpassing our 2014/15 annual reduction target.

For more information on our carbon targets and how we calculate our carbon footprint, including reporting standards and an Independent Assurance Statement from our auditors (ERMCVS), see www.tescoplc.com/carbonfigures.

	Global tonnes of CO_2e		
GHG emissions data for period 23 February 2014 to 28 February 2015	Base year 2006/07	2013/14	2014/15
Scope 1	1,311,109	1,320,122	1,313,291
Scope 2	2,503,597	3,036,282	3,145,907
Scope 1 and 2 carbon intensity (kg CO_2e/sq. ft. of stores and DCs)	49.63	30.65	30.11
Scope 3	1,129,699	1,287,661	1,166,743
Total gross emissions	4,944,405	5,644,066	5,625,941
CO_2e from renewable energy exported to grid	–	163.63	680.16
Total net emissions	4,944,405	5,643,902	5,625,261
Overall net carbon intensity (total net emissions kg CO_2e/sq. ft. of stores and DCs)	64.33	39.71	37.99

Visit **www.tesco.com/society** for more information on our policies and disclosures

Principal risks and uncertainties

We have an established risk management process to identify the principal risks that we face as a business. The risk management process relies on our judgement of the risk likelihood and impact and also developing and monitoring appropriate controls. We maintain a Group Key Risk Register of the principal risks faced by the Group and this is an important component of our governance framework and how we manage our business. Our risk management process is cascaded down the Group. The content of the Group Key Risk Register is considered and discussed through regular meetings with senior management and review by the Executive Committee and the Board. Our process for identifying and managing risk is set out in more detail on page 44 of the Annual Report and Financial Statements 2015.

The table below sets out our key risks, their movement during the year and examples of relevant controls and mitigating factors. The Board considers these to be the most significant risks faced by our Group that may impact the achievement of our three strategic priorities as set out on page 3. They do not comprise all of the risks associated with our business and are not set out in priority order.

Additional risks not presently known to management, or currently deemed to be less material, may also have an adverse effect on the business.

In September 2014, we identified an overstatement of the expected financial results. This is now the subject of an investigation by the Serious Fraud Office and civil proceedings in the United States. Details can be found on page 32 and in Note 32 on page 136 of the Annual Report and Financial Statements 2015. There are significant uncertainties as to the outcome of the existing investigation and proceedings, as to whether further proceedings may be brought against the Group in connection with the overstatement of the expected financial results and as to whether any proceedings brought against the Group would be likely to have a significant effect on the results of its operations or its financial condition.

Key to risk movement
↑ Risk increasing
→ No risk movement
↓ Risk decreasing

Principal risks	Risk movement	Key controls and mitigating factors
Customer		
If we do not meet customer needs and compete on price, product range, quality and service in the competitive UK and overseas retail markets, then we lose our share of customer purchases By not considering the customer at the heart of our decision-making processes, we adversely impact our relationship with customers	→	• We have strategically re-positioned our business to focus on the customer • We are investing further in our customer proposition, reducing prices across our ranges and improving service with additional colleague hours • Our performance is tracked within our business against measures that customers tell us are important to their shopping experience • Customer perceptions of Tesco and our competitors are regularly monitored to allow us to react quickly and appropriately
Financial strategy		
There is a risk that the financial strategy is unclear or unsustainable Weak performance could put further pressure on free cash flow and impact our ability to improve our credit rating Our ability to operate successfully in international markets may be restricted if we cannot get the returns required in each market and this could adversely impact our profitability There is a risk that future legal and regulatory changes to the pension scheme could introduce more onerous requirements and increase our financial liability and that the deficit on the existing scheme could increase due to changes in assumptions on inflation, mortality and discount rates applied in determining liabilities of the scheme and the performance of its assets Investor support may be impacted if it takes longer than expected to demonstrate that our strategy is achieving the turnaround	↑	• Strategic matters are regularly reviewed by the Executive Committee and Board and we seek external advice as required • We have clear processes for the evaluation and identification of underperforming assets to ensure that appropriate action is taken • Our plans and budgets are developed and presented to our Executive Committee and Board for approval to ensure targets and objectives are clear and consistent • Our Group Property strategy ensures that there is a clear plan to address and control retail space, re-purpose space effectively where needed and ensure the right balance between freehold and leasehold space • We are consulting on the closure of our UK pension scheme to all future accrual which, if approved, would stop the future growth of liabilities and significantly reduce liability risk in the scheme • External expert advisors and the pension scheme Trustee are fully engaged to consider the funding position and fund performance of the pension scheme as well as the impact of legislative and regulatory changes • There has been a triennial revaluation of the pension scheme assets and liabilities in the year and a deficit funding plan has been agreed with the Trustee • We engage regularly with our investors to communicate details of our strategy and plans • Further detail on the management of financial risks is set out on page 25 and in Note 22 on page 120 of the Annual Report and Financial Statements 2015
Brand, reputation and trust		
Our brand will suffer if we do not rebuild trust and transparency in our business If we cannot be firm in the face of ethical, legal, moral or operational challenges, our reputation may be damaged	↑	• Rebuilding trust and transparency in our brand is one of our three strategic priorities • Our Group processes and policies set out how we can make the right decisions for our customers, colleagues, suppliers, communities and investors • We have developed communication and engagement programmes to listen to our stakeholders and reflect their needs in our plans • We maximise the value and impact of our brand with the advice of specialist external agencies and in-house marketing expertise • We are developing new Corporate Responsibility goals that are aligned with customer priorities and our brand

Principal risks	Risk movement	Key controls and mitigating factors
Data security and privacy		
Increasing risks of cyber-attack threaten the security of customer, colleague and supplier data We must ensure that we understand the types of data that we hold and secure it adequately to manage the risk of data breaches	↑	• We have active monitoring processes to identify and deal with IT security incidents • A new Cyber Security team has been established to investigate and mitigate the risks of cyber-attack • A Group-wide Information Security Blueprint has been rolled out across our businesses • There is a programme of compliance monitoring and review being rolled out with training across our businesses • A programme to review the use, storage and security of customer data is in progress
Transformation		
If the scale of the change across our business disrupts our focus, there is a risk that we will not transform the business to where it needs to be There is a risk that we underestimate the wider impacts of the changes that we are making	NEW	• There is Executive sponsorship of the Transformation programme with the creation of a Transformation Director role • New Group structures have been designed to simplify our business and clarify accountability • A new Programme Management Office has been established to manage the Transformation programme and will be supported by experienced resource from within the business and externally as required
Competition and markets		
If we fail to address the differing challenges of the budget retailers, the premium retailers and online entrants, it may adversely impact our market share and profitability	↑	• We actively seek to be competitive on price, range and service as well as developing our online and multiple formats to allow us to compete in different markets • Our Executive Committee and operational units regularly review markets, trading opportunities and competitor strategy and activity
Performance		
If our strategy is not effectively communicated or implemented, our business may underperform against plan and competitors The delivery of long term plans may be impacted if the business focuses on short term targets only	→	• Our Board, Executive Committee and operational units meet regularly to review performance risks • All businesses have targets based on a new balanced scorecard of performance against KPIs and financial targets. Plans are monitored and reviewed regularly by the Executive Committee and the Board • An ongoing communication process informs our colleagues about the long term strategy and ensures that they understand their part in it • There are clear guidelines and policies set out to ensure that there is an appropriate focus on balance between short term and longer term delivery
Political and regulatory		
In each country in which we operate, we may be impacted by legal and regulatory changes, increased scrutiny from competition authorities and political changes that affect the retail market The regulatory landscape is becoming more restrictive in many markets and may impact our trading	↑	• We engage with government and regulatory bodies to represent the views of our customers, colleagues and communities and to manage the impact of political and regulatory changes • We aim to contribute to important discussions in public policy wherever we operate • Country developments are monitored by our local management teams • Group and country Compliance Committees monitor and guide legal and regulatory compliance with support from our Group Regulatory Ethics and Compliance team • The Tesco Bank Executive and Treating Customers Fairly Board oversee Tesco Bank's compliance with regulatory requirements
Product		
Our business may suffer if we fail to work with our suppliers to ensure that our products are designed and delivered to meet a high standard and to ensure we can trace their provenance If we do not build mutual and trusting relationships with our suppliers, this could impact our range and price proposition If we do not manage our supply chain, we may risk not being able to ensure the quality and security of product supply for customers	→	• Group and country Compliance Committees have been re-structured to simplify the identification and monitoring of the risks associated with products, suppliers and operations • We publish results of internal testing (e.g. provenance tests of content in our food) and we have in place ethical trading teams working with suppliers • Appropriate controls are in place around: product development; supplier management, including the introduction of a new Supplier Feedback forum and an independent Protector Line and Helpline; distribution standards; third party contract management; and compliance with regulatory standards • Clear procedures are operated globally to ensure product integrity and comprehensive supplier audit programmes are in place to monitor product integrity and labour standards • A comprehensive compliance programme is in place to promote, monitor and review compliance with the Groceries Supply Code of Practice in the UK. Appropriate programmes are in place in other markets • Sustainability considerations are integrated into our long-term decision making to ensure that the development of our products is aligned with our goal of reducing our impact on the environment. We look, in particular, at sustainable sourcing, improved security of supply and mitigating the impact of climate change

Principal risks	Risk movement	Key controls and mitigating factors
Technology		
Any significant failure in the IT processes of our retail operations in stores, online or in our supply chain could impact our ability to trade If we do not invest enough or efficiently or invest in the wrong areas, we may not be able to deliver our customer proposition which could impact our competitiveness As we develop new technologies, we must maintain the controls over existing platforms or it may impact systems availability and security	→	• Our IT strategy is reviewed and approved by the Executive Committee • We have governance processes in place around new system implementations and change management of existing IT, adherence to which is closely monitored • There is a clear programme of investment to maintain the integrity and efficiency of our IT infrastructure and its security • Business continuity plans are in place for key business processes
People		
Failure to attract, retain, develop and motivate the best people with the right capabilities across all levels, geographies and through the business transformation process could limit our ability to succeed There is a risk that our leaders may not play their critical role in shaping the organisation that we want to be and that they do not inspire great performance from our teams	↑	• The Executive Committee meets regularly to review and monitor people policies and procedures and talent development • We seek to understand and respond to employees' needs by listening to their feedback from open conversations, social media, colleague surveys and performance reviews • Talent planning, training and people development processes are embedded across our Group • Objectives and remuneration arrangements for senior management are approved by the Executive Committee and have been re-designed to reward behaviours as well as delivery of results
Safety, fraud, control and compliance		
If we do not implement safety standards effectively, we may endanger our customers or colleagues Given the existing size, geographical scope and complexity of our Group, the potential for fraud and dishonest activity by our suppliers, customers and employees increases There is a risk that if the compliance monitoring to our Group standards and policies is not sufficient, we could fail to identify weaknesses or breaches	↑	• Standards for Health and Safety are defined for all of our sites, monitoring processes are in place and we have created a Group team whose primary objective is to ensure that safety standards are met • Product safety standards are communicated to our suppliers and tested through audit programmes • Procedures and controls are set out across the business to reduce fraud and compliance risks, including our Group Accounting Policy, key financial controls self-assessment programme, IT access controls and appropriate segregation of duties. Group Loss Prevention and Security monitors fraud, bribery and other compliance risks • Compliance Committees monitor compliance with relevant laws and regulations • Our Group Code of Conduct has been recently refreshed and re-launched with appropriate training across the Group. This sets out clear behavioural guidance, consistent with our Values • We have comprehensive guidance across the Group to ensure compliance with the UK Bribery Act (and applicable local legislation) and use an externally managed Whistleblowing service (Protector Line) to allow colleagues to report any instances of inappropriate behaviour • A Fraud Blueprint setting out risks, controls and operational strategies informs a preventative approach
Tesco Bank		
The continually changing regulatory environment could impact the levels of capital and liquidity the Bank expects to hold, could impact the earnings profile as a result of interchange fee caps, and may affect the governance of the Bank as the new regulatory Senior Managers Regime is finalised	→	• The Bank has a defined 'Risk Appetite', approved and regularly reviewed by both the Bank's Board and the Tesco PLC Board, which sets out the key risks, their optimum ranges, alert limits and the controls required to manage them within their approved tolerance limits • The Bank has formed good working relationships with the Prudential Regulation Authority and Financial Conduct Authority • There is a comprehensive structure of governance and oversight in place, including through the Bank's Governance and Conduct Committees, to help ensure the Bank's compliance with applicable laws and regulations • The Group is actively engaged in developing and implementing plans to respond to interchange fee developments to manage the impact on our profitability

Financial risks review

The main financial risks faced by the Group relate to the availability of funds to meet business needs, fluctuations in interest and foreign exchange rates and credit risks relating to the risk of default by parties to financial transactions. Further explanation of these risks is set out in Note 22 on page 120 of the Annual Report and Financial Statements 2015. An overview of the management of these risks is set out below. Details of the main financial risks relating to Tesco Bank and the management of those risks can be found in Note 22 on page 123 of the Annual Report and Financial Statements 2015.

Financial risks	Key controls and mitigating factors
Funding and liquidity risk	
The risk of being unable to continue to fund our operations on an ongoing basis	• The Group finances its operations by a combination of retained profits, disposals of assets, debt capital market issues, commercial paper, bank borrowings and leases • New funding of £2.3 billion was raised during the year, including £2.1 billion from long term debt and £0.2 billion from property disposals. At the year end, net debt was £8.5 billion (2014: £6.6 billion) • The policy is to smooth the debt maturity profile, to arrange funding ahead of requirements and to maintain sufficient undrawn committed bank facilities and to maintain access to capital markets so that maturing debt may be refinanced as it falls due • Tesco has put in place £5 billion of committed facilities consisting of a revolving credit facility and bilateral lines as alternate sources of liquidity • At the year end, the Group had a long-term credit rating of BBB- (negative) from Fitch, Ba1 (stable) from Moody's and BB+ (stable) from Standard & Poor's
Interest rate risk	
The risk to our profit and loss account resulting from rising interest rates	• Forward rate agreements, interest rate swaps, caps and floors may be used to achieve the desired mix of fixed and floating rate debt • Our policy is to fix interest rates for the year on a minimum of 40% of actual and projected debt interest costs of the Group excluding Tesco Bank. At the year end, the percentage of interest-bearing debt at fixed rates was 79% (2014: 84%). The remaining balance of our debt is in floating rate form. The average rate of interest paid on an historic cost basis this year, excluding joint ventures and associates, was 4.09% (2014: 4.5%)
Foreign exchange risk	
The risk that exchange rate volatility may have an adverse impact on our balance sheet or profit and loss account	• Transactional currency exposures that could significantly impact the Group Income Statement are managed, typically using forward purchases or sales of foreign currencies and purchased currency options. At the year end, forward foreign currency transactions, designated as cash flow hedges, equivalent to £2.2 billion were outstanding (2014: £2.9 billion) as detailed in Note 21 on page 116 of the Annual Report and Financial Statements 2015. We translate overseas profits at average foreign exchange rates • We only hedge a proportion of the investment in our international subsidiaries as well as ensuring that each subsidiary is appropriately hedged in respect of its non-functional currency assets. During the year, currency movements increased the net value, after the effects of hedging, of the Group's overseas assets by £5 million (last year decrease of £1,102 million)
Counterparty risk	
The risk of loss arising from default by parties to financial transactions	• The Group holds positions with an approved list of highly rated counterparties • Tesco monitors the exposure, credit rating, outlook and credit default swap levels of these counterparties on a regular basis
Insurance risk	
The risk of being inadequately protected from liabilities arising from unforeseen events	• We purchased assets, earnings and combined liability protection from the open insurance market for higher value losses only • The risk not transferred to the insurance market is retained within the business with some cover being provided by our captive insurance companies, ELH Insurance Limited in Guernsey and Valiant Insurance Company Limited in the Republic of Ireland. ELH Insurance Limited covers Assets, Earnings and Combined Liability, while Valiant Insurance Company Limited covers Combined Liability only

This Strategic report, which has been prepared in accordance with the requirements of the Companies Act 2006, has been approved and signed on behalf of the Board.

Paul Moore
Company Secretary
5 May 2015


PINOT GRIGIO

Supplementary material

Board of Directors

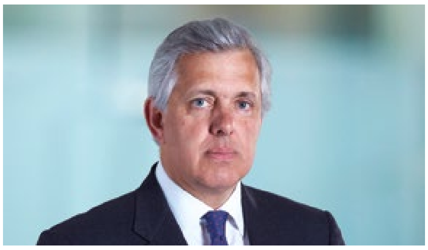
John Allan ▲ ● ✚
Non-executive Chairman
John joined the Board on 1 March 2015. After a career including Marketing, Buying and Retail Operations, John became CEO of Ocean Group plc in 1994 and then Exel in 2000, following a merger with NFC to become the global leader in logistics. John joined the Board of Deutsche Post when it acquired Exel in 2005 for a share price five times of that of 1994, and was CFO from 2007 to 2009.

John became Chairman of Dixons Retail in September 2009. Dixons conducted a comprehensive turnaround programme during which the share price more than quadrupled, culminating in a friendly merger of equals with Carphone Warehouse in August 2014 to form Dixons Carphone. He is also Chairman of Barratt Developments and Chairman of Worldpay.

Dave Lewis
Group Chief Executive
Dave became Group Chief Executive of Tesco on 1 September 2014, joining from Unilever. Over nearly 28 years, Dave worked in a variety of roles with Unilever, which took him across greater Europe, Asia and the Americas. His last three roles were Chairman for Unilever in the UK and Ireland, President for the Americas and Global President, Personal Care. During his career, Dave has been responsible for a number of business turnarounds. Dave is a Non-executive Director of British Sky Broadcasting Group plc.

Alan Stewart
Chief Financial Officer
Alan joined the Board on 23 September 2014. Alan has extensive financial experience in retail having been CFO at Marks & Spencer and WH Smith. A qualified accountant, he started his career in investment banking with HSBC in 1986. He became CFO at Thomas Cook Holdings in 1998 and was appointed UK CEO in 2001. In 2005 he moved to WH Smith as Group CFO. In 2008 he was appointed CFO at AWAS, a leading aircraft leasing business, before moving to M&S in 2010. He is also a Non-executive Director of Diageo plc.

Richard Cousins ■ ▲
Senior Independent Director
Richard was appointed a Non-executive Director on 1 November 2014 and became the Senior Independent Director on 7 April 2015. Richard brings valuable UK and international corporate experience to the Board. He has been the Group CEO of the Compass Group PLC since 2006 and is also a member of the advisory board of Lancaster University Business School. Prior to joining Compass, Richard worked for 15 years for BPB PLC and was Group Chief Executive from 2000 to 2005. Richard was previously a Non-executive Director of Reckitt Benckiser Group PLC and of HBOS PLC and P&O.



Mark Armour ■
Non-executive Director
Mark was appointed on 2 September 2013. Mark was Chief Financial Officer of Reed Elsevier Group plc (now RELX Group plc) from 1996 until 2012 and of its two parent companies, Reed Elsevier PLC and Reed Elsevier NV. Prior to joining Reed Elsevier in 1995, Mark was a partner of Price Waterhouse in London. He is a Non-executive Director of the Financial Reporting Council and a Non-executive Director and Chairman of the Audit Committee of SABMiller plc. Mark is a fellow of the Institute of Chartered Accountants.

Stuart Chambers ▲ ●
Non-executive Director
Stuart was appointed on 3 July 2010. He served as the Chairman of the Remuneration Committee until 1 January 2015 and was a Non-executive Director of Tesco Bank from 2012 to 2014. Stuart was Group Chief Executive of NSG Group from 2008 to 2009, and was Group Chief Executive of Pilkington plc prior to NSG's acquisition in 2006. He was a Non-executive Director of Smiths Group plc and a Non-executive Director of Manchester Airport Group plc. Stuart was appointed Chairman of Rexam plc on 23 February 2012 and Chairman of ARM Plc on 1 March 2014.

Byron Grote ■
Non-executive Director
Byron was appointed to the Tesco Board on 1 May 2015. He is also currently a Non-executive Director on the Boards of Anglo American, Akzo Nobel NV and Standard Chartered and was previously a Non-executive Director of Unilever. Byron served as an Executive Director at BP plc from 2000 until 2013. He was the Chief Financial Officer at BP from 2002 until 2011, following two years as Chief Executive of BP Chemicals.

Ken Hanna ▲■●
Non-executive Director
Ken was appointed on 1 April 2009 and became the Audit Committee Chairman on 5 October 2012. Ken was previously Chief Financial Officer of Cadbury plc from 2004 until 2009 and prior to that an Operating Partner of Compass Partners and CFO and then CEO of Dalgety plc. Ken has also been CFO of United Distillers and Avis Europe plc. He is currently Chairman of Inchcape plc, Aggreko plc and Shooting Star CHASE. Ken is a fellow of the Institute of Chartered Accountants.

Mikael Olsson ●✚
Non-executive Director
Mikael was appointed on 1 November 2014. Mikael brings valuable retail and international experience to the Board. He was CEO and President of the IKEA Group from 2009 until 2013. During his 34 years at IKEA, Mikael held a wide range of roles across the IKEA business and was a member of the Executive Management Group of the IKEA Group from 1995 until 2013. He is a Non-executive Director of The Schiphol Group, Volvo Car Corporation, Ikano S.A. and Lindengruppen AB.

Deanna Oppenheimer ●✚
Non-executive Director
Deanna was appointed a Non-executive Director on 1 March 2012 and became Chairman of the Remuneration Committee on 1 January 2015. She became a Non-executive Director of Tesco Bank on 17 July 2012. Deanna previously held various senior roles at Barclays, including Vice Chair of Global Retail Banking and also as Chief Executive of Europe Retail and Business Banking. She has also served as a Non-executive Director of Catellus and Plum Creek Timber. Deanna is the Founder of CameoWorks LLC and is a Non-executive Director at NCR Corporation and The AXA Group.

Committee membership (at 5 May 2015)
▲ = Nominations Committee
■ = Audit Committee
● = Remuneration Committee
✚ = Corporate Responsibility Committee

There have been a number of changes to the Board since last year which are described in the Chairman's statement on page 2 and the corporate governance report in the Annual Report and Financial Statements 2015 on pages 32 to 36.

Executive Committee

Our Executive Committee is organised around our three core capabilities – customers, channels and products – alongside leaders for each of the key functions.

Dave Lewis
Group Chief Executive
Dave became Group Chief Executive of Tesco on 1 September 2014, joining from Unilever. Over nearly 28 years, Dave worked in a variety of roles with Unilever, which took him across greater Europe, Asia and the Americas. His last three roles were Chairman for Unilever in the UK and Ireland, President for the Americas and Global President, Personal Care. During his career, Dave has been responsible for a number of business turnarounds. Dave is a Non-executive Director of British Sky Broadcasting Group plc.

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Matt Davies
UK & ROI CEO
Matt joined Tesco on 11 May 2015 as UK & ROI CEO on the Executive Committee. Prior to Tesco, Matt was CEO at Halfords Group PLC and before that CEO at Pets at Home. He brings a huge amount of experience, both in retail and business transformation. He is also a qualified Chartered Accountant with extensive corporate finance experience.

Jill Easterbrook
Group Business Transformation Director
Jill joined Tesco in 2001 and has held various leadership roles across the Group. In 2013, Jill joined the Executive Committee as Director of Developing Businesses. She subsequently became Chief Customer Officer until January 2015 when she took up the role of Group Business Transformation Director.

Benny Higgins
CEO, Tesco Bank and Group Strategy Director
Before joining Tesco Bank, Benny served as Chief Executive Officer of Retail Business at HBOS PLC. Between 1997 and 2005 Benny was Chief Executive of Retail Banking at the Royal Bank of Scotland. Prior to joining RBS, Benny was at Standard Life for 14 years. He has been Chief Executive of Tesco Bank since 2008. As well as his role leading the Bank, Benny Higgins became Group Strategy Director in January 2015.

Alison Horner
Chief People Officer
Alison joined Tesco in 1999 as a Personnel Manager and was later promoted to Personnel Director for Tesco's UK operations. After eight years in stores and general merchandise roles she joined the Executive Committee in 2011 as Group Personnel Director, with responsibility for the development of our 500,000 colleagues.

Trevor Masters
International CEO
Trevor joined Tesco in 1979, starting his Tesco career as a Store Manager, and later a Store Director. Trevor held the role of Operations Director for Extras in the UK during a period which saw the expansion of the Extra estate from 9 to 200 stores. He has also served as CEO Central Europe and CEO Asia. In January 2015, Trevor was appointed International CEO.

Adrian Morris
Group General Counsel
Adrian joined Tesco in September 2012 as Group General Counsel. Prior to Tesco, Adrian worked at BP plc as Associate General Counsel for Refining and Marketing. From 2002 to 2009, Adrian was with Centrica PLC, initially as European General Counsel and then as General Counsel for British Gas.

Rebecca Shelley
Group Communications Director
Rebecca joined Tesco in May 2012 as Group Corporate Affairs Director. Prior to Tesco, Rebecca was a partner at Brunswick LLP where she advised a range of companies on financial and corporate reputation issues. From 2000 to 2007, Rebecca worked at Prudential as Group Communications Director and was a member of its Executive Committee.

Jason Tarry
Chief Product Officer
Jason joined Tesco in October 1990 on the graduate recruitment programme. He has held a number of positions in both food and non-food divisions, including Impulse and Bakery Category Director, Non Food Sourcing Director and Clothing Category Director. Jason was appointed CEO of Group Clothing in 2012, which included UK & ROI store and online operations, as well as overseeing F&F's Asia business and franchise partnerships. In January 2015, Jason joined the Executive Committee, becoming Chief Product Officer.

Robin Terrell
Chief Customer Officer
Robin joined Tesco in February 2013 as Group Multichannel Director on the Executive Committee. From 1999 Robin worked at Amazon, ultimately as VP & Managing Director, with responsibility for Amazon's UK and French businesses. Robin has also held senior e-commerce and multichannel roles at Figleaves.com, John Lewis and House of Fraser. In January 2015, Robin was appointed Chief Customer Officer.

Corporate governance summary

The full corporate governance report can be found in the Annual Report and Financial Statements 2015.

Commercial income issue

The overstatement of expected profit was identified in the second half of the 2014/15 year. The Board sincerely regrets what has happened but moved swiftly and decisively to address these serious matters. As this subject is of such major importance, a statement addressing this matter is set out below.

Statement

In September 2014, information was brought to the Board's attention that indicated that the recognition of UK commercial income was being accelerated and the accrual of costs was being delayed. The Board announced on 22 September 2014 that it had identified an overstatement of its expected profit for the half year to 23 August 2014, principally due to this accelerated recognition of commercial income and deferral of costs, in the order of £250 million.

The Board decided immediately to appoint Deloitte to carry out an independent investigation of the commercial income numbers in the UK, and to defer the announcement of the interim results to allow time for this. The Deloitte report confirmed that amounts had been pulled forward (in the case of income) or deferred (in the case of costs), contrary to Tesco Group accounting policies; that there had been similar practices in prior reporting periods; and that the current and prior practices appeared to be linked as income pulled forward grew period by period.

In October 2014 as part of the interim results announcement, the Board further announced that the overstated recognition of commercial income was estimated at £263 million. Taking into account the build-up of such overstatement in prior years, the impact on the trading profit expectation for the half year was an over-estimate of £118 million, with overstatement of reported profits in the previous year to 28 February 2014 of £70 million, and in years prior to that of £75 million.

Subsequent to October 2014 we have continued to focus on this area and we have identified some further amounts, bringing the total one-off adjustment relating to prior years to £208 million for our UK and ROI businesses.

Commercial income arises in a number of different ways, including discounts and rebates that suppliers agree to pay us based on the volume of sales achieved and contributions to product promotion expenses. Our external auditors, PricewaterhouseCoopers LLP, focused on this area in their audit of the 2013/14 accounts because of the significance of commercial income, the judgement required in accounting for commercial income including the amounts owed at the year-end, and because of the potential risk of the manipulation of these balances.

The matters surrounding the commercial income issue are now the subject of an investigation by the Serious Fraud Office, and the Company is co-operating fully with this investigation. This has limited the extent of the Company's own investigation and what we can say about the circumstances in which the overstatement occurred. A number of individuals have ceased employment with the Group as a consequence of this investigation.

The "pulling forward" of commercial income from suppliers that was more appropriately attributed to future periods, was clearly a management failure within the UK division. The fact that it remained undiscovered has been a matter of the deepest concern.

The Board had two main priorities in their response to the commercial income issue:

1. Ensure that all available steps are taken to ensure that nothing like this can happen again. The Chief Executive's report details some of those steps. New management is in place, training has been given and the overall commercial relationship with our suppliers and the incentive structure for our commercial teams are being reset.

2. Ensure that the results accounted properly for all commercial income, whether in the UK business or our overseas operations, and with all other aspects of our relationship with our suppliers.

The overarching focus of the Board has been to ensure that this work did not, and does not, distract us from our core business of providing value and a quality service to our customers.

We have noted that the Financial Reporting Council has urged companies to provide greater clarity in respect of their commercial income and the Board has concurred that increased transparency is appropriate.

On 4 February 2015, the Grocery Code Adjudicator ('Adjudicator') announced that an investigation has been launched into the conduct of Tesco under the Groceries Supply Code of Practice. The Adjudicator is specifically investigating Tesco's conduct under provisions of the Code relating to delays in payments to suppliers and payments for shelf positioning. We are continuing to co-operate fully with the Adjudicator's investigation.

Board changes

The Board has seen significant change over the last year. As well as appointing John Allan as Chairman, we have appointed a new CEO, Dave Lewis, and a new CFO, Alan Stewart, to lead the turnaround of the business. Four of our Non-executive Directors retired and a further two Non-executive Directors will not put themselves forward for re-election at this year's Annual General Meeting ('AGM'). We have appointed three new Non-executive Directors, Richard Cousins, Mikael Olsson and Byron Grote. Ensuring we have the right skills and experience is a key priority and the Board will continue to evolve to best meet the needs of the business.

The UK Corporate Governance Code

We recognise and support the principles of the UK Corporate Governance Code. This year we complied with the relevant provisions of this Code except for the areas described below:

Board evaluation and Chairman's performance evaluation

The Board had previously agreed a three-year cycle whereby they would conduct an externally-led review in one year, followed by internally-led reviews in the subsequent two years, one led by the Chairman and one led by the Senior Independent Director. The externally-led evaluation was due in 2014/15 as the last one was conducted in 2011/12. However, given the number of changes to the Board, including the appointment of John Allan as Chairman, the Board agreed that an external review would be of more value if carried out during 2015/16. An internal review of the Board and its Committees was conducted and further details about this can be found on page 36 in the Annual Report and Financial Statements 2015.

Sir Richard Broadbent was Chairman throughout the 2014/15 year but stepped down on 1 March 2015. Given his planned departure, the Board agreed that there would be no benefit in conducting a performance review. The performance of John Allan as Chairman in 2015/16 will be assessed by the Non-executive Directors, led by our Senior Independent Director, Richard Cousins.

Audit tender

On the recommendation of the Audit Committee, the Board decided to put the Company's external audit out for tender this year. After 32 years we and PricewaterhouseCoopers LLP mutually agreed that they would not take part in the tender. They will therefore step down as the Company's Auditor at the conclusion of the 2015 AGM. A resolution to appoint the Company's new Auditor will be proposed at the Company's AGM in June, and this is set out within the separate Notice of Annual General Meeting.

Remuneration summary

The full Directors' Remuneration Report can be found in the Annual Report and Financial Statements 2015.

2014/15 reward outcomes

Looking back to 2014/15, Tesco's performance and challenges have been reflected through the remuneration outcome. As a result, no annual bonus will be paid to either the new or departing Executive Directors as the Committee determined that satisfactory financial performance had not been achieved over the course of the year. The Earnings per Share (EPS) and Return on Capital Employed (ROCE) performance targets for the Performance Share Plan (PSP) awards granted in 2012 were not met and these awards will lapse.

2014/15 pay

The tables below provide a 'single figure' of remuneration for Executive and Non-executive Directors.

Single total figure of remuneration – Executive Directors

		Salary (£'000)	Benefits (£'000)	Short-term annual bonus (£'000)	Long-term Performance Share Plan (£'000)	Pension (£'000)	**Total before buyouts (£'000)**	Buyouts (£'000)	Total (£'000)
Dave Lewis*	2014/15	570	97	0	–	143	**810**	3,323	4,133
	2013/14	–	–	–	–	–	–	–	–
Alan Stewart*	2014/15	297	42	0	–	74	**413**	1,888	2,301
	2013/14	–	–	–	–	–	–	–	–
Former Directors									
Philip Clarke**	2014/15	563	41	0	0	160	**764**	–	764
	2013/14	1,136	107	0	0	391	**1,634**	–	1,634
Laurie McIlwee**	2014/15	101	5	0	0	223	**329**	–	329
	2013/14	880	119	0	0	537	**1,536**	–	1,536

* Dave Lewis joined on 1 September 2014 and Alan Stewart joined on 23 September 2014.
** Philip Clarke ceased to be a Director on 1 September 2014 and Laurie McIlwee ceased to be a Director on 4 April 2014.

Single total figure of remuneration – Non-executive Directors

		Fees (£'000)		Taxable travel expenses* (£'000)		Benefits* (£'000)	Total (£'000)
		Tesco PLC	Tesco Bank	Tesco PLC	Tesco Bank		
Sir Richard Broadbent	**2014/15**	**625**	**–**	**0**	**–**	**81**	**706**
	2013/14	625	–	0	–	81	706
Mark Armour**	**2014/15**	**82**	**–**	**0**	**–**	**0**	**82**
	2013/14	36	–	0	–	0	36
Gareth Bullock	**2014/15**	**82**	**82**	**0**	**0**	**0**	**164**
	2013/14	82	82	1	0	0	165
Patrick Cescau	**2014/15**	**132**	**–**	**0**	**–**	**0**	**132**
	2013/14	132	–	0	–	0	132
Stuart Chambers	**2014/15**	**110**	**–**	**5**	**–**	**0**	**115**
	2013/14	112	79	3	1	0	195
Richard Cousins**	**2014/15**	**23**	**–**	**0**	**–**	**0**	**23**
	2013/14	–	–	–	–	–	–
Olivia Garfield	**2014/15**	**81**	**–**	**0**	**–**	**0**	**81**
	2013/14	62	–	0	–	0	62
Ken Hanna	**2014/15**	**124**	**–**	**3**	**–**	**0**	**127**
	2013/14	124	–	2	–	0	126
Mikael Olsson**	**2014/15**	**25**	**–**	**2**	**–**	**0**	**27**
	2013/14	–	–	–	–	–	–
Deanna Oppenheimer	**2014/15**	**96**	**82**	**56**	**8**	**0**	**242**
	2013/14	82	82	65	1	0	230
Jacqueline Tammenoms Bakker	**2014/15**	**94**	**–**	**5**	**–**	**0**	**99**
	2013/14	94	–	10	–	0	104

* The benefits and taxable travel costs shown have been grossed up for tax.
** Mark Armour was appointed on 2 September 2013. Richard Cousins and Mikael Olsson were appointed on 1 November 2014.

The figures in these tables are from the date of appointment or until the date that each Director ceased to be a Director of Tesco PLC. Full details can be found in the Annual Report and Financial Statements 2015.

Payments to former Directors

After detailed legal advice and a rigorous review, the Board paid the legally binding contractual payments to former CEO Philip Clarke and former CFO Laurie McIlwee in February 2015. Details of their departure arrangements can be found on pages 56 and 57 in the Annual Report and Financial Statements 2015.

Executive Director changes

2014/15 saw changes to the Executive team. Dave Lewis joined as CEO on 1 September 2014 and Alan Stewart joined as CFO on 23 September 2014. For both Dave and Alan, all pay and benefits have been set in-line with our remuneration policy that was approved by shareholders at the 2014 Annual General Meeting (AGM). You can find a summary of their remuneration arrangements on page 49 in the Annual Report and Financial Statements 2015. On leaving their previous employers, Dave and Alan forfeited outstanding incentive awards. These have been bought-out by Tesco in accordance with our approved remuneration policy and the buyout amounts have been included in the single figure table on page 34. Both of the Executive Directors have significant shareholding requirements to be built up over a five year period and both are on track to meet these requirements.

Changes to remuneration framework

With new Executive leadership in place, the Board has been working hard to develop a strategy to improve financial performance by building a more sustainable, customer-focused Tesco. The Committee believes that it is important that remuneration arrangements follow and support this strategy. Therefore we have proposed changes to Executive remuneration for 2015/16 to better focus performance measures on the areas that are important for shareholder value creation at this time. In February, we met with the majority of our largest shareholders to discuss our remuneration framework and found these conversations and the feedback very helpful in shaping our proposals.

Annual bonus

The performance measures for the annual bonus will be focused on sales, profit and individual measures. The Committee wants the management team entirely focused on achieving the metrics which are vital to the early phase of the turnaround plan.

Performance Share Plan

Since we are early in the turnaround phase of the business, the Committee considers it appropriate to base the 2015 award on a relative measure of Total Shareholder Return (TSR) to keep the focus on delivery of shareholder value through share price and dividend performance. A second metric, Retail Cash Generated from Operations, focuses on the business generating a sustainable, quality cash flow. The 2015 awards will be based 70% on relative Total Shareholder Return performance against a group of FTSE 100 consumer business and services companies, and 30% on cumulative Retail Cash Generated from Operations. Specifics of the plan were revised as a result of the discussions in our investor meetings.

Clawback

Clawback provisions will be introduced for the 2015/16 annual bonus and Performance Share Plan awards.

As a result of these changes to our remuneration framework it is necessary for us to seek shareholder approval for a revised remuneration policy which we will be doing at the 2015 AGM. The full revised Policy Report can be found on pages 62 and 63 in the Annual Report and Financial Statements 2015.

The remuneration policy will be applied in 2015/16 as set out in the table below:

	Element	Operation and opportunity
Fixed pay	Base salary	• CEO – £1,250,000 • CFO – £750,000
	Pension (Cash in retirement)	• 25% of base salary cash allowance in lieu of pension
	Benefits	• Core benefits include car benefits, driver, security, life assurance, disability and health insurance, and colleague discount • Executives are eligible to participate in the Company's all-employee share schemes, Sharesave and the Share Incentive Plan, on the same terms as UK colleagues.
Performance-related pay	Annual bonus (One-year performance)	• CEO – maximum opportunity of 250% of base salary • CFO – maximum opportunity of 225% of base salary • 50% in cash • 50% in shares, which are deferred for three years
	Performance Share Plan (Three-year performance)	• CEO – maximum award of 275% of base salary • CFO – maximum award of 250% of base salary • 100% in shares, which vest in three years' time

Further review in 2015/16

As a Committee we have agreed to complete a further review of remuneration in 2015/16 to ensure that future arrangements are fully aligned to our long-term strategy to deliver value to shareholders and that the performance metrics used in our incentive plans are transparent and trackable with our business plans. This will be developed over the coming months and, although we anticipate that no further changes to our Remuneration Policy will be required as a result of this review, we will consult shareholders again once this review has been completed.

Independent auditors' report to the members of Tesco PLC

We have examined the supplementary financial information included within the Strategic Report with supplementary material for the 53 week period (the 'period') ended 28 February 2015, which comprises the Summary Group income statement, Summary Group balance sheet, Summary Group cash flow statement and movements in net debt for the period then ended.

Respective responsibilities of the directors and the auditors

The directors are responsible for preparing the Strategic Report with supplementary material, in accordance with the Companies Act 2006, which includes information extracted from the full annual financial statements and the auditable part of the Directors' Remuneration Report of Tesco PLC for the 53 week period ended 28 February 2015.

Our responsibility is to report to you our opinion on the consistency of the summary financial information, included within the Strategic Report with supplementary material, with those full annual financial statements and the auditable part of the Directors' Remuneration Report.

This statement, including the opinion, has been prepared for and only for the Company's members as a body and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this statement is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Basis of opinion

Our examination involved agreeing the balances disclosed in the summary financial information to full annual financial statements. Our audit reports on the Company's full annual financial statements and the auditable part of the Directors' Remuneration Report describes the basis of our opinion on those financial statements and the auditable part of that report.

Opinion

In our opinion the supplementary financial information is consistent with the full annual financial statements and the auditable part of the Directors' Remuneration Report of Tesco PLC for the 53 week period ended 28 February 2015.

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory auditors
London
5 May 2015

Summary financial statements

Summary Group income statement

53 weeks ended 28 February 2015	53 weeks 2015 £m	52 weeks 2014 £m
Continuing operations		
Revenue	62,284	63,557
Cost of sales	(64,396)	(59,547)
Gross (loss)/profit	(2,112)	4,010
Administrative expenses	(2,695)	(1,657)
(Losses)/profits arising on property-related items	(985)	278
Operating (loss)/profit	(5,792)	2,631
Share of post-tax (losses)/profits of joint ventures and associates	(13)	60
Finance income	90	132
Finance costs	(661)	(564)
(Loss)/profit before tax	(6,376)	2,259
Taxation	657	(347)
(Loss)/profit for the year from continuing operations	(5,719)	1,912
Discontinued operations		
Loss for the year from discontinued operations	(47)	(942)
(Loss)/profit for the year	(5,766)	970
Attributable to:		
Owners of the parent	(5,741)	974
Non-controlling interests	(25)	(4)
	(5,766)	970

(Losses)/earnings per share from continuing and discontinued operations

Basic	(70.82)p	12.07p
Diluted	(70.82)p	12.06p

(Losses)/earnings per share from continuing operations

Basic	(70.24)p	23.75p
Diluted	(70.24)p	23.72p

Non-GAAP measure: underlying profit before tax

	53 weeks 2015 £m	52 weeks 2014 £m
(Loss)/profit before tax from continuing operations	(6,376)	2,259
Adjustments for:		
Total restructuring and other one-off items	6,814	801
Reversal of commercial income recognised in previous years:		
Recognised in 13/14	53	–
Recognised in years prior to 13/14	155	–
Other items	315	(180)
Underlying profit before tax	961	3,054

For further information refer to Note 3 on page 99 of the Annual Report and Financial Statements 2015.

Summary financial statements continued

Summary Group balance sheet

	28 February 2015 £m	22 February 2014 £m
Non-current assets	32,256	34,592
Current assets (including assets of the disposal groups and non-current assets classified as held for sale)	11,958	15,572
Current liabilities (including liabilities of the disposal groups classified as held for sale)	(19,810)	(21,399)
Net current liabilities	(7,852)	(5,827)
Total assets less current liabilities	24,404	28,765
Non-current liabilities	(17,333)	(14,043)
Net assets	7,071	14,722
Equity attributable to owner of the parent	7,071	14,715
Non-controlling interest	–	7
Total equity	7,071	14,722

Summary Group cash flow statement

53 weeks ended 28 February 2015	53 weeks 2015 £m	52 weeks 2014 £m
Cash flows from operating activities		
Cash generated from operations	1,467	4,316
Interest paid	(613)	(496)
Corporation tax paid	(370)	(635)
Net cash generated from operating activities	484	3,185
Purchase of property, plant and equipment, investment property and non-current assets classified as held for sale	(1,989)	(2,489)
Purchase of intangible assets	(329)	(392)
Other investing activities	303	27
Net cash used in investing activities	(2,015)	(2,854)
Net cash from financing activities	814	56
Net (decrease)/increase in cash and cash equivalents	(717)	387
Cash and cash equivalents at beginning of the year	2,813	2,531
Effect of foreign exchange rate changes	78	(105)
Cash and cash equivalents including cash held in disposal groups at the end of the year	2,174	2,813
Cash held in disposal groups	(9)	(307)
Cash and cash equivalents at the end of the year	2,165	2,506

Reconciliation of net cash flow to movement in net debt

	53 weeks 2015 £m	52 weeks 2014 £m
Net (decrease)/increase in cash and cash equivalents	(717)	387
Elimination of Tesco Bank movement in cash and cash equivalents	(131)	570
Retail cash movement in other net debt items	(1,010)	(374)
Change in net debt resulting from cash flow	(1,858)	583
Retail net interest charge on components of net debt	(443)	(392)
Retail fair value and foreign exchange movements	241	(51)
Debt disposed on disposal of China operations	255	–
Retail other non-cash movements	(79)	(140)
Increase in net debt for the year	(1,884)	–
Opening net debt	(6,597)	(6,597)
Closing net debt	(8,481)	(6,597)

Dividends

	2015		2014	
	Pence/share	£m	Pence/share	£m
Amounts recognised as distributions to owners in the financial year:				
Prior financial year final dividend	10.13	819	10.13	815
Current financial year interim dividend	1.16	95	4.63	374
Dividends paid to equity owners in the financial year	11.29	914	14.76	1,189
Current financial year proposed final dividend	–	–	10.13	819

As announced by the Company on 8 January 2015, the Board of Directors has decided not to recommend the payment of a final dividend in respect of the financial year ended 28 February 2015.

Financial calendar

Financial year end 2014/15	28 February 2015
Annual General Meeting/1Q interim management statement	26 June 2015
Half-year end 2015/16	29 August 2015
Interim results	7 October 2015
3Q and Christmas interim management statement	14 January 2016
Financial year end 2015/16	27 February 2016

Please note that these dates are provisional and subject to change, with exception of the financial year end.

Glossary

Capex % of sales
Capital expenditure as defined below, divided by Group sales including VAT and excluding IFRIC 13.

Capital expenditure
The additions to property, plant and equipment, investment property and intangible assets (excluding assets acquired under business combinations).

Constant tax rate
Using the prior year's effective tax rate.

EBITDAR
Operating profit before depreciation, amortisation, rent and movements in impairments of property, plant and equipment, investment property and intangible assets.

Fixed charge cover
The ratio of EBITDAR (excluding Tesco Bank EBITDAR) divided by financing costs (net interest including capitalised interest and excluding IAS 32 and 39 impacts and pension finance costs) plus operating lease expenses.

Free cash flow
Free cash flow is net cash generated from/(used in) operating activities less capital expenditure on property, plant and equipment, investment property and intangible assets.

Gearing
Net debt divided by total equity.

Growth in sales
The YoY% movement in sales for continuing operations excluding VAT excluding PFS and excluding IFRIC 13 for 52 weeks at constant fx rates.

Growth in trading profit
The YoY% movement in trading profit for continuing operations for 52 weeks at constant fx rates.

Loyal Customers
Loyal customers are defined based on their frequency of spend and average weekly spend in our stores and online shopping over eight weeks.

Net debt
Net debt excludes the net debt of Tesco Bank but includes that of the discontinued operations. Net debt comprises bank and other borrowings, finance lease payables, net derivative financial instruments, joint venture loans and other receivables and net interest receivables/payables, offset by cash and cash equivalents and short-term investments.

Net indebtedness
The ratio of total indebtedness divided by EBITDAR (excluding Tesco Bank EBITDAR) from continuing operations.

Retail cash flow
Cash generated from/(used in) operations for retail activities.

Return on capital employed
Return divided by the average of opening and closing capital employed.

Return
Profit (excluding the impact of one-off items) before interest after tax (applied at effective rate of tax).

Capital employed
Net assets (excluding the impact of one-off items) plus net debt plus dividend creditor less net assets held for resale and discontinued operations.

Total indebtedness
Net debt plus the IAS19 deficit in the pension schemes (net of associated deferred tax) plus the present value of future minimum rentals payable under non-cancellable operating leases.

Total shareholder return
The notional annualised return from a share, measured as the percentage change in the share price, plus the dividends paid with the gross dividends reinvested in Tesco shares. This is measured over both a one and five-year period. For example, five-year total shareholder return for 2013/14 is the annualised growth in the share price from 2008/09 and dividends paid and reinvested in Tesco shares, as a percentage of the 2008/09 share price.

Trading profit
Trading profit is an adjusted measure of operating profit and measures the performance of each segment before profits/losses arising on property-related items, the impact on leases of annual uplifts in rent and rent-free periods, intangible asset amortisation charges and costs arising from acquisitions, and goodwill impairment and restructuring and other one-off costs. The IAS 19 pension charge is replaced with the 'normal' cash contributions for pensions. An adjustment is also made for the fair value of customer loyalty awards.

Underlying diluted earnings per share
Underlying profit less tax at the effective tax rate and non-controlling interest divided by the diluted weighted average number of shares in issue during the year.

Underlying net interest
Underlying net interest, as included in underlying profit, excludes net pension finance costs and IAS 39 'Finance Instruments' - fair value measurements.

Underlying profit before tax
Underlying profit before tax excludes the impact of non-cash elements of IAS 17, 19, 32 and 39 (principally the impact of annual uplifts in rents and rent-free periods, pension costs, and the marking to market of financial instruments); the amortisation charge on intangible assets arising on acquisition and acquisition costs, and the non-cash impact of IFRIC 13. It also excludes profits/losses on property-related items and restructuring and other one-off costs.

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Tesco PLC
Tesco House
Delamare Road
Cheshunt
Hertfordshire EN8 9SL

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