Tesco

Q1 Trading Statement 2022/23

Analyst call

17 June 2022

Transcript

Ken:

Good morning, everyone. Thank you for joining us today. I'm here in Welwyn with Imran, and in a moment, we'll be delighted to take your questions. Hopefully, you've all had a chance to read the trading update that we published earlier this morning, so I won't go back over the details.

Ken:

We've made good progress in a challenging market, and I want to start by thanking all our colleagues across the group for everything they've done supporting customers and communities, day in, day out. Importantly, customers are rewarding us with their loyalty, and we've been able to grow share in every one of our markets. In our core UK market, the material and ongoing investment that we have made in the powerful combination of Aldi Price Match, Low Everyday Prices and Clubcard Prices is working. By offering the best possible prices on over 2,000 essential products, along with truly exceptional deals for our Clubcard members, we are helping to ensure that price does not become a reason to shop anywhere else.

Ken:

We know that staying competitive on prices is the most important thing we can do for our customers at this time. Although it is difficult to separate it from the significant impact of lapping last year's lockdowns, we are seeing some early indications of changing behaviour as a result of the inflationary environment. It is therefore even more important that we work with our supplier partners to mitigate as much inflation as possible. Where it is being passed on, our aim is to ensure it is a little bit less and a little bit later than the rest of the market. Given that our quarter one numbers reflect the impact of annualising last year's lockdowns, we have included the three year like-for-like measures to help you understand the longer-term strength of the business. These show that we are materially ahead of pre-pandemic levels, with total retail sales up by around 10% versus 19/20.

Ken:

Although I'm not going to go through all the numbers in detail, I would like to highlight Booker's performance, particularly in catering. While this is partly due to the lockdown effect last year, there is also significant improvement in the underlying strength of the business. Booker has added over 13,000 net new catering customers in the first quarter, while continuing to provide exceptional levels of availability and service. Taking it back to the group level at this early stage in the year, and given the uncertainties in the external environment, our retail profit guidance remains unchanged at between £2.4 and £2.6 billion. Our cashflow guidance also remains unchanged at between £1.4 and £1.8 billion.

Ken:

Before I hand over to questions and answers, a quick reminder that if you can keep to one or two questions initially, that will really help us get around everyone. And with that, I'll hand the call back to the operator.

Mark:

Thank you. If you wish to ask a question, please dial 01 on your telephone keypads now to enter the queue. If you find your question has been answered before it's your turn to speak, you can dial at 02 to cancel. And our first question comes from the line of Andrew Gwynn of BNP Paribas Exane. Please go ahead.

Andrew Gwynn:

Hi, morning all. Two questions very quickly. Firstly, just elaborate a little bit more on this changing consumer behaviour. I presume that just sort of means shift in mix, shift in range, but so far presumably nothing too exceptional on that front. And then the second question connected to that really is, to what extent does changing in the mix, do they have a significant impact on profit? Does it create a bit of competitive tension with brands? Is private label a good thing for profitability? Thank you very much.

Ken:

Thank you, Andrew. And I think the emphasis we put here is that early and the reason for that is that of course the lockdown last year makes it really difficult to get a clean read about what's been driven about normalising behaviour of the customer versus a reaction to the inflationary pressures that we are all facing. And so what we are seeing is, we are seeing what you'd expect, which is a higher frequency of shop, smaller baskets, a return to shopping in our convenience stores and all of which I think works for Tesco because of its comprehensive kind of channel penetration, whether that be convenience in our stores or online.

Ken:

What we have seen is reasonably early signs that where there is heightened levels of inflation in staples, such as bread and pasta, we are seeing the customer choose the own brand or the entry level brand variety, and to help them manage their overall basket cost. The good news from a Tesco perspective is they're still choosing to shop with Tesco because we're so competitively priced. So overall, it is really early days yet, and these are really early indicators, but we felt it important just to flag it.

Imran:

On the mix, Andrew..

Andrew Gwynn:

Sorry, just on the profit, does it...?

Imran:

Sure. No problem. Look, I mean, the way I think about it is first is the key point here for me is the fact that we're able to serve customers looking for value. We have what they're for. So that's a positive because that's good for volumes. On the flip side, as we've discussed a few times, it depends category by category, but clearly there is some tension that is introduced as customers down trade. We talked about it a few times and our drive is to continue to find ways to offset that.

Andrew Gwynn:

Okay, great. Thank you very much. Have a good weekend.

Ken:

Thanks Andrew.

Mark:

The next question comes from the line of Andrew Porteous at HSBC. Please go ahead, your line is open.

Andrew Porteous:

Yeah. Hi team. A couple from me, I guess the first of those is the gap between yourself and your big four peers has been quite stark in through the first quarter, you're winning share, where they're all losing share quite significantly. I'm just wondering if you can put your finger on what it is that's really driving that sort of out performance for Tesco versus the peers, because you could easily have lost share this quarter and it not be the worst thing in the world. And then the second thing was really a question around Booker, just on the catering side, what sort of levels of inflation are you seeing within the Booker catering business, or I guess the catering industry more broadly. And are you seeing any impacts from, I guess, some of your catering customers, are they seeing sort of low volumes or customers switching away there?

Ken:

Thanks very much, Andrew. Let me address the second one first. So, Booker performed so strongly during the quarter for a couple of reasons. First, clearly is it lap the lockdown last year and that's challenging therefore to kind of pull apart what's just normalising kind of eating out behaviour. And to what extent has that been kind of held back or constrained by inflation, we find it difficult to pull it apart. What's been interesting for us though, is that with Booker growing its catering business by 50% during the quarter is that within the catering market, Booker has been a clear winner and that really is down to the customers it serves. And what we've seen there is that Booker is not only winning new customers, but its best customers are winning in the market overall. And a lot of that is down to the fact that the Booker customers in catering are trying to manage their menus and they're pricing more effectively than the rest of the market.

Ken:

So they're quite competitively priced and Booker works very hard to help them manage their menus and their mix to keep that value proposition. That said, overall, we see catering inflation running ahead of retail inflation. In terms of our kind of first quarter performance, it's never one thing. I mean, clearly our very strong value position is helping a lot. And I think it's less about the fact that we've suddenly made a big play for value, it's more the fact that we've been consistently good value for some time now. And so the customer's learned that it can rely on us. And the other thing is that we have very consciously moved away from high-low stunt deals, multi buys towards a everyday low pricing model, which means that customers can trust they're going to get a good deal from us, no matter when they shop us as opposed to wondering when we are on our off deal.

And we believe that that's quite a powerful platform. Clearly Clubcard prices is also helping. And then I would call out the last two factors as really, really strong supply chain. So that availability has been that bit better. We have all the same challenges as the rest of the industry, but we've just been able to probably beat the market on availability by one or two points, and our shopping experience has been consistently strong, our store teams and our store leaders together with supply chain have done a magnificent job, right the way through this quarter.

Andrew Porteous:

That's really great. Thank you very much.

Ken:

Thank you.

Mark:

Now, the next question comes from the line of Clive Black at Shore Capital. Please go ahead, your line is open.

Clive Black:

Good morning, gentlemen. Thanks for the opportunity. I just wanted to have a chat about working capital if possible, because one assumes that with your overall sales level given where inflation is, that food volumes are reasonably down. But equally in the non-food world, one thinks of Target maybe one or two others…there's a lot of stock in the system and I just wondered on both those counts if you could give us some colour how you see working capital evolving with a quarter in the bank. Thank you.

Imran:

Sure. So maybe let's talk about the non-food element of your question first. So I think important to remember is that general merchandise and clothing combined are actually quite a low penetration of our total sales, think of that around 10%, so we don't actually have a very high exposure to that. Now clearly, when I look at the first quarter last year, we had disclosed we were growing almost 20%, this year in the first quarter, we called it out of the trading statement. We have a decline general merchandise bit high single digit and clothing, mid single digit, as expected as part of the normalisation.

Imran:

We have a good team working on our inventories, making sure we've got the right stock, clearly Jubilee, we had a bit more and that's sold through, but I think we're overall in a good position on inventories for non-food. When I look at the overall working capital, what I said in April nine weeks ago still holds pretty much, we had some favourable inflows from fuel and from fuel recovery, as in the volume step up as well as from the Booker catering, that's going to continue to help us in this first quarter, but clearly that's going to be lapping that, and I still continue to see a net outflow for the year at this early stage, but nothing materially different than what I said to you overall.

Clive Black:

Wonderful. And then just by way of further question, maybe for Ken, I noticed your chairman was speaking at a CEO's convention yesterday, which was interesting, but seemed particularly gloomy on the UK consumer. I just wondered, are you aligned with his thinking?

Ken:

Clive, everyone's entitled to a point of view. I tend not to speculate on future customer trends. We try and stay really close at what the consumer's doing right now, and we focus on responding to that and that's really worked for us.

Clive Black:

Thank you. Okay.

Mark:

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

William Woods:

Morning. Thanks for taking the question. First one's just on pricing in the market. Could you just talk about how you're seeing the pricing landscape in terms of how rational it is, moves by different players, in particular taking some of the lines out of Price Match that have been reported. And then secondly, it'd be good just to kind of understand current trading and how you see that going, in particular about the Jubilee weekend and the boost that we get from that. Thanks.

Ken:

Great. Thanks very much. Let's start with the Jubilee weekend. Let's start with the good news. I thought it was a fantastic celebration and a bit of a momentous occasion where Britain really came to life. I really thought it was quite a spectacular weekend and one to be proud of for the nation. Clearly, we saw some very interesting spikes in certain product categories. We sold nearly half a million bottles of Prosecco, which is doubled what we would normally see. The same was true of things like strawberries, cream, scones amazingly, including scone mix, which was one that surprised us. So a lot of people baked their own and there was a lot of street party activities. So it was a really good weekend, not only for Tesco, but for the country. I think in terms of... Remind me your first question again.

William Woods:

Sorry, the other was around pricing.

Ken:

So the market is behaving largely rationally. We see that where there is significant cost inflation in commodities, etcetera. We see that the market is behaving largely rationally and we expect that to continue. I think that we maintain a very strong, certainly amongst the full line grocers, I think the strongest value position with over 600 lines included in the Aldi Price Match. And I think there's great consistency in that. Lines may move in and out on a very temporary basis depending on market conditions, but I think there's a real consistency in that and that I think is something we absolutely plan to stick to. You will see us from time to time take cost price increases up ahead of the market and I would take certain examples like milk and also our investment in eggs, and also some of the commitments we've made to pig farmers, where we see particularly critical moments in the industry where we need to lead and take a step up in other words, to protect the sustainability of our food supply chain and that's from time to time where you'll see us do things a little bit differently.

William Woods:

Great. Thank you.

Ken:

Thank you.

Mark:

Thank you. And as a reminder for participants, if you do wish to ask a question, please dial zero one on your telephone keypad. The next question comes from the line of Xavier Le Mene of Bank of America Securities. Please go ahead.

Xavier Le Mene:

Yeah. Thank you very much for taking my question. So two, if I may. The first one, I know it's a trading statement, but can you also potentially come at the input cost you're getting and what you've been seeing in the last three months. And the second one is about the relationship with the suppliers. So how is it going? So do you have a kind of ongoing negotiation or do you have fixed price now, with the certain visibility for the next six months for instance?

Ken:

So, did I understand the first question right? Is our input costs, is it?

Xavier Le Mene:

Input costs, yes.

Ken:

Okay. So look, I'll ask Imran to address that and I'll take the supplier question. So the suppliers, we enjoy a particularly strong relationship with, and that's kind of independently verified if you like. So you may have seen the recent GCA league table that was published last week by the grocery adjudicator where we were second from the top of the table and scored incredibly strongly really on the ethics of how we work with our suppliers. And that's a policy that we have absolutely committed to and have every intent of maintaining, no matter how tough times get. The second thing is that we came top of the advantage survey, which is an independent survey of suppliers on their relationship with retailers for the sixth year running. And that gives me the confidence that we are behaving appropriately in the market, that we are seen by the industry as best in class in terms of the way we lead those relationships.

Ken:

We have many deep and long lasting partnerships and they have been absolutely essential in maintaining our best in class service levels right the way through the pandemic, and actually even now where we see challenges to availability depending on the category. And so that's a competitive differentiator for us. There's no doubt that tensions are rising because every P&L is under pressure from these inflationary moments. And that's likely to continue. I think the key for us is to maintain an objectivity and always look past it to the consumer and the customer and say "What are we doing together to minimise the impact on the customer?" That's our philosophy. We're very clear with the suppliers about that, but we're very rational and respectful in the way we work with them on it.

Imran:

So I'll take the question on input costs overall. So maybe if I break them down for you - opex and how I'm seeing that as the year has progressed. So look at this early stage, what I'd say to you is everything that we talked about in April is happening and I wouldn't have anything material to call out, right? So you remember we talked about the energy cost inflation, we talked about the payroll inflation, the distribution inflation, all of those things are there and they've played out. I would say no surprises thus far. I mean, critical to that of course is how much savings can we apply? And as you know, on a full year, we had an original pan of around 300 and I said at the time we would've continued to accelerate and figure out how much more can we save without impacting the customer shop, and that's what we're working on. I wouldn't want to give you an update today because that's work in progress.

Imran:

And then on the COGS side, the cost of goods side, you can imagine that the pressures are continuing on a regular basis, it's a tough trading environment out there, there's no doubt about that when I look at cost, but clearly I wouldn't give you a number of percent that you wouldn't expect me to given the sensitivity on that subject.

Xavier Le Mene:

Of course. Yeah. Thank you.

Mark:

Now our next question comes from the line of Rob Joyce at Goldman Sachs. Please go ahead.

Rob Joyce:

Hi, good morning. Thanks for taking the questions. First one is just on the top line. Yeah, I think previously in April you talked about sort of small positive like-for-like you are looking at this year, and then I've seen Asda come out and said they're talking about material sales decline. I was just wondering if you are still happy with that sort of small positive like-for-like for the year as we stand today. And can you maybe give us a feel on the exit rate? My sense is you may already be in that positive territory, that's the first one, that's in the UK. And the second one is just, on Booker's catering business, and just historically that's been quite a high margin business, definitely I'd say higher than the UK and ROI sort of headline number. Can you confirm that's still the case there? Thank you.

Imran:

Yeah. So I'll take the two in reverse order. The Booker catering margins are indeed the more accretive ones within the Booker environment, so that's good. And when we see growth in Booker, it's part of the plan to be fair, but it's good to see that the plan is coming through. On your first question, in terms of broad line, top line growth. What I'd say to you is, the first quarter having played out, lapping the big sort of lockdown that we had last quarter, it's not a real surprise to me that we're in negative territory. I mean, as I said, it's tough, but the reality also is the uncertainties that we talked about nine weeks ago, whether that's the inflationary environment and how that plays out, whether it's customer behaviour and how that really plays out as we lap the lockdown, as we really try to understand what customers are thinking and doing, all still have to come.

Imran:

And my view is, let's see how that actually happens as we get the first clean quarters ahead and then see where we land. So, broad-brush speaking, I would expect that still to be a possibility that we should be able to do that, but it's very much in an uncertain environment. What I feel comfortable is what we are doing is working for us, but obviously the environment is something that we need to deal with as it happens.

Rob Joyce:

Thank you.

Mark:

Thank you. And our final question comes from the line of Nick Coulter at Cit. Please go ahead.

Nick Coulter:

Hi, good morning. I get to close the show. So two quick questions from me, please. Firstly, could I ask what you are seeing in the most recent switching data? I guess, all else being equal, that should be positive. And secondly, could you comment specifically on the UK labour market as you see it, whether it's still tight and how you're mitigating the risks across the year. Thank you very much.

Ken:

Thank you very much Nick. So look, the switching data, you'll have same access as everybody else in terms of what Kantar is showing and what that shows is net net through the first quarter, we had switching gains. We saw, because we were lapping a lockdown last year for quarter one, what you're seeing is some normalisation in the market. So the discounters clearly saw switching gains. Hard to tell how much of that is due to just normalisation, because they didn't have a dot com proposition last year, how much of it is due to the new space they're putting down and how much of it is due to just customer switching. But as you rightly say, we are seeing switching gains from the rest of the market and that's been consistent. We've been really pleased that we've maintained that through the quarter.

Nick Coulter:

Thank you.

Ken:

Thank you. And in terms of the UK labour market, we're faring really well in the market, we've got good colleague availability. We've worked very hard obviously to put a very competitive reward package together for colleagues, which we were able to announce in April. We've made a number of enhancements to our reward model, including increasing our colleague discount and also increasing minimum hour contracts to 16 hours. We've got an app launching this month, which will allow colleagues to get additional hours in different stores. So we're doing an awful lot of work. We're also increasing the number of training modules and that's working really well for us. And of course we were also one of the big, big supporters of the Kickstart Programme, putting over 2,000 young people through that program. And so we have a number of different ways of accessing talent in the market, and for now, we're doing very well. Thank you.

Nick Coulter:

Okay. But as you move through the summer and into peak, you don't see any risks, so you have that in hand.

Ken:

We believe we have it in hand. We don't see any risks at this stage.

Nick Coulter:

Super. Thanks so much.

Ken:

Thank you, Nick.

Mark:

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

Ken:

So look, I'd just like to wrap up by saying an enormous thank you for taking the time to join us and for all the questions. As we said, it's been a good start in a very challenging environment. We feel very proud to be part of the Tesco team. We think they're doing a magnificent job for customers and we will continue to do so for the rest of this year. So listen, I'd just like to wish you all a great weekend. I hope you get a little bit of sunshine today. Buy maybe a little bit more prosecco and a few strawberries, and we will look forward to seeing you again in a few months. Thank you.

ENDS