

TESCO PLC ANNUAL REPORT
AND FINANCIAL STATEMENTS 1999



TESCO

Tesco is a growth business

In the UK, Tesco is the leading food retailer with 639 stores. We aim to increase food sales while developing our non-food business, offering the convenience of one-stop shopping to our customers.

Outside the UK, we currently have 182 stores. In the last financial year, we acquired the largest food retailing business in Ireland and we are expanding our hypermarket businesses in Central Europe and Asia.

By understanding customer needs better than anyone, we aim to increase value for customers, earning their lifetime loyalty and to enhance returns to shareholders.

This publication includes the operating and financial review, the Directors' report, the corporate governance statement, the accounts and the auditors' report for the 52 weeks ended 27 February 1999. The Chairman's statement and review of the business are contained in a separate statement entitled Annual Review and Summary Financial Statement 1999.

These Annual Accounts together with the Annual Review and Summary Financial Statement 1999 comprise the full Annual Report and Accounts of Tesco PLC for 1999, in accordance with the Companies Act 1985. Copies may be obtained, free of charge, by writing to the Company Secretary, Tesco House, Delamare Road, Cheshunt, Hertfordshire EN8 9SL.
Telephone 01992 632222.

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Financial highlights

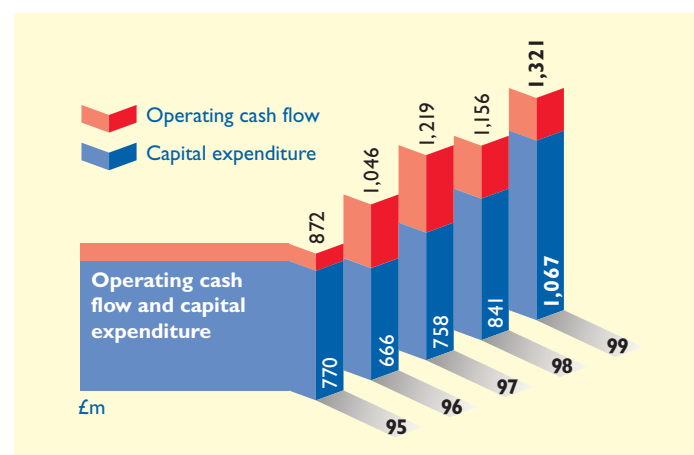
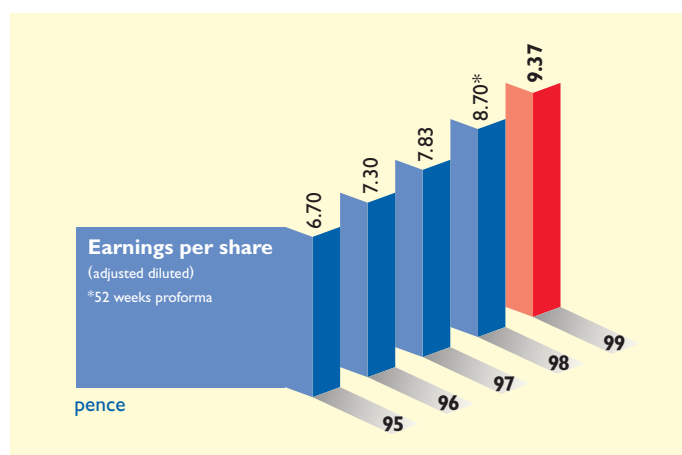
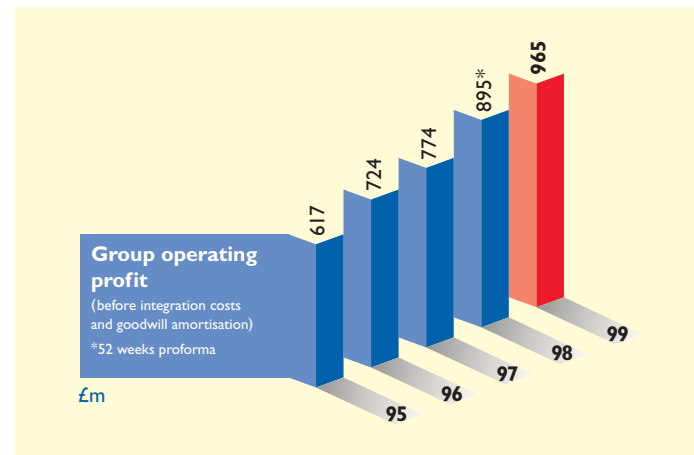
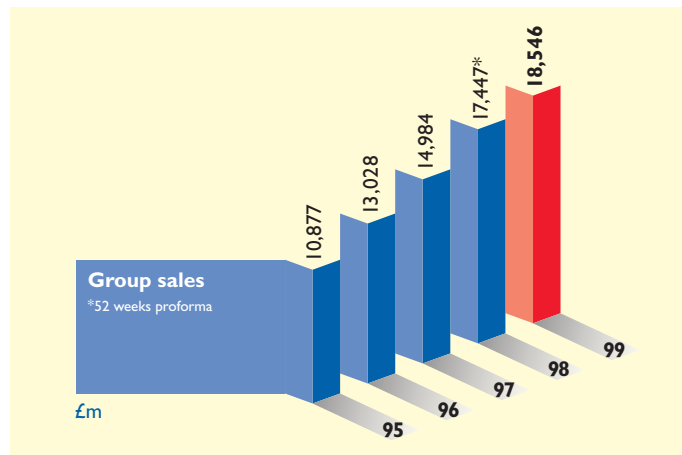
- Group sales* up **6.3%**
- Earnings per share*† up **7.7%**
- Group operating profit* up **7.8%**
- Dividend per share* up **6.5%**

	1999 52 weeks £m	1998* 52 weeks (proforma) £m	1998 53 weeks (restated) £m	1997 52 weeks £m
Group sales (including value added tax)	18,546	17,447	17,779	14,984
Group operating profit (prior to integration costs and goodwill amortisation)	965	895	912	774
Profit on ordinary activities before tax ‡	881	817	832	750
Group enterprise value (market capitalisation plus net debt)	13,528	12,556	12,556	8,121
Earnings per share †‡	9.37p	8.70p	8.84p	7.83p
Dividend per share	4.12p	3.87p	3.87p	3.45p
Number of stores	821	781	781	758
Retail selling area (000 sq ft)	21,353	18,254	18,254	16,747

† Adjusted diluted

‡ Excluding net loss on disposal of fixed assets, net loss on disposal of discontinued operations, integration costs and goodwill amortisation

* 1998/99 was a 52 week year compared to 53 weeks for 1997/98. A proforma 52 week profit and loss account for 1998 has been used for comparison



Operating and financial review

This operating and financial review analyses the performance of Tesco in the financial period ended 27 February 1999. It also explains certain other aspects of the Group's results and operations including taxation and treasury management.

Group summary

	1999 £m	1998* £m	Change %
Group sales (including value added tax)	18,546	17,447	6.3
Group operating profit (prior to integration costs and goodwill amortisation)	965	895	7.8
Profit on ordinary activities before tax†	881	817	7.8
Adjusted diluted earnings per share†	9.37p	8.70p	7.7
Dividend per share	4.12p	3.87p	6.5

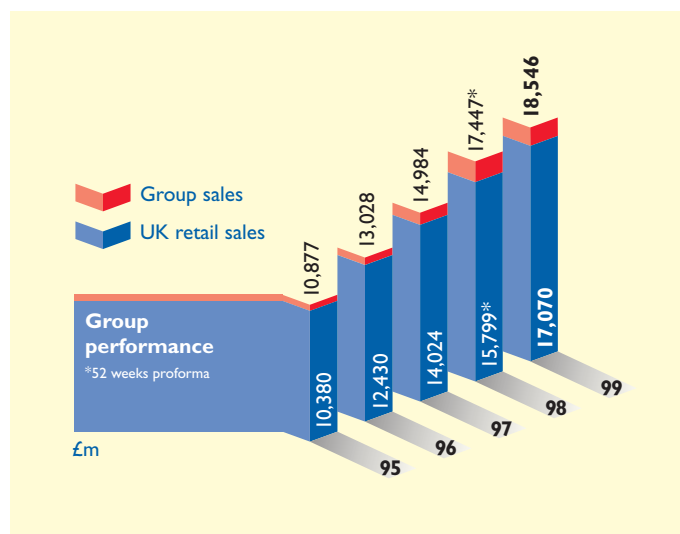
*52 weeks proforma

†Excluding net loss on disposal of fixed assets and discontinued operations, integration costs and goodwill amortisation

The financial period to 28 February 1998 was a 53 week trading year compared to a 52 week trading period this financial year. All comparisons in this operating and financial review are based on a 52 week proforma profit and loss account for 1998.

Group performance

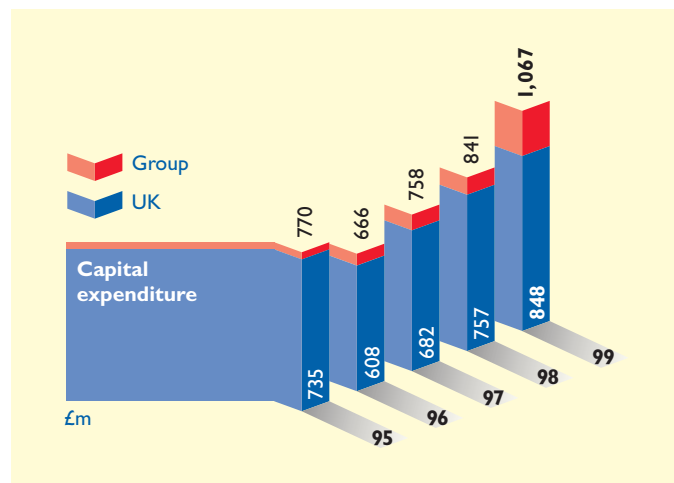
Group sales including VAT increased by 6.3% to £18,546m (1998 – £17,447m). Group sales from continuing businesses increased by 10.1% (1998 – £16,847m).



Group operating profit (prior to integration costs and goodwill amortisation) rose by 7.8% to £965m (1998 – £895m).

Group profit before tax rose by 7.8% to £881m (1998 – £817m). This excludes the net loss on disposal of fixed assets and discontinued operations of £8m (1998 – £9m), integration costs of £26m (1998 – £63m) and goodwill amortisation of £5m (1998 – nil).

Group capital expenditure was £1,067m (1998 – £841m) with £848m in the UK, £27m in Thailand, and £192m in Europe. In the current year, supported by our strong cash flows, Group capital expenditure will rise to around £1.3bn. The increase in 1999 relates mainly to our development plans in the rest of Europe and Asia.



Change in net debt

Total net debt at the year end amounted to £1,720m (1998 – £1,191m). This reflects the cash outflow from our net capital expenditure and acquisitions of £1,260m (1998 – £1,082m), partly offset by strong cash generation from the main business of £1,321m (1998 – £1,156m). As a result, gearing at the year end has increased to 39% (1998 – 31%).

Interest and taxation

Net interest payable was £90m (1998 – £72m) with the increase on last year primarily due to the financing costs of our acquisition in Thailand.

Corporation tax has been charged at an effective rate of 28.1% (1998 – 30.0%). Prior to accounting for the net loss on disposal of fixed assets, integration costs and goodwill amortisation, our underlying tax rate was 27.8% (1998 – 28.7%).

Profit-sharing increased by 8.6% to £38m (1998 – £35m). In addition staff have continued to benefit from profit related pay.

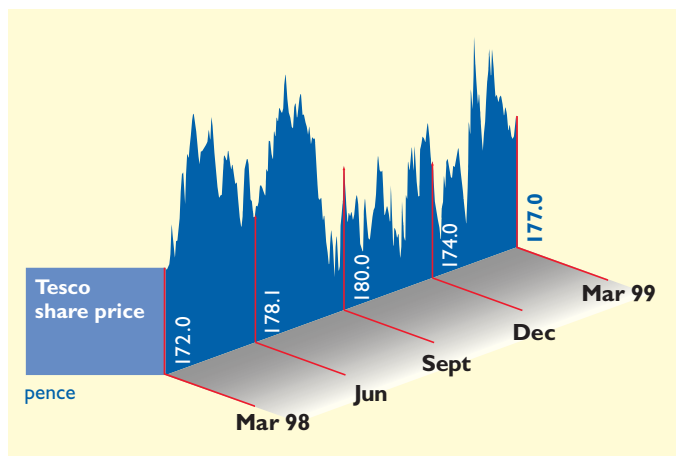
Shareholder returns and dividends

Adjusted diluted earnings per share (excluding the net loss on disposal of fixed assets and discontinued operations, integration costs and goodwill amortisation) increased by 7.7% to 9.37p (1998 – 8.70p).

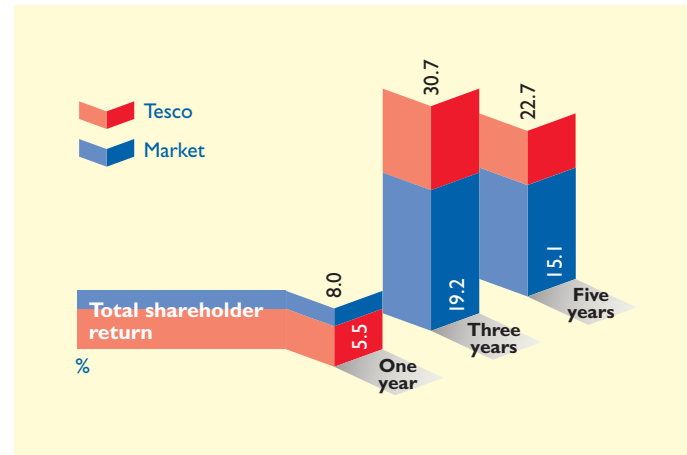
The Board has proposed a final net dividend of 2.87p giving a total dividend for the year of 4.12p (1998 – 3.87p). The dividend is covered 2.27 times by earnings.

Shareholders' funds, before minority interests, increased by £479m. This was due to retained profits of £329m and issue of new shares less expenses of £169m, offset by losses on foreign currency translation of £19m. As a result, return on shareholders' funds was 21.3%.

The share price rose from 172p at the start of the financial year to 177p on 27 February 1999, giving a market capitalisation of approximately £11.8bn (1998 – £11.4bn). The share price reached a high of 202p on 2 July 1998.



Total shareholder return, which is measured as the percentage change in the share price plus the dividend, has been 22.7% over the last five years, compared to the market average of 15.1% and has been 30.7% over the last three years, compared to the market average of 19.2%. In the last year, total shareholder return in Tesco has been 5.5% compared to the market average of 8.0%. This reflects our efforts to grow the business while ensuring returns to shareholders are improved.



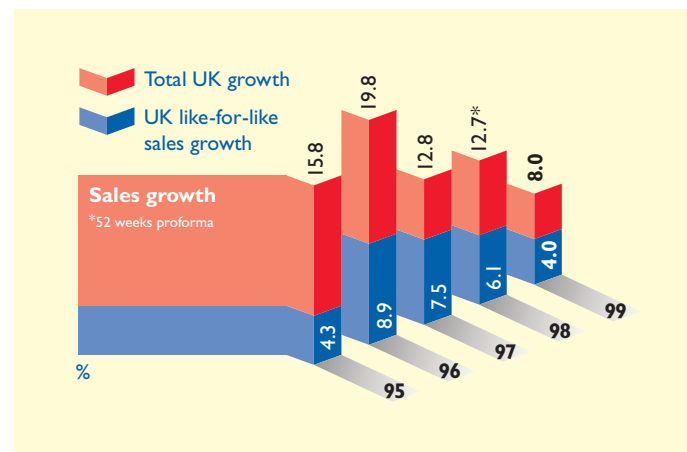
UK performance

	1999 £m	1998* £m	Change %
Food retail sales (including value added tax)	17,070	15,799	8.0
Operating profit	919	859	7.0

* 52 weeks proforma

Sales growth for the industry has again been slow, as expected, reflecting lower inflation and a modest slowdown in volume growth from the very high levels of recent years. Our market share, based on estimates of IGD data, increased again to 15.8% in the year to December 1998, from 15.2% last year. Overall, it has been a challenging year for the industry, but our business has remained focused on our customers and has achieved good results. Over the last six years, sales volumes have grown by 22%.

UK retail sales have grown by 8.0% to £17,070m (1998 – £15,799m), of which 4.0% came from existing stores including volume growth of 2.5%. New stores contributed a further 4.3% to total sales growth before closures of 0.3%.



Operating and financial review continued

UK operating profit was 7.0% higher at £919m (1998 – £859m) and the operating margin fell 0.1% to 5.8%. This reflects our strong trading performance in a very competitive and challenging environment. We continue to invest to cut prices and increase customer service, particularly through longer opening hours and more service counters.

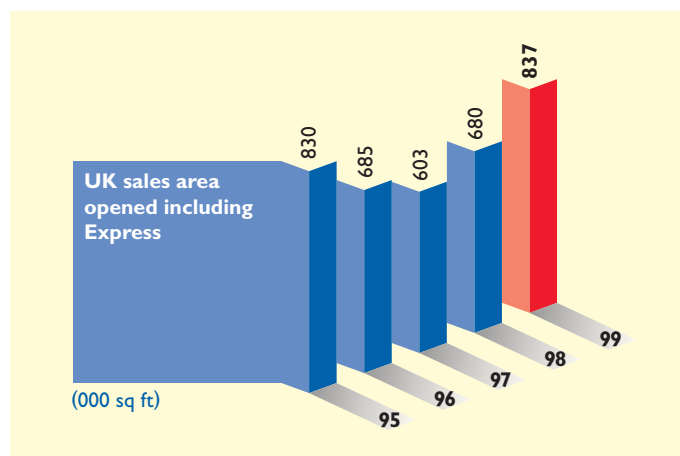
Store development and capital expenditure

In the UK we spent £350m on opening 25 new stores with a total sales area of 635,000 sq ft. This comprised 20 superstores and compact stores, one Metro, two Expresses and two Extras. As part of our programme to improve our stores and introduce non-food products, we have added over 200,000 sq ft through extensions. We also completed major refits at an additional 18 stores.

In the year, we continued to build on the success of our first Extra in Pitsea, Essex. We now have five Extras, including the latest store at Peterborough, providing one-stop shopping convenience for customers.

Express is also proving to be a promising format. We have 17 stores and during the year we announced our joint venture with Esso to develop more petrol sites, the first of which opened recently on the Fulham Road, Chelsea.

In 1999/2000, we plan to open around 26 stores with over 700,000 sq ft of new space, including 23 superstores and compact stores, one Metro store and two Express stores.



European performance

	1999 £m	1998* £m	Change %
Retail sales			
(including value added tax)	1,285	1,029	24.9
Operating profit	48	38	26.3

* 52 weeks proforma

Europe

In the rest of Europe (Central Europe and Republic of Ireland), total sales rose by 24.9% to £1,285m (1998 – £1,029m).

In **Central Europe**, a fast growing market, we successfully opened six more hypermarkets during the year, creating almost 600,000 sq ft of new modern retailing space. This included three hypermarkets in Hungary, two in the Czech Republic and one in Poland. In 1999/2000 we plan to open 10 more hypermarkets adding a further one million sq ft.

In the **Republic of Ireland** our acquisition was nearly two years ago and we have achieved the milestones we set ourselves whilst meeting the undertakings made to the Government. We have rebranded 30 stores and our customers have responded well. Next year we expect to rebrand a further 20 stores and start to build two new stores.

The business is performing strongly and remains full of potential for the future.

Asian performance

	1999 £m	1998 £m	Change %
Retail sales			
(including value added tax)	170	–	–
Operating loss	2	–	–

Asia

In May we acquired a controlling interest in Lotus, a chain of 13 hypermarkets in **Thailand** with 1.6m sq ft of selling space. In the 32 weeks to 31 December 1998, Lotus contributed £170m to Group sales and reported a small operating loss of £2m. In December 1998 we added a 14th store and over the next three years we will develop the business further by doubling the number of stores and providing a strong base for profitable long term growth.

The purchase price of our 75% stake was £206m, including £89m debt. Goodwill amounted to £117m after fair value adjustments of £38m on net assets acquired of £127m. Goodwill will be amortised over 20 years in accordance with FRS10, resulting in a charge to the Group profit and loss account of £5m this year.

After the financial year end, we announced on 23 March 1999 that we were to form a partnership company with Samsung Corporation to develop hypermarkets in [South Korea](#). This company will initially have net assets of £160m, comprising two existing Homeplus hypermarkets, three development sites and £80m cash. Tesco will invest a total of £130m, prior to costs, for an 81% controlling interest.

South Korea is a large developed market of 46 million people with GDP per capita already 70% of that in the UK but, in contrast, modern retailing is underdeveloped with only around 25 hypermarkets. The potential for us to build on the two successful Homeplus stores we now own is significant, and we plan to open a further 12 stores by the end of 2002.

We are continuing with our research in Taiwan and Malaysia.

Joint ventures

The Group operates several businesses as joint ventures with external partners including property joint ventures and Tesco Personal Finance, our financial services joint venture. The total share of profits of our joint ventures was £6m (1998 – loss of £6m).

Tesco Personal Finance has been an important part of our business strategy now for two years and is in good shape. Products launched to date, including savings, loans, visa, insurance and pensions have all been popular and over one million customers now use our financial services. This year our share of the Tesco Personal Finance operating loss was £12m. This was slightly better than expected reflecting significant improvements in efficiency and we aim to break even towards the end of the 1999/2000 financial year.

Property joint ventures contributed an operating profit of £18m principally comprising rental income on properties owned by our joint ventures with British Land and Slough Estates.

Treasury management and financial instruments

The Group's treasury operations are managed by Group Treasury within parameters defined formally and regularly reviewed by

the Board. Group Treasury's activity is routinely reported to members of the Board and is subject to review by the internal and external auditors.

Consistent with Group policy, Group Treasury does not engage in speculative activity. Financial instruments, including derivatives, are used to raise finance and to manage financial risk arising from the Group's operations.

The main financial risks faced by the Group relate to credit, interest and foreign exchange. The Board reviews and agrees policies for managing these risks as summarised below.

The Board establishes annually the policy which Group Treasury follows in managing credit risks. Limited exposures are permitted only with banks or other institutions meeting required standards as assessed normally by reference to the major credit rating agencies. Deals are authorised only with banks with which dealing mandates have been agreed.

Finance and interest rate risk

The Group's policy is to finance its operations by a combination of retained profits, bank borrowings, commercial paper, medium term notes, long term debt market issues and leases.

Derivatives, predominantly forward rate agreements and interest rate swaps and caps, are used to manage the mix of fixed and floating rate debt. The policy is to fix or cap between 30% and 70% of the interest cost on outstanding debt, although a higher percentage may be fixed within a 12 month horizon. At the year end, after taking account of interest rate swaps, £649m (1998 – £614m) or 38% of our net debt was fixed at an average rate of 8.2% for a period of five years. A further £100m (1998 – £170m) or 6%, was covered by interest caps at an average rate of 8.3% for a period of three years.

The average rate of interest paid during the year was 7.1% (1998 – 8.1%). Excluding capitalised interest, interest is covered 7.8 times by profit before interest (1998 – 8.5 times). A 1% rise in market interest rates would reduce profit before tax by less than 2%.

The Group ensures continuity of funding by arranging for short term bookings and commercial paper issuance to be fully backed by committed bank facilities, by limiting the amount of debt repayable in any one year, and by managing the average debt maturity in line with gearing levels. At the year end undrawn committed facilities amounted to £510m (1998 – £645m) and the average debt maturity of net debt, including these facilities, was over five years.

Operating and financial review continued

Foreign currency risk

The Group's policy is to use foreign currency borrowings, forward foreign currency transactions and swaps to offset part of the impact on the Group's balance sheet of exchange rate movements on the 12% of its net assets before financing which are held overseas.

The Group does not hedge exposure to currency movements on the translation of the 4.8% of profits made overseas except to the extent that those profits are matched by foreign currency interest costs.

Significant transactional currency exposures resulting predominantly from purchases in currencies other than the subsidiaries' reporting currencies are hedged by forward foreign currency transactions, currency options and by holding foreign currency cash balances.

Year 2000

Tesco has been working on the Year 2000 issue for over three years with the specific objective of ensuring business continuity under the banner of 'Shopping as Normal for our Customers'.

A central dedicated team has been co-ordinating the project across all countries and reports to the Board every month. Accountability has been firmly placed with line directors for defining and actioning their work programme, co-ordinated through this central team.

The work has concentrated on taking corrective action across systems, embedded chips and working with our many suppliers to ensure product supply and continuity of services.

The activities involved have been to:

- identify the problem
- take corrective action
- re-test new systems and processes
- validate external suppliers of goods and services
- categorise risk and develop contingency plans
- ensure good communication within the business and to external suppliers and stakeholders

The main areas of work lie within:

- computer systems
- suppliers of products for re-sale
- suppliers of equipment and services
- the supply chain and our distribution network

There is a risk to the Group, as with all companies, that suppliers may experience Year 2000 failures. We have held five major supplier conferences involving over 2,000 firms and are currently fine tuning contingency plans to ensure the transition is smooth and trade is unaffected.

We have made the necessary changes and re-tested all our business critical computer systems.

The Board have agreed store trading times over the millennium period and all areas of the business will have created staffing and contingency plans by the end of August 1999.

The approach developed within the UK has been used in Europe and Asia where compliance is also well advanced.

The programme was estimated to cost £30m over three years and we expect to spend within that budget.

We have worked closely with Government and Action 2000 as well as the Retail Industry bodies, sharing information for the good of the consumer in order to achieve 'Shopping as Normal'.

Economic Monetary Union

Our aim is for all the relevant parts of the Group to be able to handle business in euros when required. Tesco has project groups addressing the issues arising from EMU and is working with external consultants.

Going concern

The directors consider that the Group and the company have adequate resources to remain in operation for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. As with all business forecasts the directors' statement cannot guarantee that the going concern basis will remain appropriate given the inherent uncertainty about future events.

Directors' report

The directors present their annual report to shareholders on the affairs of the Group together with the audited consolidated financial statements of the Group for the 52 weeks ended 27 February 1999. The comparisons against the previous year are for the 53 weeks to 28 February 1998.

Principal activity and business review

The principal activity of the Group is the operation of food stores and associated activities in the UK, Republic of Ireland, France, Czech Republic, Slovakia, Hungary, Poland and Thailand. A review of the business is contained in the Annual Review which is published separately and, together with this document, comprises the full Tesco PLC Annual Report and Accounts.

Group results

Group turnover excluding VAT rose by £706m to £17,158m, representing an increase of 4.3%. Group profit on ordinary activities before taxation, integration costs, loss on disposals and goodwill amortisation was £881m compared with £832m for the previous year, an increase of 5.9%. Including integration costs, loss on disposals and goodwill amortisation, Group profit on ordinary activities before taxation for the year was £842m. The amount allocated to the employee profit-sharing scheme this year was £38m as against £35m last year. After provision for tax of £237m and dividends, paid and proposed, of £277m, profit retained for the financial year amounted to £329m.

Dividends

The directors recommend the payment of a final dividend of 2.87p per ordinary share to be paid on 1 July 1999 to members on the Register at the close of business on 23 April 1999. Together with the interim dividend of 1.25p per ordinary share paid in December 1998, the total for the year comes to 4.12p compared with 3.87p for the previous year, an increase of 6.5%.

Tangible fixed assets

Capital expenditure amounted to £1,067m compared with £841m during the previous year. In the directors' opinion, the properties of the Group have a market value in excess of the book value of £6,032m included in these financial statements.

Acquisitions

During the year the Group acquired, for a consideration of £206m, a retailing business in Thailand. Details of acquisitions are set out in note 32 to the financial statements.

Post Balance Sheet event

On 23 March 1999 the Group announced it is to form a partnership company with Samsung Corporation to develop hypermarkets in South Korea. The Group will initially invest £80m in cash for 51% of the business and a further £50m for an additional 30% holding in June 1999.

Share capital

The authorised and issued share capital of the company, together with details of the shares issued during the period, are shown in note 23 to the financial statements. A bonus issue was made on 3 July 1998 on the basis of two new shares for every one held on that date.

Company's shareholders

The company is not aware of any ordinary shareholders with interests of 3% or more.

Directors and their interests

The names and biographical details of the present directors are set out in the separately published Annual Review.

Mr T P Leahy, Mr J Gildersleeve, Mr T J R Mason and Baroness O'Cathain retire from the Board by rotation according to the company's Articles of Association. Mr P A Clarke, Mr D T Potts, Mr C L Allen, being appointed during the year and Dr H Einsmann, appointed on 1 April 1999, will also retire. Being eligible, they all offer themselves for re-election.

The service contracts of Mr T P Leahy, Mr J Gildersleeve, Mr T J R Mason, Mr P A Clarke and Mr D T Potts are terminable on two years' notice from the company.

Baroness O'Cathain, Mr C L Allen and Dr H Einsmann do not have service contracts.

Directors' report continued

Directors and their interests continued

The interests of directors and their immediate families in the shares of Tesco PLC, along with details of directors' share options, are set out on pages 12 to 16.

At no time during the year did any of the directors have a material interest in any significant contract with the company or any of its subsidiaries.

Employment policies

The Group depends on the skills and commitment of its employees in order to achieve its objectives. Company staff at every level are encouraged to make their fullest possible contribution to Tesco success.

A key business priority is to provide First Class Service to the customer. Ongoing training programmes seek to ensure that employees understand the company's customer service objectives and strive to achieve them.

The Group's selection, training, development and promotion policies ensure equal opportunities for all employees regardless of gender, marital status, race, age or disability. All decisions are based on merit.

Internal communications are designed to ensure that employees are well informed about the business of the Group. These include a staff magazine called 'Tesco TODAY', videos and staff briefing sessions. Staff attitudes are frequently researched through surveys and store visits, and management seeks to respond positively to the needs of employees.

Employees are encouraged to become involved in the financial performance of the Group through a variety of schemes, principally the Tesco employee profit-sharing scheme, the savings-related share option scheme and the profit related pay scheme.

Political and charitable donations

Contributions to community projects and to charity amounted to £1,301,000 (1998 – £1,259,000). There were no political donations.

Supplier payment policy

Tesco PLC is a signatory to the CBI Code of Prompt Payment. Copies of the Code may be obtained from the CBI, Centre Point, 103 New Oxford Street, London WC1A 1DU. Payment terms and conditions are agreed with suppliers in advance. Tesco PLC has no trade creditors in its balance sheet. The Group pays its creditors on a timely basis which varies according to the type of product and territory in which the suppliers operate.

Auditors

On 1 July 1998, Price Waterhouse merged with Coopers & Lybrand. Price Waterhouse have resigned as auditors and the new merged firm, PricewaterhouseCoopers, have been appointed to fill the casual vacancy.

PricewaterhouseCoopers have expressed their willingness to continue in office. In accordance with section 384 of the Companies Act 1985, a resolution proposing the reappointment of PricewaterhouseCoopers as auditors of the company will be put to the Annual General Meeting.

Annual General Meeting

A separate circular accompanying the Annual Accounts explains the special business to be considered at the Annual General Meeting on 4 June 1999.

This report was approved by the Board on 12 April 1999.

By Order of the Board

Rowley Ager

Secretary

12 April 1999

Tesco PLC

Registered Number: 445790

Corporate governance

Statement of compliance with the principles in the Combined Code

This statement sets out the manner in which the company has applied the principles set out in Section 1 of the Combined Code on Corporate Governance issued by the London Stock Exchange in June 1998. Its purpose is to provide an explanation which enables the company's shareholders to evaluate how these principles have been applied.

Directors

The Board of Tesco PLC comprises ten executive directors and six independent non-executive directors. The Board is chaired by Mr J A Gardiner, an independent non-executive director, who has primary responsibility for running the Board. The Chief Executive, Mr T P Leahy, has executive responsibilities for the operations, results and strategic development of the Group. Clear divisions of accountability and responsibility both exist and operate effectively for these positions. In addition, Mr G F Pimlott is the senior non-executive director. The Board structure ensures that no one individual or group dominates the decision-making process.

The full Board meets ten times a year and, in addition, annually devotes two days to a conference with senior executives on longer term planning. The Board manages overall control of the Group's affairs by the schedule of matters reserved for its decision. Insofar as corporate governance is concerned, these include the approval of financial statements, major acquisitions and disposals, authority levels for expenditure, treasury policies, risk management policies and succession plans for senior executives. In order that the Board is able to make considered decisions, a written protocol exists, and has been communicated to senior managers, ensuring that relevant information is presented to all Board members one week before Board meetings. All directors have access to the services of the Company Secretary and may take independent professional advice at the company's expense in the furtherance of their duties.

The Board delegates day-to-day and business management control to the Executive Committee which comprises the executive directors. This meets formally every week and its decisions are communicated throughout the Group on a regular basis. The Executive Committee is responsible for implementing Group policy, the monitoring and performance of the business and reporting to the full Board thereon.

Appointments to the Board for both executive and non-executive directors are the responsibility of the Nominations Committee which is chaired by Mr J A Gardiner and whose members are set out in the table on page 11.

The company's Articles of Association ensure that on a rotational basis one-third of the directors resign every year and, if so desire and being eligible, offer themselves for re-election. This is reflected in the section on 'Directors and their interests' within the Directors' report on pages 7 and 8. Non-executive directors are appointed for a period of three years.

Directors' remuneration

The Board has a long-established Remuneration Committee composed entirely of non-executive directors which is chaired by Baroness O'Cathain, and whose members are set out in the table on page 11. The responsibilities of the Remuneration Committee, together with an explanation of how it applies the Directors' remuneration principles of the Combined Code, are set out in the Report of the Directors on Remuneration on pages 12 to 16.

Relations with shareholders

The Board attaches a high importance to maintaining good relationships with all shareholders and, primarily through the Investor Relations department, ensures that shareholders are kept informed of significant company developments. During the year, directors have met with more than 40 of our leading shareholders representing over 45% of the issued shares of the company.

While the focus of dialogue is with institutional shareholders to whom regular presentations are made on company direction, care is exercised to ensure that any price-sensitive information is released to all shareholders, institutional and private, at the same time in accordance with London Stock Exchange requirements.

The Board regards the Annual General Meeting as an opportunity to communicate directly with private investors and actively encourage participative dialogue. The Chairman, executive directors and chairpersons of the Audit and Remuneration Committees attend the Annual General Meeting and are available to answer questions from shareholders present.

Corporate governance continued

Relations with shareholders continued

Each year-end, every shareholder may choose to receive a full Annual Report and Financial Statements or an abbreviated Annual Review and Summary Financial Statement. At the half-year, all shareholders receive an Interim Report. These reports, together with publicly-made trading statements, are available on the company's website (<http://www.tesco.co.uk>).

Accountability and audit

The company has an Audit Committee, chaired by Mr J W Melbourn and consisting entirely of non-executive directors, which meets a minimum of three times a year. Membership of the Audit Committee is set out in the table on page 11. Its terms of reference represent current best practice. The Audit Committee's primary responsibilities include monitoring internal control throughout the Group, approving the Group's accounting policies and reviewing the interim and annual financial statements before submission to the Board. In terms of financial reporting, an assessment of Group performance is set out in the Operating and Financial Review on pages 2 to 6.

Internal financial control

The Board has decided that until the working party set up by the Institute of Chartered Accountants in England and Wales has produced guidance for directors on the application of the Combined Code provision on internal control, the Board will report on internal financial control in accordance with the guidance issued by the Rutteman Working Group in December 1994.

The Board has overall responsibility for the systems of internal financial control. Implementation and maintenance of the internal financial control system is the responsibility of executive management. The Board, through the Audit Committee, has reviewed the effectiveness of the systems of internal financial control for the accounting year and the period to the date of approval of the financial statements although it should be understood that such systems are designed to provide reasonable but not absolute assurance against material misstatement or loss.

The Group has an established framework of internal financial controls, the key features of which are as follows:

Organisational structure The responsibilities of the Board set out above are designed to ensure effective control over strategic, financial and compliance issues.

Financial framework The Group operates a comprehensive system of financial reporting to the Board and senior management, based upon an annual budget and regular forecasts. Weekly and periodic reports of actual results together with key performance indicators are produced. The Group monitors financial performance along with other non-financial objectives through a balanced scorecard approach ensuring overall alignment of goals and objectives.

Policies and procedures The Group employs over 200,000 people including over 1,700 senior managers. Management control is formalised at all levels and is regulated by cascading limits of authority. Formal policies and procedures also exist for areas which are identified, by their nature, as being significant risk areas. Policies and procedures are regularly subject to compliance audits.

Quality and integrity of personnel The Group attaches high importance to the values of trust, honesty and integrity of personnel in responsible positions and operates a policy of recruiting and promoting suitably experienced personnel with clearly defined accountabilities.

Investment appraisal The capital investment programme is subject to formalised review procedures with key criteria requiring to be met. All major initiatives require business cases to be prepared, normally covering a minimum period of five years. Post investment appraisals are also carried out.

Control monitoring PricewaterhouseCoopers, our external auditors, contribute an independent perspective on certain aspects of the internal financial control system arising from their audit work and annually report their findings to the Audit Committee. The Group also maintains an internal audit function whose work is focused on areas of perceived high risk, as identified by risk analysis, and who regularly provide reports to the Audit Committee.

Pension fund

The assets of the pension funds, established for the benefit of the Group's employees, are held separately from those of the Group. Both the Tesco PLC Pension Scheme and the Tesco PLC Money Purchase Pension Scheme are managed by a trustee company. Its board comprises three executive directors, two senior managers and four members appointed from staff and pensioners. Management of the assets of the Tesco PLC Pension Scheme is delegated to a number of independent fund managers. Contributions to the Tesco PLC Money Purchase Pension Scheme are paid into insurance policies administered by the Equitable Life Assurance Society. There is no self-investment in Tesco shares or property occupied by the Tesco Group. Details of pension commitments are set out in note 26 to the financial statements on page 37.

Statement of compliance with the Code Provisions in the Combined Code

Throughout the year ended 27 February 1999, the company has been in compliance with all the Code Provisions set out in Section 1 of the Combined Code on Corporate Governance, except as detailed below.

Following the issuance of the Combined Code, the company resolved in September 1998 that Mr G F Pimlott held the position of senior independent non-executive director with effect from 19 October 1998, as in accordance with Code provision A.2.1.

With regard to Code provision B.1.7 on the length of directors' service agreements, the Remuneration Committee considers that the current length of two years is both appropriate and necessary although it reviews the matter every year.

With regard to Code provision C.2.1, the company always counts proxy votes but has not hitherto announced the proxy votes lodged on each resolution although the company will adopt this procedure with effect from the Annual General Meeting on 4 June 1999.

Board Committee membership	Nominations Committee	Remuneration Committee	Audit Committee
Independent directors			
Mr J A Gardiner	*	*	*
Mr G F Pimlott	*	*	*
Mr J W Melbourn	*	*	*
Baroness O'Cathain	*	*	
Mr C L Allen (a)		*	*
Dr H Einsmann (b)			
Executive directors			
Mr T P Leahy	*		

a) Appointed to the Board on 19 February 1999

b) Appointed to the Board on 1 April 1999

Report of the Directors on Remuneration

Directors' remuneration policy

The remuneration packages, including contract periods, of executive directors are determined by the Remuneration Committee ('the Committee'). It ensures that the remuneration package is appropriate for their responsibilities, taking into consideration the overall financial and business position of the Group, the highly competitive industry of which the Group is part and the importance of recruiting and retaining management of the appropriate calibre. The remuneration of the non-executive directors is determined by the Board as a whole on the recommendation of the Executive Committee after considering external market research.

Compliance

The Committee is constituted and operated throughout the period in accordance with the principles outlined in the Stock Exchange Listing Rules derived from Schedule A of the Combined Code. In framing the remuneration policy, full consideration has been given to the best practice provisions set out in Schedule B, annexed to the Listing Rules. The auditors'

report set out on page 17 covers the disclosures referred to in this report that are specified for audit by the London Stock Exchange.

Details of directors' emoluments and interests, including executive and savings-related share options, are set out below and on pages 13 to 16.

The following summarises the remuneration packages for executive directors. Copies of the executive directors' contracts of employment are available for inspection by shareholders as required.

Base salary and benefits

The base salary, contract periods, benefits (which comprise car benefits, life assurance, disability and health insurance) and other remuneration issues of executive directors and other senior executives, are normally reviewed annually by the Committee, having regard to competitive market practice supported by two external, independent surveys.

Table 1 Directors' emoluments	Salary £000	Profit sharing £000	Benefits £000	Incentive scheme		Total 1999 £000	Total 1998 £000
				Short term £000	Long term £000		
Lord MacLaurin (a)	—	—	—	—	—	—	259
Mr J A Gardiner	300	—	—	—	—	300	232
Mr T P Leahy	565	8	16	184	128	901	798
Mr D E Reid	512	8	36	165	115	836	743
Mr R S Ager	366	8	17	117	82	590	550
Mr C L Allen (b)	3	—	—	—	—	3	—
Mr P A Clarke (b)	58	2	2	14	9	85	—
Mr J Gildersleeve	475	8	40	153	106	782	709
Mr A T Higginson	347	—	11	115	80	553	267
Mrs L James	257	8	21	83	58	427	385
Dr M G Jones (c)	10	—	—	—	—	10	33
Mr T J R Mason	347	8	20	113	79	567	493
Mr J W Melbourn	37	—	—	—	—	37	31
Baroness O'Cathain	32	—	12	—	—	44	40
Mr G F Pimlott	30	—	—	—	—	30	28
Mr D T Potts (b)	79	2	3	19	13	116	—
Mr J M Wemms	398	8	35	128	89	658	589
	3,816	60	213	1,091	759	5,939	5,157

a) Former director.

b) Mr P A Clarke and Mr D T Potts were appointed to the Board on 16 November 1998 and Mr C L Allen was appointed to the Board on 19 February 1999.

c) Dr M G Jones resigned from the Board on 11 June 1998.

Profit-sharing

The Group operates an approved employee profit-sharing scheme for the benefit of all employees, including executive directors, with over two years' service with the Group at its year end. Shares in the company are allocated to participants in the scheme on a pro rata basis to base salary earned up to Inland Revenue approved limits.

Executive incentive scheme

The company operates performance-related award schemes designed to provide a growing element of variable reward to reflect the performance of the Group. The executive incentive scheme introduced in March 1993 was designed and introduced for this purpose.

Long term share bonuses are awarded annually, based on improvements in earnings per share, achievement of strategic corporate goals and comparative performance against peer companies including total shareholder return. The maximum long term bonus is 25% of salary. Shares awarded have to be

held for a period of four years, conditional upon continuous service with the company. The share equivalent of dividends which would have been paid on the shares is added to the award during the deferral period.

Short term share bonuses are awarded annually, based on improvements in earnings per share and on the achievement of strategic corporate goals. The maximum short term bonus payable is 25% of salary, which is augmented by up to a further 12½% of salary if the participants elect for the trustees of the scheme to retain the fully paid ordinary shares awarded for a minimum period of two years, conditional upon continuous service with the company. The share equivalent of dividends which would have been paid on the shares is added to the award during the deferral period.

Table 2 Gains made on share options

	Number of shares at exercise price (pence)					Price at exercise pence	Value realisable	
	72.3(a)	72.3	77.3	90.3	104.0		1999 £000	1998 £000
Mr T P Leahy	—	—	—	—	—	—	—	125
Mr D E Reid	—	—	—	—	—	—	—	903
Mr R S Ager	69,123	—	—	119,556	255,312	443,991	182	386
Mr P A Clarke	—	—	—	—	251,580	251,580	165	153
Mr J Gildersleeve	—	—	43,968	256,824	623,157	923,949	183	781
Mr A T Higginson	—	—	—	—	—	—	—	—
Mrs L James	—	—	—	223,182	300,048	523,230	187	466
Mr T J R Mason	—	—	—	291,552	437,805	729,357	180	594
Mr D T Potts	59,622	—	79,713	—	393,432	532,767	172	410
Mr J M Wemms	—	27,648	—	128,412	100,000	256,060	183	232
Date of grant	29 October 1992	27 May 1993	29 September 1994	27 April 1995	13 October 1995			

a) Mr D T Potts exercised these options at a discounted rate of 61.7p as targets relating to growth in earnings per share have been achieved in accordance with ABI guidelines.

The value realisable from shares acquired on exercise is the difference between the fair market value at exercise and the exercise price of the options, although the shares may have been retained. Where individual directors exercised options on different dates and sold the shares, the price at exercise shown represents an average of the prices on these dates weighted to the number of options exercised. The market price of the shares at 27 February 1999 was 177p. The share price during the 52 weeks to 27 February 1999 ranged from 157p to 202p.

Report of the Directors on Remuneration continued

Executive incentive scheme continued

The Committee sets performance targets annually for the incentive scheme for each of the criteria noted above, confirms achievement of performance and awards to be made under the scheme and directs the general administration of the scheme. The Executive Committee has adopted a policy of extending the Group Board executive incentive scheme to a wider body of senior executives within the Group. The scheme rules and awards of this extension are administered on a consistent basis as previously set out for the executive directors.

The holding period for both the long term and short term shares may be extended to seven and five years respectively by the scheme members. During this holding period, the shares held are increased by 12½% at the beginning of each year based on the scheme shares held. This holding period may be extended only subject to personal shareholding targets set by the Committee being met by the scheme members and conditional upon continuous employment with the company.

Share options

Executive directors are included in an approved executive share option scheme (ESOS), and are eligible to join the employees' savings-related share option scheme (SAYE) when they have completed one year's service.

Executive options granted since 1995 may be exercised only subject to the achievement of performance criteria related to growth in earnings per share, in accordance with ABI guidelines.

Pensions

Executive directors are members of the Tesco PLC Pension Scheme which provides a pension of up to two-thirds of base salary on retirement, normally at the age of 60, dependent upon service. The scheme also provides for dependants' pensions and lump sums on death in service. The scheme is a defined benefit pension scheme, which is approved by the Inland Revenue.

Service agreements

Executive directors have service contracts with entitlement to notice of 24 months. This notice period is renewed annually by the Remuneration Committee and is regarded as an essential part of the remuneration package, designed to retain key executives within the company.

Non-executive directors

Non-executive directors do not have contracts but each appointment is subject to review every three years. Non-executive directors receive a basic fee plus an additional sum in respect of committee membership. Baroness O'Cathain has the benefit of the use of a company car.

	Age at 27 Feb 1999	Years of service	Increase in accrued pension during the year (a) £000	Transfer value of increase during the year £000	Accrued total pension at 27 Feb 1999 (b) £000
Mr T P Leahy	43	20	18	165	189
Mr D E Reid	52	14	21	292	212
Mr R S Ager	53	13	13	183	160
Mr P A Clarke (c)	38	24	5	36	48
Mr J Gildersleeve	54	34	14	203	255
Mr A T Higginson (d)	41	1	12	102	14
Mrs L James	49	14	11	141	100
Mr T J R Mason	41	17	13	117	109
Mr D T Potts (c)	41	26	4	44	73
Mr J M Wemms	59	27	14	246	250

- The increase in accrued pension during the year excludes any increase for inflation.
- The accrued pension is that which would be paid annually on retirement at 60 based on service to 27 February 1999.
- The increase in accrued pension during the year for Mr P A Clarke and Mr D T Potts relates to the period from 16 November 1998 when they were appointed to the Board of Directors.
- Part of Mr A T Higginson's benefits, in respect of pensionable earnings in excess of the earnings limit imposed by the Finance Act 1989, are provided on an unfunded basis within a separate unapproved arrangement.

Table 4 Share options held by directors and not exercised at 27 February 1999

Executive share options schemes (1984), (1994) and (1996)					Number of shares at exercise price (pence)				
	72.3 (a)	72.3 (b)	70.0 (b)	81.0 (b)	77.3 (b)	90.3	104.0	98.3	Sub-total
Mr T P Leahy	62,211	51,150	417,144	471,372	—	398,523	248,256	523,728	2,172,384
Mr D E Reid	—	11,058	11,427	—	—	194,835	557,712	223,728	998,760
Mr R S Ager	—	51,153	75,714	—	106,833	—	—	250,170	483,870
Mr P A Clarke	—	—	—	—	—	—	—	165,504	165,504
Mr J Gildersleeve	—	—	—	—	—	—	—	122,034	122,034
Mr A T Higginson	—	—	—	—	—	—	—	—	—
Mrs L James	—	—	—	—	42,813	—	—	113,646	156,459
Mr T J R Mason	—	—	—	—	—	—	—	284,745	284,745
Mr D T Potts	—	—	—	—	—	—	—	97,581	97,581
Mr J M Wemms	—	—	87,141	—	—	—	566,603	275,643	929,387
Date exercisable (d)	29 October 1995	27 May 1996	10 June 1997	12 August 1997	29 September 1997	27 April 1998	13 October 1998	3 July 1999	

	Sub-total b/f	117.7	151.7	160.3	176.7(c)	164.0(c)	178.0(c)	Total
Mr T P Leahy	2,172,384	—	120,660	—	—	126,832	—	2,419,876
Mr D E Reid	998,760	—	601,305	—	—	90,245	—	1,690,310
Mr R S Ager	483,870	94,335	299,904	—	89,433	26,831	149,171	1,143,544
Mr P A Clarke	165,504	—	76,281	—	17,718	29,946	146,991	436,440
Mr J Gildersleeve	122,034	—	504,999	—	150,564	56,100	364,092	1,197,789
Mr A T Higginson	—	—	—	411,642	373,584	63,415	—	848,641
Mrs L James	156,459	—	225,150	—	—	19,514	113,263	514,386
Mr T J R Mason	284,745	—	198,669	—	149,076	63,415	255,796	951,701
Mr D T Potts	97,581	—	119,238	—	—	38,756	288,730	544,305
Mr J M Wemms	929,387	50,994	154,944	34,731	65,658	—	—	1,235,714
Date exercisable (d)		17 April 2000	7 October 2000	17 November 2000	21 May 2001	30 September 2001	28 January 2002	

- a) The options may be exercised at 61.7p as targets related to growth in earnings per share have been achieved in accordance with ABI guidelines.
- b) The 72.3p, 70.0p, 81.0p and 77.3p options may be exercised at 61.7p, 59.7p, 69.0p and 66.0p respectively, provided targets related to growth in earnings per share are achieved in accordance with ABI guidelines. If the targets are not met, the option holders retain the right to exercise the options at the higher price.
- c) Options granted in the year.
- d) Date of expiry is seven years from date exercisable, with the exception of the 98.3p, 117.7p, 151.7p and 160.3p options which expire four years from date exercisable.

Report of the Directors on Remuneration continued

Table 5 Share options held by directors and not exercised at 27 February 1999

Savings-related share option scheme (1981)				Number of shares	Exercise price pence	Value realisable	
	As at 28 Feb 1998	Granted	Exercised	As at 27 Feb 1999		1999 £000	1998 £000
Mr T P Leahy	25,095	—	—	25,095	61.7-83.0	—	—
Mr D E Reid	19,575	—	—	19,575	61.7-121.7	—	15
Mr R S Ager	23,145	4,963	12,855	15,253	61.7-136.0	18	—
Mr P A Clarke	21,711	1,488	3,855	19,344	61.7-136.0	5	—
Mr J Gildersleeve	19,692	—	—	19,692	61.7-121.7	—	23
Mr A T Higginson	—	—	—	—	—	—	—
Mrs L James	25,926	—	6,426	19,500	61.7-83.0	9	—
Mr T J R Mason	20,475	—	—	20,475	61.7-83.0	—	18
Mr D T Potts	20,700	—	—	20,700	83.3	—	—
Mr J M Wemms	25,095	—	—	25,095	61.7-83.0	—	—

The subscription price for the savings-related share option scheme granted during the year was 136p and the option matures in either 2002 (three-year scheme) or 2004 (five-year scheme). The shares relating to options exercised in the year were all retained.

Between 27 February 1999 and 12 April 1999 there have been no changes in the number of share options held by the directors. For further details on the company share option schemes see note 25.

	27 Feb 1999		28 Feb 1998	
	Ordinary shares	Options to acquire ordinary shares	Ordinary shares	Options to acquire ordinary shares
Table 6 Disclosable interests of the directors, including family interests				
Mr J A Gardiner	353,325	—	353,325	—
Mr T P Leahy	1,233,415	2,444,971	1,052,841	2,318,139
Mr D E Reid	1,418,418	1,709,885	1,212,093	1,619,640
Mr R S Ager	797,067	1,158,797	803,925	1,345,245
Mr P A Clarke (a)	65,145	455,784	43,698	515,076
Mr J Gildersleeve	771,244	1,217,481	723,789	1,570,674
Mr A T Higginson	60,512	848,641	—	411,642
Mrs L James	737,681	533,886	476,292	930,765
Dr M G Jones	—	—	6,894	—
Mr T J R Mason	452,596	972,176	347,541	1,233,246
Mr J W Melbourn	6,570	—	6,570	—
Baroness O'Cathain	46,473	—	46,473	—
Mr G F Pimlott	26,134	—	25,566	—
Mr D T Potts (a)	157,588	565,005	123,660	770,286
Mr J M Wemms	765,054	1,260,809	663,111	1,451,211

a) Mr P A Clarke and Mr D T Potts respectively held at 16 November 1998, their date of appointment to the Board, 60,834 and 156,417 ordinary shares, and 312,648 and 415,610 options to acquire ordinary shares.

Options to acquire ordinary shares shown above comprise options under the executive share option schemes (1984), (1994), (1996) and the savings-related share option scheme (1981) (note 25).

Between 27 February 1999 and 12 April 1999 there were no changes in the number of shares held by the directors.

Directors' responsibilities for the preparation of the financial statements

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the Group as at the end of the financial year and of the profit or loss for the financial year.

The directors consider that in preparing the financial statements on pages 18 to 40 the company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and that all accounting standards which they consider to be applicable have been followed.

The directors have responsibility for ensuring that the company keeps accounting records which disclose, with reasonable accuracy, the financial position of the company and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Auditors' report to the shareholders of Tesco PLC

We have audited the financial statements on pages 18 to 40 which have been prepared under the historical cost convention and the accounting policies set out on pages 22 and 23.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report including, as described above, the financial statements. Our responsibilities, as independent auditors, are established by statute, the Auditing Practices Board, the Listing Rules of the London Stock Exchange and our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law or the Listing Rules regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

We review whether the statement on pages 9 to 11 reflects the company's compliance with those provisions of the Combined Code specified for our review by the London Stock Exchange, and we report if it does not. We are not required to form an opinion on the effectiveness of the company's corporate governance procedures or its internal controls.

Basis of opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the company and the Group at 27 February 1999 and of the profit and cash flows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PRICEWATERHOUSECOOPERS 

Chartered Accountants and Registered Auditors
London
12 April 1999

Group profit and loss account

52 weeks ended 27 February 1999

	Note	Total 1999 £m	Total 1998 (restated) £m
Sales at net selling prices	1	18,546	17,779
Value added tax		(1,388)	(1,327)
Turnover excluding value added tax	1/2	17,158	16,452
Operating expenses			
– Normal operating expenses		(16,155)	(15,505)
– Employee profit-sharing	3	(38)	(35)
– Integration costs	2	(26)	(63)
– Goodwill amortisation	11	(5)	–
Operating profit	1/2	934	849
Loss on disposal of discontinued operations		–	(8)
Net loss on disposal of fixed assets		(8)	(1)
Share of operating profit/(loss) of joint ventures	1	6	(6)
Profit on ordinary activities before interest		932	834
Net interest payable	7	(90)	(74)
Profit on ordinary activities before taxation		842	760
Profit before integration costs, loss on disposal of discontinued operations, net loss on disposal of fixed assets and goodwill amortisation		881	832
Integration costs		(26)	(63)
Loss on disposal of discontinued operations		–	(8)
Net loss on disposal of fixed assets		(8)	(1)
Goodwill amortisation		(5)	–
Tax on profit on ordinary activities	8	(237)	(228)
Profit on ordinary activities after taxation		605	532
Minority interests		1	–
Profit for the financial year		606	532
Dividends	9	(277)	(255)
Retained profit for the financial year	24	329	277
		Pence	Pence
Earnings per share	10	9.14	8.12
Adjusted for integration costs after taxation		0.27	0.79
Adjusted for net loss on disposal of fixed assets and loss on disposal of discontinued operations after taxation		0.12	0.14
Adjusted for goodwill amortisation		0.06	–
Adjusted earnings per share	10	9.59	9.05
Diluted earnings per share	10	8.93	7.93
Adjusted for integration costs after taxation		0.26	0.78
Adjusted for net loss on disposal of fixed assets and loss on disposal of discontinued operations after taxation		0.12	0.13
Adjusted for goodwill amortisation		0.06	–
Adjusted diluted earnings per share	10	9.37	8.84
Dividend per share	9	4.12	3.87
Dividend cover (times)		2.27	2.28

Accounting policies and notes forming part of these financial statements are on pages 22 to 40.

Statement of total recognised gains and losses

52 weeks ended 27 February 1999

	Group		Company	
	1999 £m	1998 (restated) £m	1999 £m	1998 £m
Profit for the financial year	606	532	209	291
Loss on foreign currency net investments	(19)	(14)	–	–
Total recognised gains and losses relating to the financial year	587	518	209	291

Reconciliation of movements in shareholders' funds

52 weeks ended 27 February 1999

	Group		Company	
	1999 £m	1998 (restated) £m	1999 £m	1998 £m
Profit for the financial year	606	532	209	291
Dividends	(277)	(255)	(277)	(255)
	329	277	(68)	36
Loss on foreign currency net investments	(19)	(14)	–	–
New share capital subscribed less expenses	147	42	256	80
Payment of dividends by shares in lieu of cash	22	18	22	18
Goodwill arising on acquisitions	–	(445)	–	–
Amounts written back in respect of goodwill previously offset against reserves	–	135	–	–
Net addition to shareholders' funds	479	13	210	134
Shareholders' funds at 28 February 1998	3,903	3,890	2,489	2,355
Shareholders' funds at 27 February 1999	4,382	3,903	2,699	2,489

Accounting policies and notes forming part of these financial statements are on pages 22 to 40.

Balance sheets

27 February 1999

		Group		Company	
	Note	1999 £m	1998 (restated) £m	1999 £m	1998 £m
Fixed assets					
Intangible assets	11	112	—	—	—
Tangible assets	12	7,105	6,311	—	—
Investments	13	102	—	5,001	4,017
Investments in joint ventures	13	234	185	252	201
		7,553	6,496	5,253	4,218
Current assets					
Stocks	14	667	584	—	—
Debtors	15	151	133	1,924	1,271
Investments	16	201	196	2	2
Cash at bank and in hand		127	29	—	—
		1,146	942	1,926	1,273
Creditors: falling due within one year	17	(3,075)	(2,713)	(3,292)	(2,266)
Net current liabilities		(1,929)	(1,771)	(1,366)	(993)
Total assets less current liabilities		5,624	4,725	3,887	3,225
Creditors: falling due after more than one year	18	(1,230)	(812)	(1,188)	(736)
Provisions for liabilities and charges	21	(17)	(10)	—	—
Total net assets		4,377	3,903	2,699	2,489
Capital and reserves					
Called up share capital	23	339	110	339	110
Share premium account	24	1,577	1,528	1,577	1,528
Other reserves	24	40	40	—	—
Profit and loss account	24	2,426	2,225	783	851
Equity shareholders' funds		4,382	3,903	2,699	2,489
Minority interest		(5)	—	—	—
Total capital employed		4,377	3,903	2,699	2,489

Terry Leahy

Andrew Higginson

Directors

Financial statements approved by the Board on 12 April 1999.

Accounting policies and notes forming part of these financial statements are on pages 22 to 40.

Group cash flow statement

52 weeks ended 27 February 1999

	Note	1999 £m	1998 £m
Net cash inflow from operating activities	31	1,321	1,156
Returns on investments and servicing of finance			
Interest received		34	28
Interest paid		(162)	(116)
Interest element of finance lease rental payments		(1)	(6)
Net cash outflow from returns on investments and servicing of finance		(129)	(94)
Taxation Corporation tax paid (including advance corporation tax)		(237)	(238)
Capital expenditure and financial investment			
Payments to acquire tangible fixed assets		(1,032)	(805)
Receipts from sale of tangible fixed assets		27	82
Net cash outflow for capital expenditure and financial investment		(1,005)	(723)
Acquisitions and disposals			
Purchase of subsidiary undertakings	32	(184)	(649)
Sale of subsidiary undertakings		(4)	259
Net cash acquired with subsidiary undertakings	32	2	65
Net cash disposed of as part of sale of subsidiary undertakings		–	(2)
Purchase of interests in joint ventures	30	(69)	(32)
Net cash outflow from acquisitions and disposals		(255)	(359)
Equity dividends paid		(238)	(214)
Cash outflow before use of liquid resources and financing		(543)	(472)
Management of liquid resources			
Increase in short term deposits		(7)	(116)
Financing			
Ordinary shares issued for cash		42	38
Increase in other loans		719	443
Capital element of finance leases repaid		(15)	(21)
Net cash inflow from financing		746	460
Increase/(decrease) in cash in the period		196	(128)
Reconciliation of net cash flow to movement in net debt			
Increase/(decrease) in cash in period		196	(128)
Cash inflow from increase in debt and lease financing		(704)	(422)
Loans and finance leases acquired with subsidiary		(19)	(20)
Loans and finance leases disposed of as part of sale of business		–	10
Cash used to increase liquid resources		7	116
Amortisation of 4% unsecured deep discount loan stock		(3)	(3)
Foreign exchange differences		(6)	5
Increase in net debt		(529)	(442)
Net debt at 28 February 1998	34	(1,191)	(749)
Net debt at 27 February 1999	34	(1,720)	(1,191)

Accounting policies and notes forming part of these financial statements are on pages 22 to 40.

Accounting policies

Basis of financial statements

The financial statements have been prepared in accordance with applicable accounting standards, under the historical cost convention, and are in accordance with the Companies Act 1985.

Basis of consolidation

The Group profit and loss account and balance sheet consist of the financial statements of the parent company, its subsidiary undertakings and the Group's share of interests in joint ventures. The accounts of its subsidiary undertakings are prepared to or around 27 February 1999 apart from Global T.H., Tesco Polska Sp. z o.o., Tesco Stores ČR a.s., Tesco Stores SR a.s. and Tesco Stores Thailand Limited which are prepared to 31 December 1998. In the opinion of the directors it is necessary for the above named subsidiaries to prepare financial statements to an accounting date earlier than the rest of the Group to enable the timely publication of the Group financial statements. The Group's interests in joint ventures are accounted for using the gross equity method.

Provisions

The Group has adopted Financial Reporting Standard 12, 'Provisions, Contingent Liabilities and Contingent Assets'. This has involved restating the 1997/98 Ireland integration costs in the profit and loss account to that amount actually incurred in the year. For 1998/99 a further charge for integration costs has been incurred.

Stocks

Stocks comprise goods held for resale and development properties, and are valued at the lower of cost and net realisable value. Stocks in stores are calculated at retail prices and reduced by appropriate margins to the lower of cost and net realisable value.

Money market investments

Money market investments are stated at cost. All income from these investments is included in the profit and loss account as interest receivable and similar income.

Fixed assets and depreciation

Fixed assets include amounts in respect of interest paid, net of taxation, on funds specifically related to the financing of assets in the course of construction.

Depreciation is provided on an equal annual instalment basis over the anticipated useful working lives of the assets, after they have been brought into use, at the following rates:

Land premiums paid in excess of the alternative use value on acquisition – at 4% of cost.

Freehold and leasehold buildings with greater than 40 years unexpired – at 2.5% of cost.

Leasehold properties with less than 40 years unexpired are amortised by equal annual instalments over the unexpired period of the lease.

Plant, equipment, fixtures and fittings and motor vehicles – at rates varying from 10% to 33%.

Goodwill

The Group has adopted Financial Reporting Standard 10, 'Goodwill and Intangible Assets' in its accounts this year. The standard does not require restatement for goodwill arising and taken to reserves in previous years. All goodwill which arose in previous years has been written off through reserves.

Goodwill arising on consolidation as a result of the acquisitions of subsidiaries or joint ventures after 1 March 1998 is capitalised under the heading Intangible Fixed Assets and amortised on a straight line basis over its useful economic life, up to a maximum of 20 years.

Impairment of fixed assets and goodwill

Tangible fixed assets, other than investment properties, are subject to review for impairment in accordance with Financial Reporting Standard 11, 'Impairment of Fixed Assets and Goodwill'. The carrying values of tangible fixed assets and goodwill are written down by the amount of any impairment, and the loss is recognised in the profit and loss account in the year in which this occurs.

Leasing

Plant, equipment and fixtures and fittings which are the subject of finance leases are dealt with in the financial statements as tangible assets and equivalent liabilities at what would otherwise have been the cost of outright purchase.

Rentals are apportioned between reductions of the respective liabilities and finance charges, the latter being calculated by reference to the rates of interest implicit in the leases. The finance charges are dealt with under interest payable in the profit and loss account.

Leased assets are depreciated in accordance with the depreciation accounting policy over the anticipated working lives of the assets which generally correspond to the primary rental periods. The cost of operating leases in respect of land and buildings and other assets is expensed as incurred.

Deferred taxation

Deferred taxation is provided on accelerated capital allowances and other timing differences, only to the extent that it is probable that a liability will crystallise.

Pensions

The expected cost of pensions in respect of the Group's defined benefit pension schemes is charged to the profit and loss account over the working lifetimes of employees in the scheme. Actuarial surpluses and deficits are spread over the expected remaining working lifetimes of employees.

Post-retirement benefits other than pensions

The cost of providing other post-retirement benefits, which comprise private healthcare, is charged to the profit and loss account so as to spread the cost over the service lives of relevant employees in accordance with the advice of qualified actuaries. Actuarial surpluses and deficits are spread over the expected remaining working lifetimes of relevant employees.

Foreign currencies

Assets and liabilities in foreign currencies are translated into sterling at the financial year end exchange rates. Profits and losses of overseas subsidiaries are translated into sterling at average rates of exchange.

Gains and losses arising on the translation of the net assets of overseas subsidiaries are taken to reserves, less exchange differences arising on related foreign currency borrowings. Other exchange differences are taken to the profit and loss account.

Financial instruments

Derivative instruments utilised by the Group are interest rate swaps and caps, cross currency swaps, forward rate agreements, interest rate swap options and forward exchange contracts.

Termination payments made or received in respect of derivatives are spread over the life of the underlying exposure in cases where the underlying exposure continues to exist. Where the underlying exposure ceases to exist, any termination payments are taken to the profit and loss account.

Interest differentials on derivative instruments are recognised by adjusting net interest payable. Premia or discounts on derivative instruments are amortised over the shorter of the life of the instrument or the underlying exposure.

Currency swap agreements and forward exchange contracts are valued at closing rates of exchange. Resulting gains or losses are offset against foreign exchange gains or losses on the related borrowings or, where the instrument is used to hedge a committed future transaction, are deferred until the transaction occurs.

The disclosures required by Financial Reporting Standard 13, 'Derivatives and other Financial Instruments: Disclosures' have been followed.

Notes to the financial statements

Note 1 Segmental analysis of sales, turnover, profit and net assets

The Group's operations of food retailing and associated activities and property development are carried out in the UK, Republic of Ireland, France, Hungary, Poland, Czech Republic, Slovakia and Thailand. The results for Thailand and continental European operations are for the year ended 31 December 1998. In 1998, the Group disposed of Catteau S.A. whose results are included for the period to 24 February 1998, the date of disposal.

	1999				1998 (restated)			
	Sales including VAT £m	Turnover excluding VAT £m	Profit £m	Assets £m	Sales including VAT £m	Turnover excluding VAT £m	Profit £m	Assets £m
Continuing operations								
Food retailing – UK	17,070	15,814	919	5,392	16,115	14,952	875	4,780
Property development	21	21	–	32	19	19	–	55
Total UK	17,091	15,835	919	5,424	16,134	14,971	875	4,835
Food retailing – Rest of Europe	1,285	1,167	48	522	1,045	944	39	259
Food retailing – Thailand	170	156	(2)	151	–	–	–	–
Total continuing operations	18,546	17,158	965	6,097	17,179	15,915	914	5,094
Discontinued operations:								
Food retailing – France	–	–	–	–	600	537	(2)	–
	18,546	17,158	965		17,779	16,452	912	
Integration costs			(26)				(63)	
Goodwill amortisation			(5)				–	
Operating profit			934				849	
Loss on disposal of discontinued operations			–				(8)	
Net loss on disposal of fixed assets			(8)				(1)	
Share of operating profit/(loss) from joint ventures			6				(6)	
Net interest payable			(90)				(74)	
Profit on ordinary activities before taxation			842				760	
Operating margin (pre-integration costs)			5.6%				5.5%	
Capital employed			6,097					5,094
Net debt (note 19)			(1,720)					(1,191)
Net assets			4,377					3,903

The analysis of capital employed by geographical area is calculated on net assets excluding net debt. Inter-segmental turnover between the geographical areas of business is not material. Turnover is disclosed by origin. There is no material difference in turnover by destination. The Group's share of sales in the joint ventures which is not included in the numbers above is £81m (1998 – £34m).

	1999			1998		
	Continuing operations £m	Acquisitions £m	Total £m	Continuing operations £m	Discontinued operations £m	Total £m
Note 2 Analysis of operating profit						
Turnover excluding VAT	17,002	156	17,158	15,915	537	16,452
Cost of sales	(15,695)	(155)	(15,850)	(14,693)	(524)	(15,217)
Gross profit	1,307	1	1,308	1,222	13	1,235
Administration expenses	(371)	(3)	(374)	(371)	(15)	(386)
Operating profit/(loss)	936	(2)	934	851	(2)	849

Cost of sales includes distribution costs and store operating costs. Integration costs, goodwill amortisation and employee profit-sharing are included within administration expenses.

Integration costs of £95m relating to our Irish businesses were included within administration expenses in 1998. These have been restated in line with Financial Reporting Standard 12, 'Provisions, Contingent Liabilities and Contingent Assets', to reflect actual costs incurred of £63m. The charge made for integration costs in 1999 is £26m.

Note 3 Employee profit-sharing

This represents the amount allocated to the trustees of the profit-sharing scheme and is based on the UK profit after interest before net loss on disposal of fixed assets and taxation.

	1999 £m	1998 £m
Note 4 Profit on ordinary activities before taxation		
Profit on ordinary activities is stated after charging the following:		
Depreciation	401	358
Goodwill amortisation	5	–
Operating lease costs (a)	159	137
Auditors' remuneration (b)	1	–
Employment costs (note 5)	1,736	1,642

a) Operating lease costs include £35m for hire of plant and machinery (1998 – £19m).

b) Auditors' remuneration amounted to £0.7m (1998 – £0.5m) and includes £0.1m (1998 – £0.1m) for the company. The auditors also received £1.9m (1998 – £1.6m) in respect of non-audit services of which £1.1m (1998 – £0.5m) related to overseas operations. These fees were principally in respect of acquisitions and systems implementation.

	1999 £m	1998 £m
Note 5 Employment costs		
a) Employment costs during the year		
Wages and salaries	1,558	1,481
Social security costs	105	99
Other pension costs (note 26)	73	62
	1,736	1,642

b) Number of persons employed

The average number of employees per week during the year was: UK 172,712 (1998 – 164,716), Rest of Europe 19,497 (1998 – 20,864), Thailand 6,133 (1998 – nil) and the average number of full-time equivalents was: UK 108,284 (1998 – 105,008), Rest of Europe 17,116 (1998 – 19,164) and Thailand 5,631 (1998 – nil).

Notes to the financial statements continued**Note 6 Directors' emoluments and interests**

Details of directors' emoluments and interests are given in the Report of the Directors on Remuneration on pages 12 to 16.

		1999	1998
Note 7 Net interest payable	£m	£m	£m
Interest receivable and similar income on money market investments and deposits		22	26
Less interest payable on:			
Short term bank loans and overdrafts repayable within five years	(46)		(52)
Finance charges payable on finance leases	(8)		(11)
4% unsecured deep discount loan stock 2006 (a)	(8)		(8)
E.C.S.C. loans 1998-1999 (b)	–		(1)
10¾% bonds 2002	(21)		(21)
7½% bonds 2007	(21)		(11)
8¾% bonds 2003	(17)		(18)
5¼% bonds 2009	(1)		–
Medium term notes	(17)		–
Interest capitalised	35		31
Share of interest of joint ventures	(8)		(9)
		(112)	(100)
		(90)	(74)

a) Interest payable on the 4% unsecured deep discount loan stock 2006 includes £3m (1998 – £3m) of discount amortisation.

b) E.C.S.C. refers to the European Coal and Steel Community.

Note 8 Taxation	1999 £m	1998 £m
UK taxation:		
Corporation tax at 31.0% (1998 – 31.2%)	257	251
Share of joint ventures	(2)	(5)
Prior year items	(32)	(20)
Deferred taxation (see note 21) – current year	5	1
– prior year	2	(8)
	230	219
Overseas taxation	7	9
	237	228

Note 9 Dividends	1999 Pence per share	1998 Pence per share	1999 £m	1998 £m
Declared interim	1.25	1.18	83	78
Proposed final	2.87	2.69	194	177
	4.12	3.87	277	255

Note 10 Earnings per share and diluted earnings per share

Earnings per share and diluted earnings per share have been calculated in accordance with Financial Reporting Standard 14, 'Earnings per Share'. The standard requires that earnings should be based on the net profit attributable to ordinary shareholders. The calculation for earnings, including and excluding integration costs, net loss on disposal of fixed assets, loss on disposal of discontinued operations and goodwill amortisation is based on the profit for the financial year of £606m (1998 – £532m).

For the purposes of calculating earnings per share, the number of shares is the weighted average number of ordinary shares in issue during the year of 6,627m (1998 – 6,553m).

The calculation for diluted earnings per share uses the weighted average number of ordinary shares in issue adjusted by the effects of all dilutive potential ordinary shares. The dilution effect is calculated on the full exercise of all ordinary share options granted by the Group, including performance based options which the Group consider to have been earned. The calculation compares the difference between the exercise price of exercisable ordinary share options, weighted for the period over which they were outstanding, with the average daily mid-market closing price over the period.

	52 weeks to 27 Feb 1999	53 weeks to 28 Feb 1998
Weighted average number of dilutive share options (m)	153	156
Weighted average number of shares in issue in the period (m)	6,627	6,553
Total number of shares for calculating diluted earnings per share (m)	6,780	6,709

Note 11 Intangible fixed assets

	1999 £m	1998 £m
Cost		
At 28 February 1998	–	–
Additions at cost	117	–
At 27 February 1999	117	–
Amortisation		
At 28 February 1998	–	–
Charge for the period	5	–
At 27 February 1999	5	–
Net carrying value		
At 28 February 1998	–	–
At 27 February 1999	112	–

Goodwill arising on the purchase of our Thailand business has been capitalised and amortised over 20 years in accordance with the provisions set out in Financial Reporting Standard 10, 'Goodwill and Intangible Assets'.

Notes to the financial statements continued**Note 12 Tangible fixed assets**

	Land and buildings £m	Plant equipment fixtures and fittings and vehicles £m	Total £m
Cost			
At 28 February 1998	6,167	2,168	8,335
Currency translation	10	11	21
Additions at cost (a)	669	398	1,067
Purchase of subsidiary undertakings	98	64	162
	6,944	2,641	9,585
Disposals	(26)	(108)	(134)
At 27 February 1999	6,918	2,533	9,451
Depreciation			
At 28 February 1998	739	1,285	2,024
Currency translation	1	4	5
Charge for period	147	254	401
Purchase of subsidiary undertakings	4	11	15
	891	1,554	2,445
Disposals	(5)	(94)	(99)
At 27 February 1999	886	1,460	2,346

Net book value (b) (c)

At 27 February 1999	6,032	1,073	7,105
At 28 February 1998	5,428	883	6,311

Capital work in progress included above (d)

At 27 February 1999	124	21	145
At 28 February 1998	118	17	135

a) Includes £24m (1998 – £20m) in respect of interest capitalised net of tax relief of £9m (1998 – £8m) principally relating to land and building assets.

b) Net book value includes capitalised interest, net of tax relief, at 27 February 1999 of £288m (1998 – £278m).

Plant, equipment, fixtures and fittings and vehicles subject to finance leases included in net book value is:

	Cost £m	Depreciation £m	Net book value £m
At 28 February 1998	179	149	30
Movement in the period	—	8	(8)
At 27 February 1999	179	157	22

c) The net book value of land and buildings comprises:

	1999 £m	1998 £m
Freehold	5,130	4,628
Long leasehold – 50 years or more	557	508
Short leasehold – less than 50 years	345	292
At 27 February 1999	6,032	5,428

d) Capital work in progress does not include land.

	Group		Company		
	Joint ventures (b) £m	Own shares (c) £m	Share in Group undertakings (a) £m	Loans to Group undertakings £m	Joint ventures (b) £m
Note 13 Fixed asset investments					
At 28 February 1998	185	—	1,017	3,000	201
Additions	51	102	984	—	51
Share of loss of joint ventures	(2)	—	—	—	—
Disposals	—	—	—	—	—
At 27 February 1999	234	102	2,001	3,000	252

a) The company's principal operating subsidiary undertakings are:

	Business	Share of equity capital	Country of incorporation
Tesco Stores Limited	Food Retail	100%	Registered in England
Tesco Property Holdings Limited	Property Investment	100%	Registered in England
Tesco Insurance Limited	Insurance	100%	Guernsey
Tesco Distribution Limited	Distribution	100%	Registered in England
Spen Hill Properties Limited	Property Development	100%	Registered in England
Tesco Ireland Limited	Food Retail	100%	Republic of Ireland
Global T.H.	Food Retail	99%	Hungary
Tesco Polska Sp. z o.o.	Food Retail	98%	Poland
Tesco ČR a.s.	Food Retail	100%	Czech Republic
Tesco Stores Thailand Limited	Food Retail	75%	Thailand
Tesco SR a.s.	Food Retail	100%	Slovakia
Tesco Stores Hong Kong Limited	Purchasing	100%	Hong Kong

All principal subsidiary undertakings, none of which is owned directly by Tesco PLC, operate in their country of incorporation.

b) The Group's joint ventures are:

	Business	Share of issued share capital, loan capital and debt securities	Country of incorporation and principal country of operation
Shopping Centres Limited	Property Investment	50%	Registered in England
BLT Properties Limited	Property Investment	50%	Registered in England
Tesco British Land Property Partnership	Property Investment	50%	Registered in England
Tesco Personal Finance Group Limited	Personal Finance	50%	Registered in Scotland
Tesco Personal Finance Life Limited	Personal Finance	50%	Registered in Scotland

The Group's share of gross assets and gross liabilities of the joint ventures is disclosed below:

	1999 £m	1998 £m
Gross assets	821	588
Gross liabilities	(587)	(403)
	234	185

c) The investment in own shares represents 99 million 5p ordinary shares in Tesco PLC valued at £1.03 each. These shares are held by a qualifying employee share trust (QUEST) in order to satisfy options under savings-related share option schemes which become exercisable over the next few years. The carrying value of £102m (market value £176m) represents the exercise amount receivable in respect of these shares subscribed for by the QUEST at market value. Funding is provided to the QUEST by Tesco Stores Limited, the company's principal operating subsidiary. The QUEST has waived its rights to dividends on these shares.

Notes to the financial statements continued**Note 13 Fixed asset investments** *continued*

The net borrowings of the joint ventures, as at 27 February 1999, were as follows:

	1999 £m	1998 (restated) £m
Cash and deposits	979	555
Debenture stock – repayable 2001	(38)	(36)
Term bank loan – repayable 2003	(134)	(128)
Other loans	(900)	(578)
	(93)	(187)

There is no recourse to Group companies in respect of the borrowings of the joint ventures, apart from £15m (1998 – £15m) which has been guaranteed by Tesco PLC (note 29).

Details of transactions and balances with the joint ventures are set out in note 30.

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Note 14 Stocks				
Goods held for resale	595	501	–	–
Development property	72	83	–	–
	667	584	–	–

Additions to development property include £2m (1998 – £3m) of interest capitalised. Accumulated capitalised interest at 27 February 1999 was £14m (1998 – £12m).

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Note 15 Debtors				
Amounts owed by Group undertakings	–	–	1,690	1,002
Prepayments and accrued income	31	34	202	262
Advance corporation tax recoverable	–	3	–	3
Other debtors	100	96	12	4
Amounts owed by undertakings in which the company has a participating interest	20	–	20	–
	151	133	1,924	1,271

Debtors falling due after one year included above:

Advance corporation tax recoverable	–	3	–	3
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	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Note 16 Investments				
Money market deposits	199	176	–	–
Bonds and certificates of deposit (market value £2m, 1998 – £20m)	2	20	2	2
	201	196	2	2

	Group		Company	
	1999 £m	1998 (restated) £m	1999 £m	1998 £m
Note 17 Creditors falling due within one year				
Bank loans and overdrafts (a) (b)	811	607	1,341	1,263
Trade creditors	1,100	972	–	–
Amounts owed to Group undertakings	–	–	1,733	796
Other creditors	446	387	3	–
Corporation tax (c)	236	257	–	15
Other taxation and social security	92	99	–	–
Accruals and deferred income (d)	177	197	21	15
Finance leases (note 22)	19	17	–	–
Proposed final dividend	194	177	194	177
	3,075	2,713	3,292	2,266

- a) Bank deposits at subsidiary undertakings of £767m (1998 – £750m) have been offset against borrowings in the parent company under a legal right of set-off.
- b) Includes £9m (1998 – £8m) secured on various properties.
- c) The corporation tax liability represents the charge for the year after deducting tax relief for capitalised interest and advance corporation tax recoverable within one year.
- d) A gain of £45m, realised in a prior year, on terminated interest rate swaps is being spread over the life of replacement swaps entered into at the same time for similar periods. Accruals and deferred income include £6m (1998 – £5m) attributable to these realised gains with £12m (1998 – £18m) being included in other creditors falling due after more than one year (note 18).

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Note 18 Other creditors falling due after more than one year				
4% unsecured deep discount loan stock 2006 (a)	87	83	87	83
Finance leases (note 22)	8	25	–	–
10¾% bonds 2002 (b)	200	200	200	200
8¾% bonds 2003 (c)	200	200	200	200
7½% bonds 2007 (d)	325	250	325	250
5¼% bonds 2009 (e)	150	–	150	–
E.C.S.C. loans 1998-1999	–	3	–	3
Medium term notes (f)	226	–	226	–
Other loans (g)	22	31	–	–
	1,218	792	1,188	736
Accruals and deferred income (note 17)	12	20	–	–
	1,230	812	1,188	736

- a) The 4% unsecured deep discount loan stock is redeemable at a par value of £125m in 2006.
- b) The 10¾% bonds are redeemable at a par value of £200m in 2002.
- c) The 8¾% bonds are redeemable at a par value of £200m in 2003.
- d) The 7½% bonds are redeemable at a par value of £325m in 2007.
- e) The 5¼% bonds are redeemable at a par value of £150m in 2009.
- f) The medium term notes are of various maturities and include foreign currency and sterling denominated notes swapped into floating rate sterling.
- g) Secured on various properties.

Notes to the financial statements continued

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Note 19 Net debt				
Due within one year				
Bank and other loans	811	607	1,341	1,263
Finance leases	19	17	–	–
Due within one to two years				
Bank and other loans	137	12	127	3
Finance leases	4	7	–	–
Due within two to five years				
Bank and other loans	477	422	465	400
Finance leases	4	17	–	–
Due wholly or in part by instalments after five years				
Finance leases	–	1	–	–
Due otherwise than by instalments after five years				
Bank and other loans	596	333	596	333
Gross debt	2,048	1,416	2,529	1,999
Less: Cash at bank and in hand	127	29	–	–
Money market investments and deposits	201	196	2	2
Net debt	1,720	1,191	2,527	1,997

Note 20 Financial instruments**Analysis of interest rate exposure and currency of net debt**

The interest rate exposure and currency of Group net debt at 27 February 1999 after swaps was:

	Total £m	Floating rate debt £m	Fixed rate debt £m	Weighted average interest rate 27 Feb 1999 %	Fixed rate debt Weighted average time for which rate is fixed Years
Currency					
Sterling	1,527	1,040	487	9.0	6
Irish punt	159	(3)	162	5.9	4
Thai baht	177	177	–	–	–
Other	(143)	(143)	–	–	–
Net debt at 27 February 1999	1,720	1,071	649	8.2	5
% of net debt		62%	38%		
Net debt at 28 February 1998	1,191	577	614	8.2	5

The interest rate exposure of the Group has been further managed by the purchase of interest rate caps with an aggregate notional principal of £100m (1998 – £170m), an average strike rate of 8.3% and a three year maturity. The current value of these contracts, if realised, is nil.

The following interest rate hedging transactions were undertaken in achieving the above position:

- i) Swaps converting Irish punt floating debt, with a notional principal sterling equivalent at year end rates of £162m, to Irish punt fixed debt for an average period of four years and interest rate of 5.8%.
- ii) Swaps converting £115m net notional principal sterling denominated fixed rate debt into floating debt for an average period of six years and interest rate of 7.2%. Offset within this amount are swaps converting £200m notional principal sterling floating rate debt into fixed rate debt which are cancellable at the banks' option.

The current value of these contracts, if realised, would generate a profit of £24m (1998 – nil). In addition, as set out in note 17, a gain of £45m was crystallised by selling profitable swaps and entering into new swaps for an equivalent remaining life and contract value at less attractive rates. This gain is being released over the period of the replacement swaps and an amount of £18m (1998 – £23m) has been deferred as at 27 February 1999.

Long term debt over one year with a book value of £1,218m (1998 – £792m) has an estimated current value, considering only the movements in risk-free interest rates, of £1,335m (1998 – £866m). The difference between the book value and the current value of this long term debt is partially offset by the deferred realised gain on the swaps.

Currency analysis of net assets

The Group's net assets by currency on 27 February 1999

	Financing		Net investment	
	Net assets before financing £m	Gross debt £m	1999 £m	1998 £m
Currency				
Sterling	5,685	(1,659)	4,026	3,822
Irish punt	204	(178)	26	(55)
Thai baht	169	(190)	(21)	–
Other	367	(21)	346	136
Total net assets	6,425	(2,048)	4,377	3,903

The currency value shown is the year end value.

Other significant financial instruments outstanding at the year end are £222m nominal value forward foreign exchange contracts hedging the cost of foreign currency denominated purchases. On a mark-to-market basis these contracts show a profit of nil.

Notes to the financial statements continued

	Deferred taxation £m	Integration costs £m	Total £m
Note 21 Provisions for liabilities and charges			
At 28 February 1998	6	32	38
Restatement of integration costs	4	(32)	(28)
At 28 February 1998 (restated)	10	—	10
Amount charged in the year	7	—	7
At 27 February 1999	17	—	17

Details of the restatement of provisions for liabilities and charges are disclosed in note 2.

	Amount provided		Potential amount for deferred tax on timing differences	
	1999 £m	1998 (restated) £m	1999 £m	1998 £m
Deferred taxation				
Excess capital allowances over depreciation	—	—	315	312
Capital gains deferred by rollover relief	—	—	(8)	—
Short term timing differences	17	10	12	(8)
	17	10	319	304

Deferred taxation balances relate to short term timing differences.

Where possible taxation on capital gains has been or will be deferred by rollover relief under the provisions of the Taxation of Chargeable Gains Act 1992.

Note 22 Leasing commitments**a) Finance leases**

The future minimum finance lease payments to which the Group was committed at 27 February 1999 and which have been guaranteed by Tesco PLC are:

	£m
Gross rental obligations	30
Less: finance charges allocated to future periods	(3)
	27

	1999 £m	1998 £m
Net amounts payable are:		
Within one year	19	17
Between one and five years	8	24
After five years	—	1
	27	42

b) Operating leases

Group commitments during the 52 weeks to 26 February 2000, in terms of lease agreements expiring, are as follows:

	1999 £m	1998 £m
Within one year	4	4
Between one and five years	10	8
After five years	135	127
	149	139

	Ordinary shares of 5p each	
	Number	£m
Note 23 Called up share capital		
Authorised at 28 February 1998	8,130,000,000	407
Authorised during the year	1,070,000,000	53
Authorised at 27 February 1999	9,200,000,000	460
Allotted, issued and fully paid:		
Issued at 28 February 1998	2,200,255,616	110
Bonus issue on 3 July 1998	4,411,053,536	221
Scrip dividend election	8,490,005	–
Share options exercised	150,397,941	8
Issued at 27 February 1999	6,770,197,098	339

During the year, 4.6 billion shares were issued for an aggregate consideration of £278m, which comprised £22m for scrip dividend and £256m for share options.

Between 27 February 1999 and 12 April 1999, options on 1,723,447 ordinary shares and 623,058 ordinary shares have been exercised under the terms of the savings-related share option scheme (1981) and the executive share option schemes (1984 and 1994) respectively. As at 27 February 1999 the directors were authorised to purchase up to a maximum in aggregate of 677,019,709 ordinary shares.

	Group		Company	
	1999 £m	1998 £m	1999 £m	1998 £m
Note 24 Reserves				
a) Share premium account				
At 28 February 1998	1,528	1,431	1,528	1,431
Premium on issue of shares less costs	248	79	248	79
Bonus issue on 3 July 1998	(221)	–	(221)	–
Scrip dividend election	22	18	22	18
At 27 February 1999	1,577	1,528	1,577	1,528
b) Other reserves				
At 27 February 1999 and 28 February 1998	40	40	–	–
c) Profit and loss account				
At 28 February 1998	2,198	2,310	851	815
Restatement for prior year accounting adjustment	27	–	–	–
At 28 February 1998 (restated)	2,225	2,310	851	815
Goodwill arising on acquisition of subsidiary undertakings	–	(445)	–	–
Amount written back in respect of goodwill previously offset against reserves	–	135	–	–
Loss on foreign currency net investments	(19)	(14)	–	–
Issue of shares	(109)	(38)	–	–
Retained profit for the financial year	329	277	(68)	36
At 27 February 1999	2,426	2,225	783	851

The prior year adjustment has resulted from the adoption of Financial Reporting Standard 12, 'Provisions, Contingent Liabilities and Contingent Assets', and represents the release of a provision of £32m for integration costs not incurred in 1998 less taxation of £5m.

Other reserves comprise a merger reserve arising on the acquisition of Hillards plc in 1987.

In accordance with section 230 of the Companies Act 1985 a profit and loss account for Tesco PLC, whose result for the year is shown above, has not been presented in these accounts.

The cumulative goodwill written off against the reserves of the Group as at 27 February 1999 amounted to £718m (1998 – £718m).

During the year the company received £128m on the issue of 31 million shares in respect of the exercise of options awarded under the savings-related share option scheme. Employees paid £19m to the Group for the issue of these shares and the balance of £109m comprised contributions to the qualifying share ownership trust (QUEST) from subsidiary undertakings.

Notes to the financial statements continued**Note 25 Share options****Company schemes**

The company had five principal share option schemes in operation during the year:

- i) The savings-related share option scheme (1981) permits the grant to employees of options in respect of ordinary shares linked to a building society/bank save-as-you-earn contract for a term of three and five years with contributions from employees of an amount between £5 and £250 per month. Options are capable of being exercised at the end of the three and five year period at a subscription price not less than 80% of the middle market quotation of an ordinary share immediately prior to the date of grant.
- ii) The executive share option scheme (1984) permitted the grant of options in respect of ordinary shares to selected executives. The scheme expired after 10 years on 9 November 1994. Options were generally exercisable between three and 10 years from the date of grant at a subscription price determined by the Board but not less than the middle market quotation within the period of 30 days prior to the date of grant. Some options have been granted at a discount of 15% of the standard option price but the option holder may take advantage of that discount only if, in accordance with investor protection ABI guidelines, certain targets related to earnings per share are achieved.
- iii) The executive share option scheme (1994) was adopted on 17 October 1994. The principal difference between this scheme and the previous scheme is that the exercise of options will normally be conditional upon the achievement of a specified performance target related to the annual percentage growth in earnings per share over any three year period. There will be no discounted options granted under this scheme.
- iv) The executive share option scheme (1996) was adopted on 7 June 1996. This scheme was introduced following legislative changes which limited the number of options which could be granted under the previous scheme. As with the previous scheme, the exercise of options will normally be conditional upon the achievement of a specified performance target related to the annual percentage growth in earnings per share over any three year period. There will be no discounted options granted under this scheme.
- v) The international executive share option scheme (1996) was adopted on 7 June 1996. This scheme permits the grant to selected non-UK executives of options to acquire ordinary shares on substantially the same basis as their UK counterparts. Options are normally exercisable between three and ten years from their grant at a price of not less than the average of the middle market quotations for the ordinary shares as derived from the London Stock Exchange Daily Official List for the three dealing days immediately preceding their grant and will normally be conditional on the achievement of a specified performance target determined by the Remuneration Committee when the options are granted. There will be no discounted options granted under this scheme.

The company has granted outstanding options in connection with the five schemes as follows:

Savings-related share option scheme (1981)

Date of grant	Number of executives and employees	Shares under option 27 Feb 1999	Subscription prices (pence)
22 October 1993	783	2,944,424	53.7
26 October 1994	12,102	35,782,151	61.7
27 October 1995	16,189	34,003,287	83.3
31 October 1996	27,868	49,143,759	83.0
30 October 1997	36,815	46,980,808	121.7
29 October 1998	57,159	71,026,894	136.0

Executive share option scheme (1984)

Date of grant	Number of executives	Shares under option 27 Feb 1999	Subscription prices (pence)
1 November 1989	81	804,432	64.0
17 May 1991	5	220,002	91.3
29 May 1992	105	3,777,503	92.3
29 October 1992	4	197,556	72.3
27 May 1993	4	195,483	72.3
10 June 1994	181	3,960,726	70.0
12 August 1994	1	471,372	81.0
29 September 1994	10	410,055	77.3

Executive share option scheme (1994)

Date of grant	Number of executives	Shares under option 27 Feb 1999	Subscription prices (pence)
27 April 1995	10	1,334,490	90.3
13 October 1995	503	14,462,309	104.0

Note 25 Share options *continued***Executive share option scheme (1996)**

Date of grant	Number of executives	Shares under option 27 Feb 1999	Subscription prices (pence)
3 July 1996	29	3,695,277	98.3
23 September 1996	975	26,609,025	99.7
17 April 1997	1,057	20,580,537	117.7
7 October 1997	42	4,770,168	151.7
17 November 1997	2	446,373	160.3
21 May 1998	1,322	22,394,650	176.7
30 September 1998	37	1,609,009	164.0
28 January 1999	1,363	21,650,614	178.0

International executive share option scheme (1996)

Date of grant	Number of executives	Shares under option 27 Feb 1999	Subscription prices (pence)
7 October 1997	118	1,914,690	151.7
21 May 1998	299	2,862,000	176.7
28 January 1999	383	4,116,500	178.0

The subscription price and number of shares have been adjusted as a result of the bonus issue on 3 July 1998.

Note 26 Pension commitments

The Group operates a funded defined benefit pension scheme for full-time employees, the assets of which are held as a segregated fund, administered by trustees.

The pension cost relating to the scheme is assessed in accordance with the advice of an independent qualified actuary using the projected unit method. The latest actuarial assessment of this scheme was at 5 April 1996. The assumptions which have the most significant effects on the results of the valuation are those relating to the rate of return on investments and the rate of increase in salaries and pensions. It was assumed that the investment return would be 8½% per annum with dividend growth of 4% per annum, that salary increases would average 5½% per annum and that pensions would increase at the rate of 3½% per annum.

At the date of the latest actuarial valuation, the market value of the scheme's assets was £792m and the actuarial value of these assets represented 108% of the benefits that had accrued to members, after allowing for expected future increases in earnings.

Benefit improvements to members have been agreed with the trustees which have resulted in an increased company cost. This increasing ongoing cost has been offset by the amortisation of the surplus as a level percentage of pay over nine years. The pension cost of this scheme to the Group was £55m (1998 – £44m).

The Group also operates a defined contribution pension scheme for part-time employees which was introduced on 6 April 1988. The assets of the scheme are held separately from those of the Group, being invested with an insurance company. The pension cost represents contributions payable by the Group to the insurance company and amounted to £17m (1998 – £15m). There were no material amounts outstanding to the insurance company at the year end.

The Group also operates defined contribution schemes in the Republic of Ireland and Hungary. The contributions payable under these schemes of £1m (1998 – £3m) have been fully expensed against profits in the current year.

Notes to the financial statements continued

Note 27 Post-retirement benefits other than pensions

The company operates a scheme offering post-retirement healthcare benefits. The cost of providing for these benefits has been accounted for on a basis similar to that used for defined benefit pension schemes.

The liability as at 24 February 1996 of £10m, which was determined in accordance with the advice of qualified actuaries, is being spread forward over the service lives of relevant employees and £1m (1998 – £1m) has been charged to the profit and loss account. An amount of £3m (1998 – £4m) is being carried in the balance sheet. It is expected that payments will be tax deductible, at the company's tax rate, when made.

Note 28 Capital commitments

At 27 February 1999 there were commitments for capital expenditure contracted for but not provided of £260m (1998 – £214m).

Note 29 Contingent liabilities

Certain bank loans and overdraft facilities of joint ventures have been guaranteed by Tesco PLC. At 27 February 1999, the amounts outstanding on these facilities were £15m (1998 – £15m).

The company has irrevocably guaranteed the liabilities as defined in Section 5(c) of the Republic of Ireland (Amendment Act) 1986 of various subsidiary undertakings incorporated in the Republic of Ireland.

Note 30 Related party transactions

During the year there were no material transactions or amounts owed or owing with any of the Group's key management or members of their close family.

During the year the Group traded with its five joint ventures, Shopping Centres Limited, BLT Properties Limited, Tesco British Land Property Partnership, Tesco Personal Finance Group Limited and Tesco Personal Finance Life Limited. The main transactions during the year were:

- i) Equity funding of £28m (£26m in Tesco Personal Finance Group Limited and £2m in Tesco Personal Finance Life Limited).
- ii) Equity funding of £21m and the sale of two properties to Tesco British Land Property Partnership worth £33m. Additionally the Group made rental payments of £13m (1998 – nil) to Tesco British Land Property Partnership.
- iii) The Group made rental payments of £3m (1998 – £3m) and £11m (1998 – £9m) to Shopping Centres Limited and BLT Properties Limited respectively. In addition, BLT Properties Limited purchased a property from Spenhill Properties Limited (a fellow Group company) for £7m.
- iv) The Group has charged Tesco Personal Finance Limited (a 100% subsidiary of Tesco Personal Finance Group Limited) an amount totalling £10m in respect of services, loan interest and assets transferred, of which £9m was outstanding at 27 February 1999. Tesco Personal Finance Limited received fees totalling £11m from the Group for managing certain financial products, £3m of which was outstanding at 27 February 1999.
- v) The Group made loans totalling £20m to Tesco Personal Finance Group Limited.

Note 31 Reconciliation of operating profit to net cash inflow from operating activities

	1999 £m	1998 £m
Operating profit	934	849
Depreciation and goodwill amortisation	406	358
Increase in goods held for resale	(69)	(6)
Increase/(decrease) in development property	13	(108)
Increase in debtors	(12)	(36)
Increase in trade creditors	81	97
(Decrease)/increase in other creditors	(32)	2
Increase in working capital	(19)	(51)
Net cash inflow from operating activities	1,321	1,156

Note 32 Acquisitions

On 20 May 1998 the company acquired a controlling interest in Lotus, a chain of hypermarkets in Thailand, from the CP Group for £206m. The results of this business from this date to 31 December 1998 have been consolidated within the Group profit and loss account. In the period from 1 January 1998 to 20 May 1998 they made a loss after taxation of £3m, and in the year to 31 December 1997 they made a loss after taxation of £71m with no minority interests.

This acquisition has been accounted for using acquisition accounting and has been consolidated into the Tesco Group balance sheet as follows:

	Balance sheet at acquisition £m	Fair value adjustments £m	Fair value balance sheet £m
Fixed assets	185	(38)	147
Stock	23	—	23
Debtors	3	—	3
Net cash	2	—	2
Loans	(19)	—	(19)
Creditors	(67)	—	(67)
Shareholders' funds	127	(38)	89
Goodwill			117
Total purchase consideration			206

The fair value adjustments of £38m relate to revaluation of the property portfolio.

The outflow of cash for the purchase of the Thailand business comprises:

	£m
Cash consideration	117
Bank overdraft of acquired subsidiary undertakings (including loans of £19m)	89
	206

The £206m purchase consideration comprises net cash outflow, £182m, acquired loans, £19m, and accrued acquisition costs, £5m.

Note 33 Post Balance Sheet event

On 23 March 1999, the Group announced it is to form a partnership company with Samsung Corporation to develop hypermarkets in South Korea. The Group will invest £80m in cash for 51% of the business and a further £50m for an additional 30% holding in June 1999.

Notes to the financial statements continued**Note 34 Analysis of changes in net debt**

	At 28 Feb 1998 £m	Cash flow £m	Other non cash changes £m	Acquisitions £m	Exchange movements £m	At 27 Feb 1999 £m
Cash in hand, at bank	29	96	—	—	2	127
Overdrafts	(131)	100	—	—	—	(31)
	(102)	196	—	—	2	96
Money market investments and deposits	196	7	—	—	(2)	201
Bank and other loans	(476)	(298)	(3)	—	(3)	(780)
Finance leases	(17)	(2)	—	—	—	(19)
Debt due within one year	(493)	(300)	(3)	—	(3)	(799)
Bank and other loans	(767)	(421)	—	(19)	(3)	(1,210)
Finance leases	(25)	17	—	—	—	(8)
Debt due after one year	(792)	(404)	—	(19)	(3)	(1,218)
	(1,191)	(501)	(3)	(19)	(6)	(1,720)

Five year record

Year ended February	1995	1996	1997	1998 ¹	1999
Financial statistics £m					
Turnover excluding VAT					
UK	9,655	11,560	13,118	14,971	15,835
Rest of Europe	446	534	769	1,481	1,167
Thailand	–	–	–	–	156
	10,101	12,094	13,887	16,452	17,158
Operating profit ²					
UK	600	713	760	875	919
Rest of Europe	17	11	14	37	48
Thailand	–	–	–	–	(2)
	617	724	774	912	965
Operating margin ²					
UK	6.2%	6.2%	5.8%	5.8%	5.8%
Rest of Europe	3.8%	2.1%	1.8%	2.5%	4.1%
Thailand	–	–	–	–	(1.3)%
Total Group	6.1%	6.0%	5.6%	5.5%	5.6%
Share of profit/(loss) from joint ventures	–	–	–	(6)	6
Net interest payable	(22)	(43)	(24)	(74)	(90)
Underlying profit ³	595	681	750	832	881
Wm Low/Ireland integration costs ⁴	(39)	–	–	(63)	(26)
Goodwill amortisation	–	–	–	–	(5)
Loss on disposal of discontinued operations	–	–	–	(8)	–
Net loss on disposal of fixed assets	(5)	(6)	–	(1)	(8)
Profit before taxation	551	675	750	760	842
Taxation	(170)	(209)	(230)	(228)	(237)
Minority interest	–	–	–	–	1
Profit for the financial year	381	466	520	532	606
Adjusted diluted earnings per share ³	6.70p	7.30p	7.83p	8.84p	9.37p
Earnings per share	6.90p	7.50p	8.03p	9.05p	9.59p
Dividend per share	2.87p	3.20p	3.45p	3.87p	4.12p
Net worth – £m ⁵	3,104	3,588	3,890	3,903	4,377
Return on shareholders' funds ⁶	20.3%	20.4%	20.1%	21.3%	21.3%
Return on capital employed ⁷	16.2%	16.9%	17.1%	18.7%	17.2%
Net assets per share ⁸	50p	56p	60p	59p	65p
UK food retail productivity £					
Turnover per employee ⁹	140,842	143,335	146,326	142,570	146,236
Profit per employee ⁹	8,752	8,841	8,478	8,333	8,487
Wages per employee ⁹	13,941	13,948	14,222	14,351	14,776
Weekly sales per sq ft ^{10/11}	17.00	18.31	19.74	20.48	21.05
UK food retail statistics					
Market share in food and drink shops ¹²	12.0%	13.7%	14.6%	15.2%	15.8%
Number of stores	519	545	568	618	639
Total sales area – 000 sq ft ¹¹	12,641	13,397	14,036	15,215	15,975
Sales area opened in year – 000 sq ft	830	685	603	680	837
Average store size (sales area) – 000 sq ft ¹³	24,900	25,600	26,300	26,600	26,654
Average sales area of stores opened in year – 000 sq ft ¹³	28,200	30,700	25,800	26,700	26,900
Full-time equivalent employees ¹⁴	68,552	80,650	89,649	105,008	108,284
Share price pence					
Highest	85	113	123	180	202
Lowest	67	82	88	113	157
Year end	84	90	116	172	177

Notes

- 1 53 week period.
- 2 Excludes integration costs and goodwill amortisation. Operating margin is based upon turnover exclusive of VAT.
- 3 Underlying profit and adjusted diluted earnings per share excludes net loss on disposal of fixed assets, loss on disposal of discontinued operations, Wm Low and Ireland integration costs and goodwill amortisation.
- 4 Integration costs in 1998 have been restated in accordance with FRS12.
- 5 Total capital employed at the year end.
- 6 Underlying profit divided by weighted average shareholders' funds.
- 7 Operating profit divided by average capital employed.
- 8 Based on number of shares at year end.
- 9 Based on turnover exclusive of VAT, operating profit and total staff cost per full-time equivalent employee.
- 10 Based on weighted average sales area and turnover inclusive of VAT excluding property development.
- 11 Store sizes exclude lobby and restaurant areas.
- 12 Based on Tesco food, grocery, non-food and drink sales and Institute of Grocery Distribution/Office for National Statistics data for the year to the previous December.
- 13 Average store sizes exclude Metro and Express stores.
- 14 Based on average number of full-time equivalent employees in the UK.



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Front cover: *Customer assistant Irene Collins helping customers at our store in Sevenoaks*