

June 22, 2012

# Tesco PLC

## TSCO-GB GBP 3.10

Industry Group: Food Retail  
52 Week Range: GBP 2.95 - GBP 4.16  
Market Cap: GBP 24,870.50 Mil.

### Data as of Last Available Filing

Annual: 2012-02-29  
Semi Annual: 2012-02-29  
Quarterly: N/A

### Peer Group

Publix Super Markets Inc. (PUSH-US)  
Royal Ahold N.V. (AH-NL)  
J Sainsbury PLC (SBRY-GB)  
Kroger Co. (KR-US)  
Carrefour S.A. (ONPH-GB)  
Wm. Morrison Supermarkets PLC (MRW-GB)  
Wal-Mart de Mexico S.A.B. de C.V. (WALMEXV-MX)  
Wesfarmers Ltd. (WES-AU)  
Whole Foods Market Inc. (WFM-US)  
Woolworths Ltd. (WOW-AU)  
Tesco PLC (TSCO-GB)

Company numbers are TTM (trailing twelve months) or latest available. Share price data is previous day's close unless otherwise stated.

### Overview

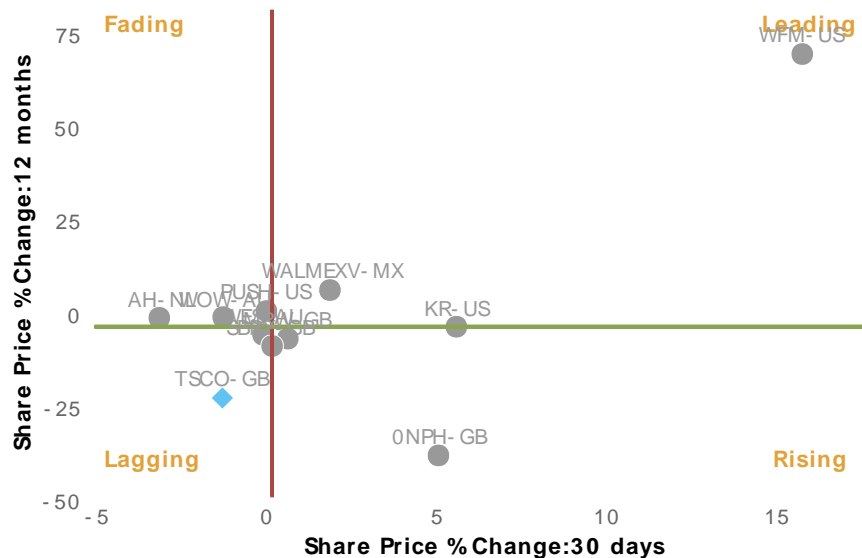
- Tesco PLC trades at a lower Price/Book multiple (1.4) than its peer median (1.8).
- TSCO-GB's operating performance is relatively good compared to its peers. The market currently does not expect high earnings growth relative to its peers but seems to expect the company to maintain its relatively high rates of return.
- TSCO-GB's relatively high profit margins are burdened by relative asset inefficiency.
- Changes in the company's annual revenue and earnings are around the median among its peers.
- TSCO-GB's return on assets currently and over the past five years is around the peer median and suggest that it does not have any particular operational advantages versus peers.
- The company's relatively low gross margin and median pre-tax margin suggest operations may be constrained on pricing versus peers.
- TSCO-GB's revenue growth in recent years and current PE ratio are both around their respective peer medians suggesting that historical performance and long-term growth expectations for the company are largely in sync.
- The company's capital investment seems appropriate for a business with peer median returns.
- TSCO-GB has the financial and operating capacity to borrow quickly.

## Share Price Performance

Relative underperformance over the last year and the last month suggest a lagging position.

TSCO-GB's share price performance of -23.3% for the last 12 months is below its peer median. The 30-day trend in its share price performance of -1.3% is also below the peer median implying that the company's stock performance is lagging its peers.

Share Price Performance



## Drivers of Valuation: Operations or Expectations?

Valuation (P/B) = Operating Advantage (ROE) \* Growth Expectations (P/E)

Price/Book or P/B valuation is a function of the observed operating performance of the company as measured by ROE multiplied by the market's current implied growth expectation as measured by the P/E. We define Valuation Premium as the difference between the Market Capitalization and Book Value of Equity, and as a proxy for the NPV of cash-flow associated to the Book Equity investment.

Based on the analysis of the relative contribution to the P/B valuation of "Operations ROE" vs. "Expectations P/E", we quickly garner insight into peers comparative performance and the market's assessment of their strategies - are they just "Harvesting" the current business pipeline or are investors betting on a strategic "Turnaround"?

The market seems to expect TSCO-GB to maintain its relatively high returns.

TSCO-GB's operating performance is higher than the median of its chosen peers (ROE of 17.2% compared to the peer median ROE of 13.0%) but the market does not seem to expect high growth (PE of 8.5 compared to peer median of 9.9) but simply to maintain its relatively high rates of return. The company trades at a lower Price/Book multiple of 1.4 compared to its peer median of 1.8.

## Valuation Characteristics

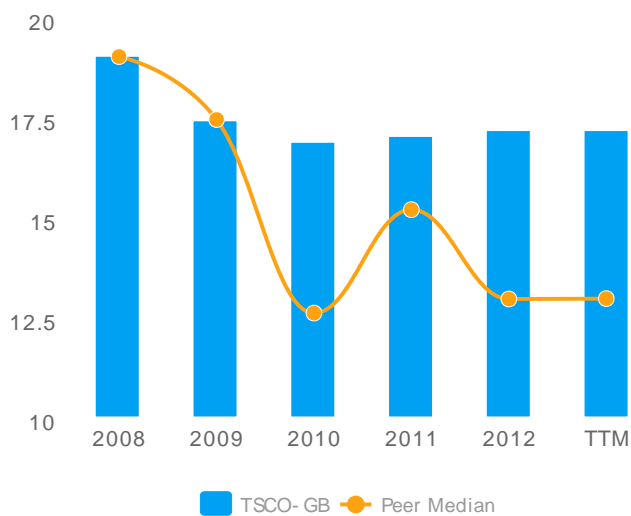


**TSCO-GB has moved to a relatively high ROE from a median ROE and PE profile at the prior year-end.**

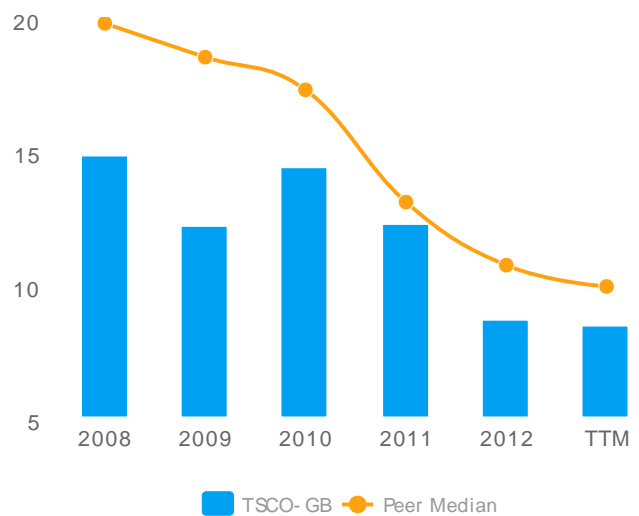
TSCO-GB's ROE continues to trend upward and is now similar to its four-year average ROE of 17.6%. Though its ROE has remained relatively stable at 17.2% compared to 2011, its peer median has decreased to 13.0% from 15.2% during this period. Relative to peers, ROE rose 2.3 percentage points.

Looking at the last five year-ends, TSCO-GB's current PE of 8.5 has touched a new low and compares to a 2008 year-end high of 14.8. PE decreased (relative to prior year-end 2011) for both the company (to 8.5 from 12.3) and the peer median (to 9.9 from 13.1). Combining both ROE and PE implies that TSCO-GB's current PB (price/book) of 1.4 has touched a new low (relative to the last five year-ends), which compares to a 2008 year-end high of 2.7.

### ROE % (On Common Equity)



### Price To Earnings

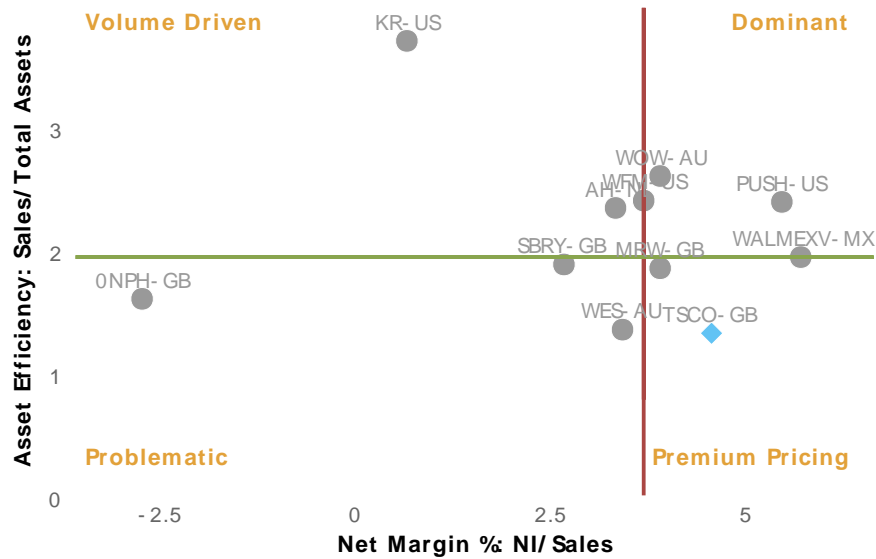


## Operations Diagnostic

### TSCO-GB's relatively high profit margins are burdened by relative asset inefficiency.

The company's relatively high profit margins (currently 4.6% vs. peer median of 3.7%) are burdened by asset inefficiency with asset turns of 1.3x compared to the peer median of 1.9x. Overall, this suggests a premium pricing operating model relative to its peers.

#### Operating Advantage

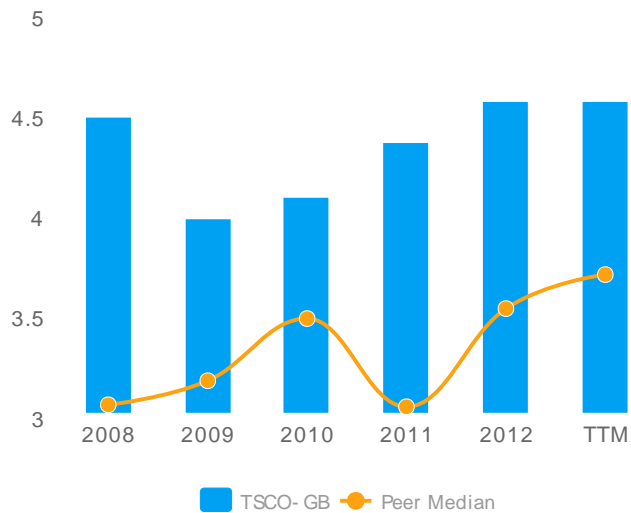


### TSCO-GB has maintained its Premium Pricing profile from the prior year-end.

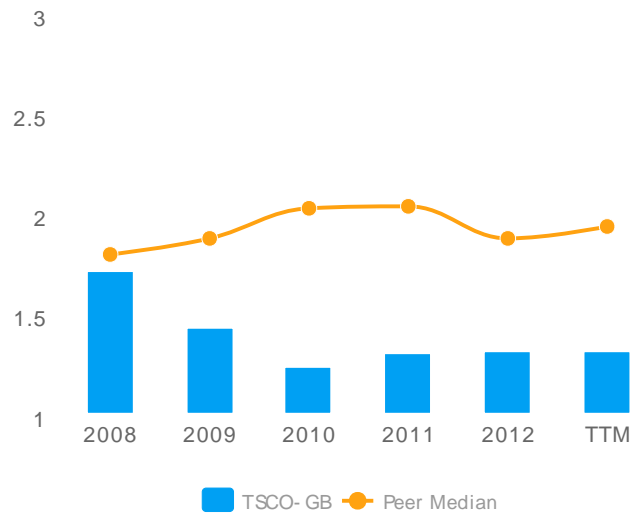
TSCO-GB's net margin is its highest over the last four years and compares to a low of 4.0% in 2009. Though its net margin has remained relatively stable at 4.6% compared to 2011, its peer median has increased to 3.7% from 3.0% during this period.

TSCO-GB's asset turnover is upward trending and is now similar to its four-year average asset turnover of 1.4. Compared to 2011, asset turnover has remained relatively stable for both the company (1.3) and the peer median (1.9). Overall, asset turnover and net margin trends suggest that TSCO-GB's ROA at 6.0% has maintained its upward trend and is now similar to its four-year average ROA of 6.0%.

### Net Margin %



### Sales/ Total Assets (x)

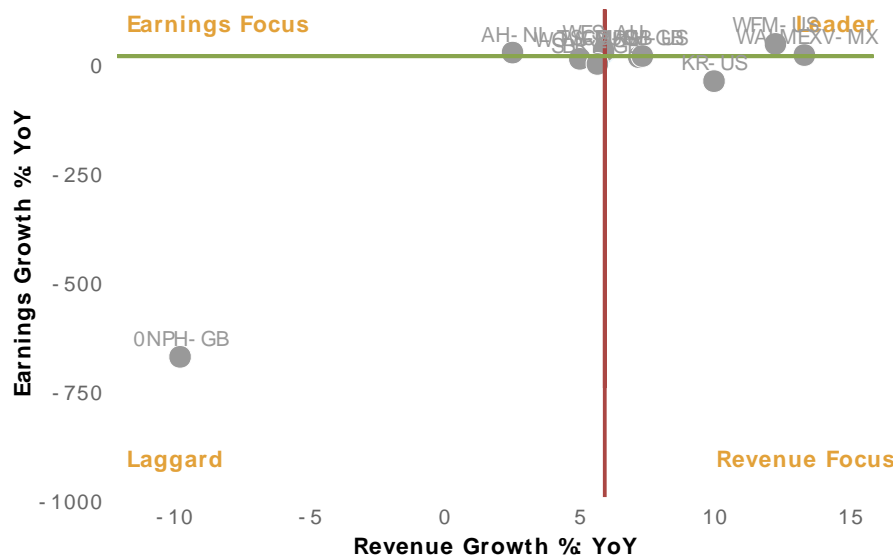


## Earnings Leverage

Changes in revenue and earnings are around the median among its peers.

Growth in TSCO-GB's revenues and earnings have been in-line with its chosen peers (annual revenue growth of 5.9% and earnings growth of 11.0% respectively). Its top-line performance seems to imply 'more of the same' for earnings. TSCO-GB is currently converting every 1% of change in revenue into 1.9% change in annual reported earnings.

### Earnings Leverage

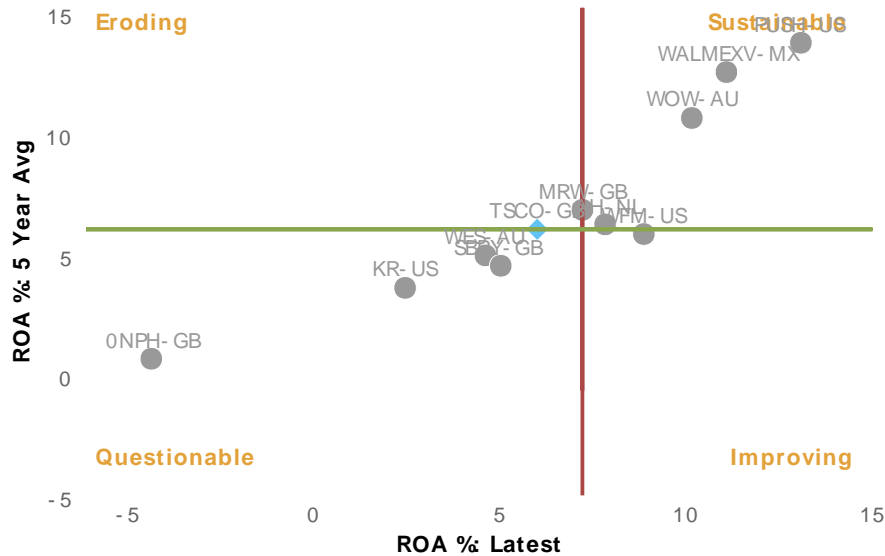


## Sustainability of Returns

**TSCO-GB's around median returns suggest no particular relative operational advantage.**

TSCO-GB's return on assets currently is around peer median (6.0% vs. peer median 7.2%) -- similar to its returns over the past five years (6.0% vs. peer median 6.0%). This performance suggests that the company has no specific competitive advantages relative to its peers.

### Sustainable Operating Advantage

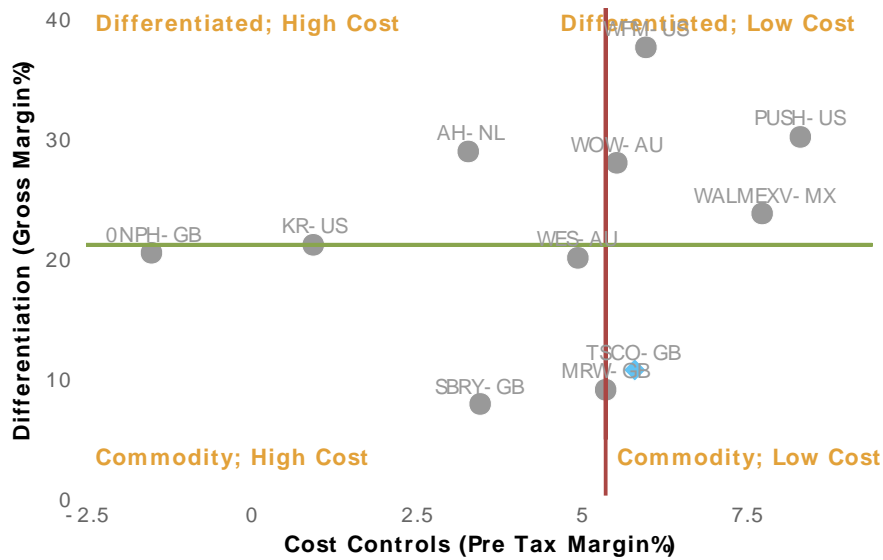


## Drivers of Margin

**Relatively low gross margin suggests operations may be constrained on pricing.**

The company's comparatively low gross margins of 10.5% versus peer median of 20.9% suggests that it has a non-differentiated strategy or is in a pricing constrained position. However, TSCO-GB's pre-tax margin of 5.8% is around the peer median which, when combined with the gross margin, suggests lower operating costs relative to peers.

## Drivers of Margins

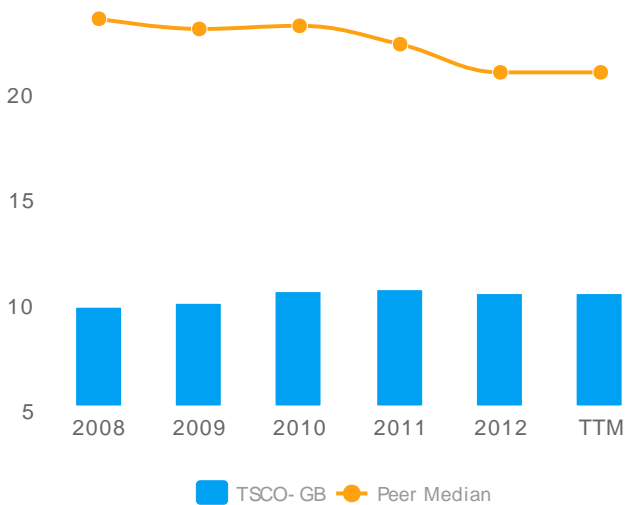


**TSCO-GB has moved to a relatively low gross margin from a Commodity/Low Cost profile at the prior year-end.**

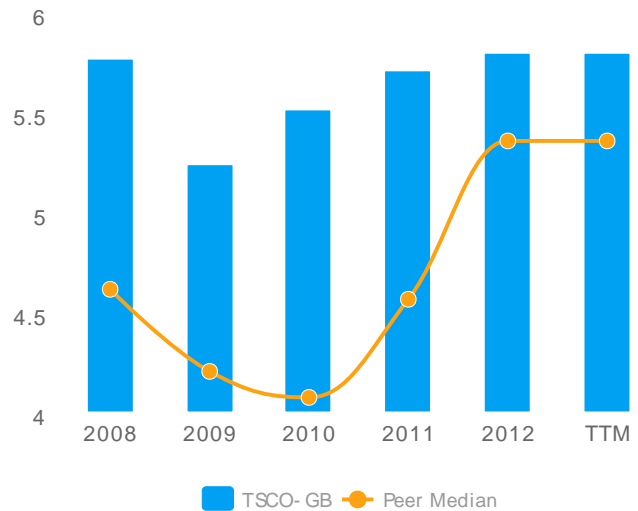
TSCO-GB's gross margin is similar to last year's high of 10.6%, which compares to the 2009 low of 9.7%. Though its gross margin has remained relatively stable at 10.5% compared to 2011, its peer median has decreased to 20.9% from 22.2% during this period. Gross margin rose 1.2 percentage points relative to peers.

TSCO-GB's pre-tax margin is its highest over the last four years and compares to a low of 5.2% in 2009. Though its pre-tax margin has remained relatively stable at 5.8% compared to 2011, its peer median has increased to 5.4% from 4.6% during this period. Relative to peers, pre-tax margin fell 0.7 percentage points.

### Gross Margin %



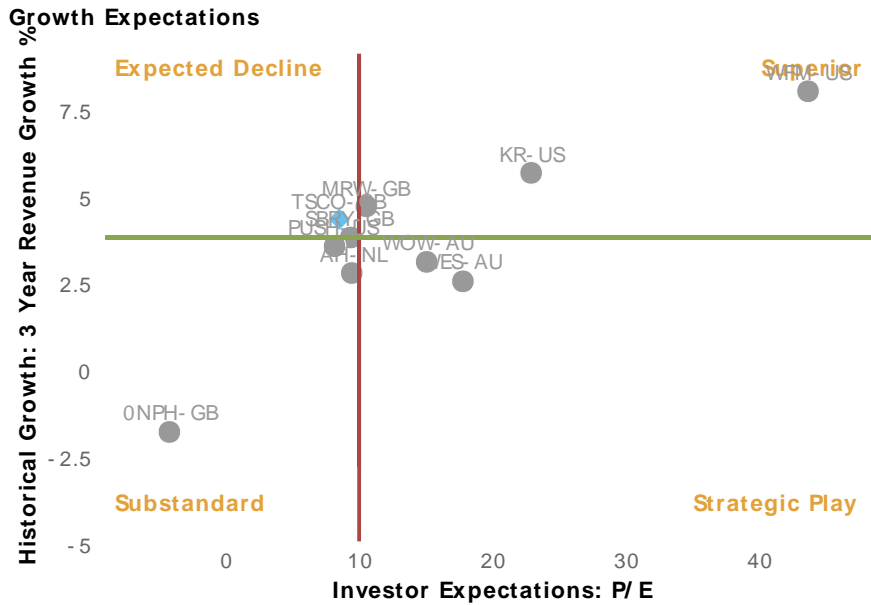
### Pre-Tax Margin %



## Growth Expectations

Historical performance and long-term growth expectations for the company largely in sync.

TSCO-GB's revenues have grown at about the same rate as its peers (4.3% vs. 3.7% respectively for the past three years). Similarly, the stock price implies median long-term growth as its PE ratio is around the peer median of 8.5. The historical performance and long-term growth expectations for the company are largely in sync.



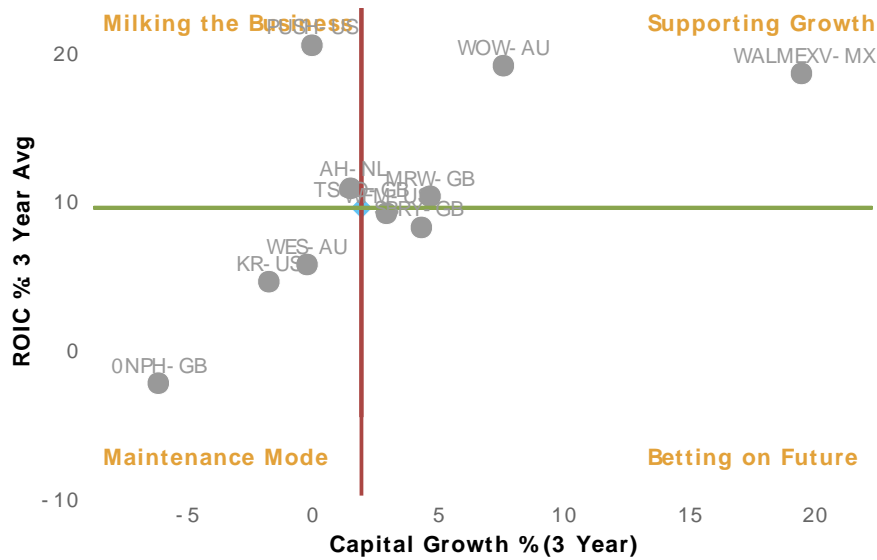
## Capital Investment Strategy

TSCO-GB's capital investment level seems appropriate in a business with peer median returns.

TSCO-GB's annualized rate of change in the capital of 1.9% over the past three years is around its peer median of 1.9%. This median investment has likewise generated a peer median return on capital of 9.3% over the same three years. This median return on investment implies that company is investing appropriately.



## Capital Investment Strategy

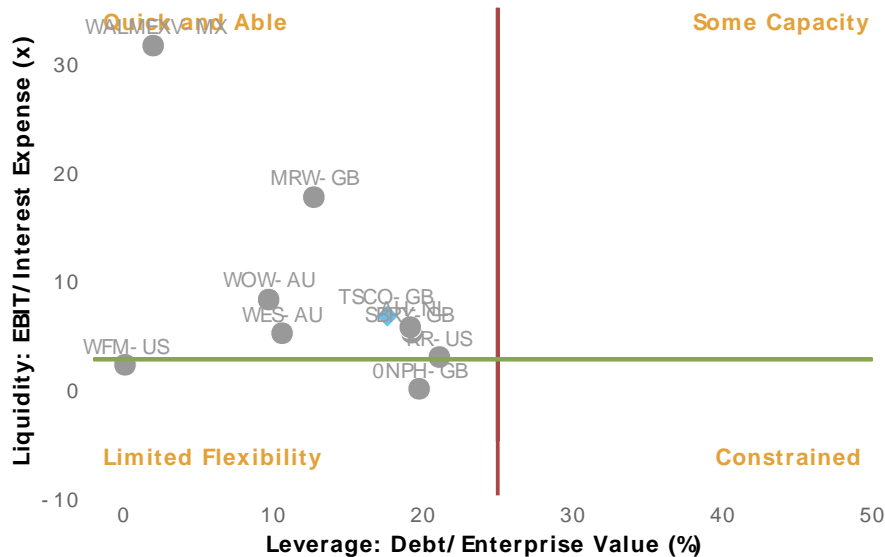


## Leverage & Liquidity

**TSCO-GB has the financial and operating capacity to borrow quickly.**

With debt at a relatively low 17.6% of its enterprise value compared to an overall benchmark of 25% (Note: The peer median is currently 12.7%), and a well-cushioned interest coverage level of 6.5x, TSCO-GB can probably borrow quickly. We classify the company as Quick & Able in terms of its capacity to raise additional debt. All 10 peers for the company have an outstanding debt balance.

## Borrowing Capacity

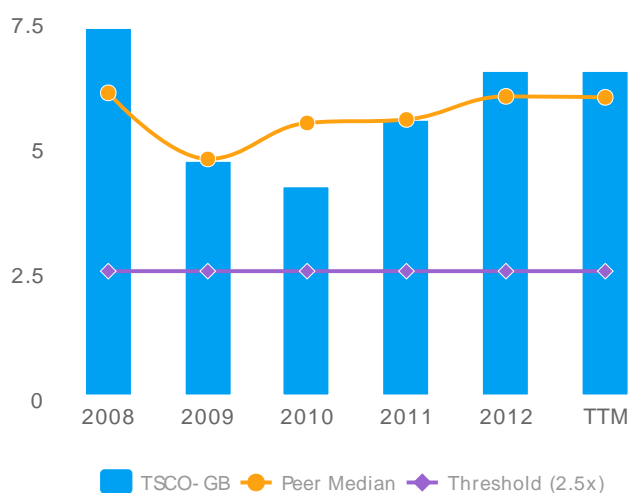


## TSCO-GB has maintained its Quick & Able profile from the prior year-end.

TSCO-GB's interest coverage is upward trending and is above (but within one standard deviation of) its four-year average interest coverage of 5.5x. Though its interest coverage increased to 6.5x from 5.5x (in 2011), its peer median remained relatively stable during this period at 6.0. Interest coverage rose 0.5 points relative to peers.

TSCO-GB's debt-EV is similar to its four-year average debt-EV of 17.8%. The increase in its debt-EV to 17.6% from 15.5% (in 2011) was also accompanied by an increase in its peer median during this period to 12.7% from 10.5%.

### Interest Coverage (x)



### Debt to Enterprise Value %



## Key Valuation Items

Company	Market Cap(mn)	Price/Book	Price/Earnings	Dividend Yield (%)
Publix Super Markets Inc.	7,756.2	2.0	8.1	4.5
Royal Ahold N.V.	8,086.2	1.8	9.4	4.4
J Sainsbury PLC	5,524.1	1.0	9.3	5.7
Kroger Co.	8,025.9	3.2	22.8	2.0
Carrefour S.A.	7,837.4	1.5	(4.3)	4.8
Wm. Morrison Supermarkets PLC	6,910.7	1.3	10.5	3.9
Wal-Mart de Mexico S.A.B. de C.V.	29,935.9	5.3	N/A	1.5
Wesfarmers Ltd.	22,111.1	1.3	17.7	5.4
Whole Foods Market Inc.	11,212.8	5.1	43.6	0.5
Woolworths Ltd.	20,919.7	4.1	15.0	4.7
Tesco PLC	24,870.5	1.4	8.5	4.8
<b>Peer Median</b>	<b>8,086.2</b>	<b>1.8</b>	<b>9.9</b>	<b>4.5</b>
<b>Best In Class</b>	<b>29,935.9</b>	<b>5.3</b>	<b>43.6</b>	<b>5.7</b>

## Revenues & Margins

Company	Revenues (mn)	Gross Margin (%)	Pre-Tax Margin (%)	Net Margin (%)
Publix Super Markets Inc.	17,226.9	29.9	8.3	5.5
Royal Ahold N.V.	28,802.1	28.7	3.3	3.3
J Sainsbury PLC	22,294.0	7.6	3.5	2.7
Kroger Co.	56,059.0	20.9	0.9	0.7
Carrefour S.A.	79,413.6	20.2	(1.5)	(2.7)
Wm. Morrison Supermarkets PLC	17,663.0	8.8	5.4	3.9
Wal-Mart de Mexico S.A.B. de C.V.	19,308.8	23.5	7.7	5.7
Wesfarmers Ltd.	36,154.8	19.8	4.9	3.4
Whole Foods Market Inc.	6,801.8	37.3	6.0	3.7
Woolworths Ltd.	35,343.5	27.7	5.5	3.9
Tesco PLC	64,539.0	10.5	5.8	4.6
<b>Peer Median</b>	<b>28,802.1</b>	<b>20.9</b>	<b>5.4</b>	<b>3.7</b>
<b>Best In Class</b>	<b>79,413.6</b>	<b>37.3</b>	<b>8.3</b>	<b>5.7</b>

## Key Assets (% of Revenues)

Company	Capital (%)	Goodwill & Intangibles(%)	Working Capital (%)	Cash & Equivalents (%)
Publix Super Markets Inc.	22.5	N/A	1.7	4.2
Royal Ahold N.V.	26.5	2.5	1.5	6.6
J Sainsbury PLC	37.7	0.7	(5.2)	3.6
Kroger Co.	14.5	1.3	(1.2)	1.1
Carrefour S.A.	19.2	10.2	(9.3)	5.0
Wm. Morrison Supermarkets PLC	40.2	1.7	(5.5)	1.4
Wal-Mart de Mexico S.A.B. de C.V.	35.2	7.8	1.1	5.3
Wesfarmers Ltd.	56.8	37.3	2.6	6.5
Whole Foods Market Inc.	32.0	6.7	6.5	10.7
Woolworths Ltd.	23.6	9.7	(2.7)	2.0
Tesco PLC	45.7	7.2	(9.5)	5.6

## Key Working Capital Items

Company	Inventory DSO	Receivable DSO	Payable DSO	Cash Conversion Cycle*
Publix Super Markets Inc.	18.2	7.3	16.2	(16.8)
Royal Ahold N.V.	15.9	8.2	25.8	(47.1)
J Sainsbury PLC	14.3	4.1	30.6	(12.1)
Kroger Co.	20.4	3.6	14.4	9.6
Carrefour S.A.	31.1	32.7	72.2	(8.5)
Wm. Morrison Supermarkets PLC	14.4	4.7	29.0	(9.9)
Wal-Mart de Mexico S.A.B. de C.V.	34.4	9.6	41.4	(93.4)
Wesfarmers Ltd.	33.7	14.2	35.7	(9.0)
Whole Foods Market Inc.	12.5	6.2	7.9	5.7
Woolworths Ltd.	26.1	7.0	35.2	(28.8)
Tesco PLC	19.1	27.1	33.2	13.0
<b>Peer Median</b>	<b>19.1</b>	<b>7.3</b>	<b>30.6</b>	<b>(9.9)</b>
<b>Best In Class</b>	<b>12.5</b>	<b>3.6</b>	<b>72.2</b>	<b>(93.4)</b>

\* Inventory DSO + Receivable DSO - Payable DSO

## Cash Management Indicators

Company	Current Assets DSO	Current Liabilities DSO	Cash Float DSO*	Excess Cash DSO**
Publix Super Markets Inc.	41.5	35.4	(19.9)	5.8
Royal Ahold N.V.	55.0	49.7	(80.5)	20.3
J Sainsbury PLC	30.6	49.8	(30.3)	3.8
Kroger Co.	30.2	34.7	(9.5)	(2.3)
Carrefour S.A.	88.6	122.6	(56.1)	14.8
Wm. Morrison Supermarkets PLC	25.4	45.3	(24.8)	(2.4)
Wal-Mart de Mexico S.A.B. de C.V.	57.3	53.4	(59.3)	14.3
Wesfarmers Ltd.	72.0	62.4	(22.3)	12.8
Whole Foods Market Inc.	54.1	30.3	(25.7)	28.2
Woolworths Ltd.	44.1	53.9	(36.1)	1.7
Tesco PLC	69.9	104.6	(53.4)	11.4
<b>Peer Median</b>	<b>54.1</b>	<b>49.8</b>	<b>(30.3)</b>	<b>11.4</b>
<b>Best In Class</b>	<b>25.4</b>	<b>122.6</b>	<b>(80.5)</b>	<b>(2.4)</b>

\* CurrAssetsDSO - CurrLiabDSO - CashDSO

\*\* Excess Cash = Cash & Eqvts - 2%\*Revenue

## Key Liquidity Items

Company	Debt/Enterprise Value (%)	Current Ratio	Interest Coverage (x)	Cash Flow To Total Debt (%)
Publix Super Markets Inc.	0.9	1.2	N/A	1,784.7
Royal Ahold N.V.	19.1	1.0	5.5	50.7
J Sainsbury PLC	19.2	0.6	5.0	39.5
Kroger Co.	21.1	0.8	2.7	30.6
Carrefour S.A.	19.8	0.7	(0.2)	18.1
Wm. Morrison Supermarkets PLC	12.7	0.6	17.4	72.6
Wal-Mart de Mexico S.A.B. de C.V.	2.0	1.1	31.3	219.4
Wesfarmers Ltd.	10.6	1.1	4.9	58.0
Whole Foods Market Inc.	0.1	2.0	2,477.1	4,150.6
Woolworths Ltd.	9.7	0.8	8.0	57.9
Tesco PLC	17.6	0.7	6.5	37.2
<b>Peer Median</b>	<b>12.7</b>	<b>0.8</b>	<b>6.0</b>	<b>57.9</b>
<b>Best In Class</b>	<b>0.1</b>	<b>2.0</b>	<b>2,477.1</b>	<b>4,150.6</b>

## Key Cash Flow Items (% of Revenues)

Company	Operating Cash Flow (%)	Capex (%)	Interest Expense (%)	Dividends (%)
Publix Super Markets Inc.	8.7	2.3	N/A	1.5
Royal Ahold N.V.	4.8	2.3	0.8	1.0
J Sainsbury PLC	4.8	5.5	0.7	1.3
Kroger Co.	2.8	2.2	0.5	0.3
Carrefour S.A.	2.3	2.3	0.7	0.8
Wm. Morrison Supermarkets PLC	5.3	4.1	0.3	1.7
Wal-Mart de Mexico S.A.B. de C.V.	8.1	4.6	0.2	2.5
Wesfarmers Ltd.	5.6	4.5	1.0	2.7
Whole Foods Market Inc.	8.0	4.6	0.0	0.5
Woolworths Ltd.	5.1	4.3	0.7	2.2
Tesco PLC	7.1	5.2	0.9	1.8

## Company Profile

Tesco Plc is engaged in the business of offering food, non-food and other retailing services. It operates various store formats that offer products, such as fresh produce, wines and spirits, in-store bakery, ready-meals and sandwiches. The firm's food brands include Tesco Finest and Tesco Value in the United Kingdom. The company's online businesses include online grocery and Tesco Direct, which operates in South Korea and Ireland. Tesco Direct provides a platform to extend the reach of its general merchandise, clothing and electrical offers through the Internet and catalogues. In addition, it has also entered into new business areas such as banking and telecom. The company, through its subsidiary, Tesco Bank, provides retail banking and insurance services, credit cards, MasterCard and Visa credit card transactions in the United Kingdom. The Telecoms business, primarily operated by Tesco Mobile network, offers mobile handsets, including the latest smart phones. Tesco provides retailing and associated activities in the United Kingdom, China, the Czech Republic, Hungary, Ireland, India, Japan, Malaysia, Poland, Slovakia, South Korea, Thailand, Turkey and the U.S. The company was founded by Jack Cohen in 1919 and is headquartered in Waltham Cross, the United Kingdom.

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