Tesco shares suffer as pressures abroad overshadow UK growth

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Tesco shares fell 8 percent after Britain’s biggest retailer missed first-half profit forecasts as weak trading in Thailand and Poland eclipsed accelerating sales growth in its main UK business.

The supermarket group, being rebuilt by Chief Executive Dave Lewis following a 2014 accounting scandal, unsettled investors as problems abroad compounded fears that already brutal competition in its home market would further intensify with the planned merger of its two closest rivals — Sainsbury’s and Asda.

Tesco, which said it was “firmly on track” to meet its medium-term targets, reported underlying operating profit of 933 million pounds - up 24 percent on last year but short of analysts’ average forecast of 978 million pounds.

Profit fell 29.1 percent in Asia and by 3.3 percent in central Europe, partly offsetting growth of 47.6 percent in the UK and Ireland where the 3.7 billion pound acquisition of wholesaler Booker has allowed Tesco to expand to provide food to restaurants, bars and smaller grocers.

Shares in Tesco, up 12 percent this year prior to the update, slumped 7.9 percent by 1420 GMT, on course for the biggest one-day drop since Sept. 2014.

Chief Financial Officer Alan Stewart told reporters analysts had failed to fully factor in problems in Thailand, while Lewis was unperturbed by the share price fall.

“The market will decide what it wants to decide,” he said.

“There’s been lots and lots of pots in the road as we’ve gone over the last three and a half years, this is one of the things that we’re working through,” he said, adding that total group first half sales up over 12 percent and profit up over 24 percent was “bang in line with where we wanted to be.”

FACING CHALLENGES

Lewis, a former Unilever executive, has been steering a steady recovery after the accounting scandal capped a dramatic downturn in trading.
He has lowered Tesco’s prices versus all its major competitors, streamlined product ranges and improved their quality, while raising store standards and transforming relationships with suppliers.

Lewis has also pursued new growth avenues. In addition to the Booker deal he has formed a global purchasing alliance with France’s Carrefour and launched a new discount format called Jack’s.

Analysts said the results showed Tesco was performing well in the core UK and Ireland division, which contributes nearly three quarters of group profit, but that challenges, including from Brexit, lie ahead.

Laith Khalaf, senior analyst at Hargreaves Lansdown, said revenues, profits and debt were all heading in the right direction, but margins were not improving as quickly as hoped.

“The acquisition of Booker is progressing well, and a recent buying agreement with … Carrefour will give Tesco extra muscle in a market where it may soon face the combined power of Sainsbury’s and Asda,” he said.

Tesco has a leading 27.4 percent share of Britain’s 200 billion pound grocery market, according to industry data, although it could be overtaken by Sainsbury’s proposed 7.3 billion pound takeover of Walmart’s Asda.

That tie-up, which the regulator is probing, is driven in part by the rise of discounters Aldi and Lidl, who are gaining ground on Britain’s big four grocers, as well as the growth of Amazon.

On Monday Aldi raised its UK stores target to 1,200 by 2025.

THAILAND AND POLAND

In Asia second quarter like-for-like sales fell 4.8 percent, reflecting Tesco’s decision to exit non-profitable cash and carry sales in Thailand, the impact of the Thai government issuing welfare cards which cannot be redeemed in Tesco stores and Tesco’s own price cuts.

Underlying sales in the Central Europe division fell 2.0 percent, reflecting weak sales in Poland, where changes to Sunday trading regulations resulted in 13 fewer trading days.

Lewis said Tesco was committed to both Thailand and Poland, though he did not rule out a possible future exit from the latter.

Tesco is market leader in Thailand, which has the group’s best profit margins. But Tesco only has a 4 percent market share in Poland and it is the group’s only loss-making business.

Asked if he would consider a disposal Lewis said: “I'm a very commercially rational businessman.”

Lewis said the difficulties in Thailand and Poland did not imperil Tesco’s key margin target for the group to earn between 3.5 and 4 pence of operating profit for every pound customers spend by the end of its 2019-20 financial year.

Analysts at Barclays maintained their “overweight” stance on Tesco but cut their 2018-19 operating profit forecast for Tesco by about 3 percent to 2.06 billion pounds.

Tesco held its own in a strong summer for Britain’s overall grocery industry which was boosted by record hot weather, a royal wedding and the soccer World Cup, delivering a 2.5 percent increase in second quarter like-for-like sales - an eleventh straight quarter of growth.