TESCO

Tesco PLC • Annual report and financial statements 1998

Contents of accounts

This publication includes the operating and financial review, the Directors' report, the corporate governance statement, the accounts and the auditors' report for the 53 weeks ended 28 February 1998. The Chairman's statement and review of the business are contained in a separate statement entitled Annual Review and Summary Financial Statement 1998.

These Annual Accounts together with the Annual Review and Summary Financial Statement 1998 comprise the full Annual Report and Accounts of Tesco PLC for 1998, 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.

Throughout this report, all references to the UK exclude the newly acquired business in Northern Ireland.

Operating and financial review

This operating and financial review analyses the performance of Tesco in the financial period ended 28 February 1998. It also explains certain other aspects of the Group's results and operations including taxation and treasury management.

Group summary

	1998* £m	1997 £m	Change %
Group sales (including value added tax)	**17,779**	14,984	18.7%
Group operating profit (prior to integration costs)	**912**	774	17.8%
Profit on ordinary activities before tax (excluding net loss on disposal of fixed assets, discontinued operations and integration costs)	**832**	750	10.9%
Fully diluted earnings per share (excluding net loss on disposal of fixedassets, discontinued operations and integration costs)	**26.6p**	23.5p	13.2%
Dividend per share	**11.6p**	10.35p	12.1%

*53 weeks

Group performance

Group sales including VAT increased by 18.7% to £17,779m (1997 – £14,984m). Excluding the businesses acquired in the year in Northern Ireland and the Republic of Ireland, Group sales increased by 11.2% to £16,669m. On a comparable 52 week basis, Group sales rose by 9.2%.

Group operating profit (prior to integration costs) rose by 17.8% to £912m (1997 – £774m). On a 52 week basis, operating profits were up 15.6% to £895m.

Group profit before tax rose by 10.9% to £832m (1997 – £750m). This excludes the net loss on disposal of fixed assets and discontinued operations of £9m (1997 – nil) and integration costs of £95m. On a 52 week basis, profit before tax rose by 8.9% to £817m.

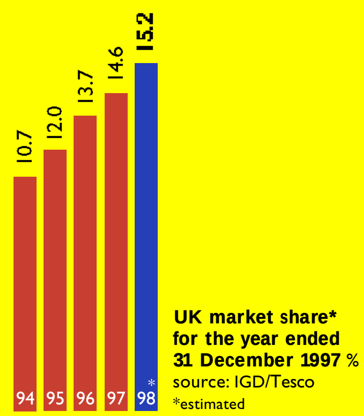
UK performance

	1998* £m	1997 £m	Change %
Food retail sales (including value added tax)	**15,762**	14,024	12.4%
Operating profit	**866**	760	13.9%

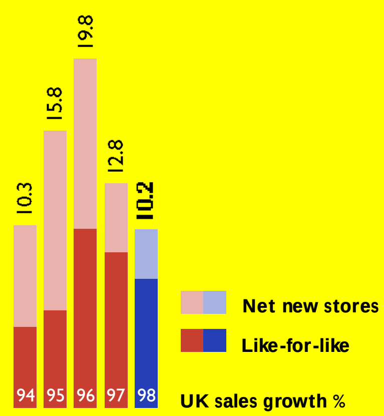
*53 weeks

Tesco has seen another year of strong like-for-like volume growth. Over the last five years, sales volumes have grown by nearly 19%.

Sales growth for the industry as a whole has slowed, 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 15.2% in the year to December 1997, from 14.6% last year.



UK sales (excluding property development sales) have grown by 12.4% to £15,762m (1997 – £14,024m). This was for the 53 week period ended 28 February 1998 (1997 – 52 weeks). On a comparable basis sales rose 10.2%, of which 6.1% came from existing stores including volume growth of 4.5%. New stores contributed a further 4.5% to total sales growth before closures of 0.4%.

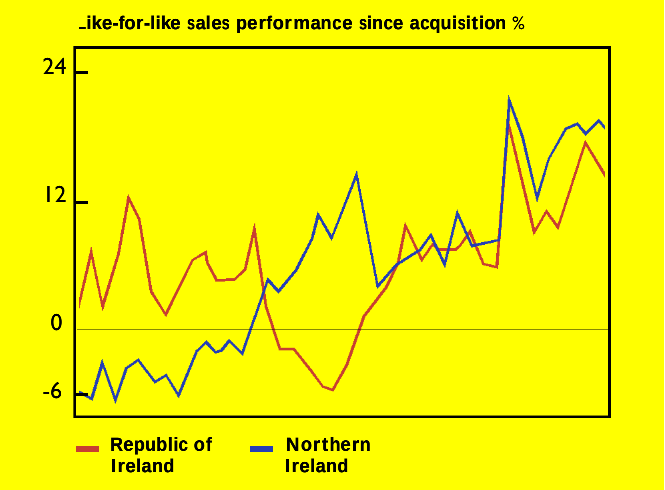


UK operating profit was 13.9% higher at £866m (1997 – £760m) and the operating margin rose to 5.9%. On a 52 week basis, UK operating profit was £850m, up 11.8%.This reflected our strong trading driven by continued investment for customers in service. We lowered prices, improved service and built loyalty. The costs of this investment were more than offset by our productivity programmes, a recovery in petrol profits and the strength of sterling.

Northern Ireland and Republic of Ireland

In May 1997 we acquired the food retailing businesses in Northern Ireland and the Republic of Ireland of Associated British Foods Plc for £643m. In the year, these businesses contributed £1,110m to Group sales and £49m to operating profit, more than offsetting the attributable funding cost of £38m.These profits are in line with our prediction at the time of the acquisition. Integration and reorganisation costs and asset write-offs totalling £95m have been charged to the Group results this year.

In Northern Ireland, total sales increased by 4.3% on the comparable period last year. Like-for-like sales were up 5.0% including volume growth of 7.5%.The poor like-for-like sales performance at acquisition of minus 5% has been substantially improved and at the year end was ahead by around 20%.This performance reflects the launch of Tesco products across the whole range, the introduction of Clubcard and the store refit programme. Sixteen stores have been re-opened as Tesco already and we are currently refitting one store every week.



In the Republic of Ireland, we have listened to customers and established plans to improve the offer and grow the business, whilst honouring our commitments to staff and the Irish government. So far we have introduced Clubcard, improved service, lowered prices and introduced more products including Tesco brand – made in Ireland. We have also started to improve the stores and open new ones. Eleven re-branded stores have already been opened and a further six refits are under way. We have also opened a new 30,000 square-foot Tesco store at Athlone. All of this activity has met with a good response from customers. Total sales have increased by 7.7% on the comparable period last year, including like-for-like sales growth of 4.5%. By the end of the year, like-for-like sales were up by around 14%.

Our initial progress has been encouraging and we are on track with our plan to generate good profits and returns from these businesses.

Europe

We completed the disposal of our food retailing business in France, Catteau S.A., to Promodes S.A. on 24 February 1998 for £250m. After adding back goodwill of £135m to net assets of £115m, we recovered our investment prior to exit costs of £8m. In the year, Catteau contributed £600m to Group sales including VAT and made a small operating loss of £2m.

In Central Europe, our aim is to become a major retailer and to participate in the steady growth in consumer demand and expenditure that is expected to occur as these economies develop. We are investing early, to grow the business by opening large stores. So far we have opened two hypermarkets in Hungary, including an 86,100 square-foot store in November 1997 at Fogarasi in Budapest. Initial trading at this store and the Polus store, opened in 1996, is encouraging. These two stores already account for over half of our sales in Hungary. In the year ahead we will open six hypermarkets including a further three in Hungary, two in the Czech Republic and one in Poland. In total, we will add around 600,000 square feet of new space – almost as much as we will open in the UK.

Total Central Europe sales rose by 28.6% to £288m (1997 – £224m) reflecting a full year's contribution from our businesses in the Czech Republic and Slovakia and our two new stores in Hungary. The initial period in these emerging markets is characterised by substantial investment in new stores and the infrastructure needed to support them which will naturally hold back profits in the short term.The operating loss of £1m reported in the year to 31 December 1997 will rise to around £13m in the year ahead. We are building a business for the longer term in this region, our early trading experience is encouraging and we are on track.

Central European sales performance

	Sales £m	Existing stores sales growth (in local currency) %	Total stores sales growth (in local currency) %
Hungary	**78**	23.9	80.5
Poland	**34**	41.2	99.4
Czech Republic	**96**	6.4	6.4
Slovakia	**80**	13.9	13.9
Total	**288**		

Tesco Personal Finance

Our new financial services business was launched in July 1997. It provides a good opportunity to improve service, choice and value for customers. It now includes Clubcard Plus, Tesco Visa Card, the Instant Access Savings Account and we are rolling out Loans and Home Insurance. We are at an early stage in the development of this business but already we are seeing a real demand for these products and services from customers. By the year end, Tesco Personal Finance had over 550,000 accounts with deposits of nearly £600m. We are currently incurring significant start-up costs to build the business. This year, our share of the operating loss was £15m and we expect to incur similar costs in the year ahead.

Profit sharing

Profit sharing increased by 9.4% to £35m (1997 – £32m). In addition staff have also benefited this year from profit related pay.

Interest and taxation

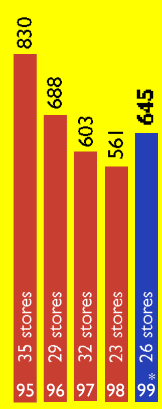
Net interest payable was £65m (1997 – £24m) with the increase on last year primarily due to the financing costs of our acquisition in Northern Ireland and the Republic of Ireland. Corporation tax has been charged at an effective rate of 30.7% – the same as last year. Prior to accounting for the net loss on disposal of fixed assets and discontinued operations and the acquisition provisions, our underlying tax rate was 29%.

Store development and capital expenditure

In the UK we opened 23 stores with a total sales area of 561,500 square feet. This comprised eight superstores, 12 compact stores and three Metro stores. There were five closures. As part of our programme to improve our stores and introduce non-food products, we have added 118,000 square feet through extensions. In the year ahead, we will add at least a further 200,000 square feet through extensions, much of which will be utilised to grow our non-food business.

Our newest trading format, Tesco Extra at Pitsea in Essex, developed from our extension programme. The initial success of this store has encouraged us to look at other stores which we can extend and convert to the Extra format, as well as to open new ones.

In 1998/99, we plan to open around 650,000 square feet of new space, comprising 26 stores: two new Extra stores at Cardiff and Peterborough, three superstores, 17 compact stores, one Metro store and three Express stores.

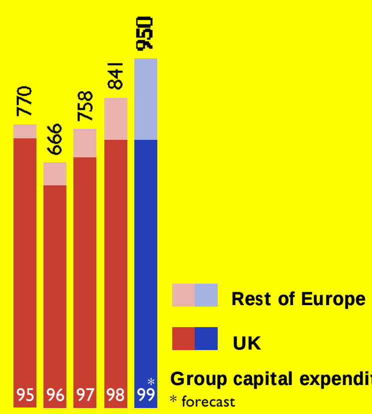


UK new stores sales area opened and planned including Express (000 sq ft)
* forecast

Following our acquisition in Ireland, we opened one 30,000 square-foot new store at Athlone. We are currently looking at a number of potential sites for new and replacement stores in both Northern Ireland and the Republic of Ireland, in addition to the store refit programme.

In Central Europe, we opened one hypermarket of 86,100 square feet in Budapest, Hungary. In the year ahead, we plan to open six hypermarkets: another three in Hungary, two in the Czech Republic and one in Poland. In total, we will add around 600,000 square feet of new space – almost as much as we will open in the UK.

Group capital expenditure was £841m (1997 – £758m) with £737m in the UK, £63m in Northern Ireland and the Republic of Ireland, and £41m in the rest of Europe. In the current year, supported by our strong cashflows, capital expenditure will rise to around £950m. The increase relates mainly to our development plans in Northern Ireland and the Republic of Ireland and more substantially in Central Europe.



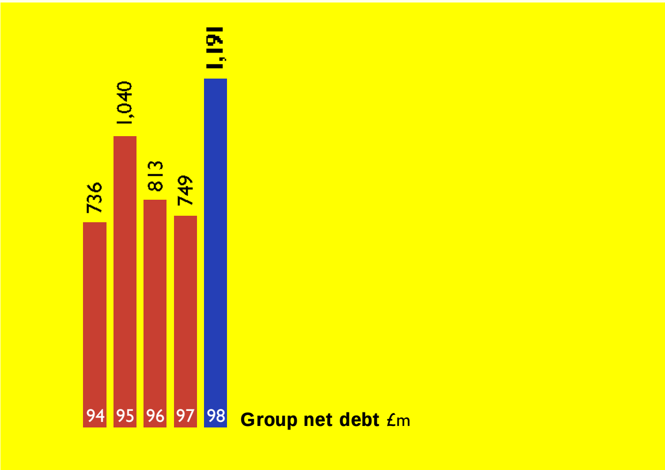
Group capital expenditure £m
* forecast

Operating and financial review

continued

Change in net debt

Total net debt at the year end amounted to £1,191m (1997 – £749m). This reflects the cash outflow from our net capital expenditure and acquisitions of £1,339m (1997 – £726m), partly offset by the proceeds from the disposal of Catteau S.A., together with strong cash generation from the main business of £1,156m (1997 – £1,219m). As a result, gearing at the year end has increased to 31% (February 1997 – 19%).



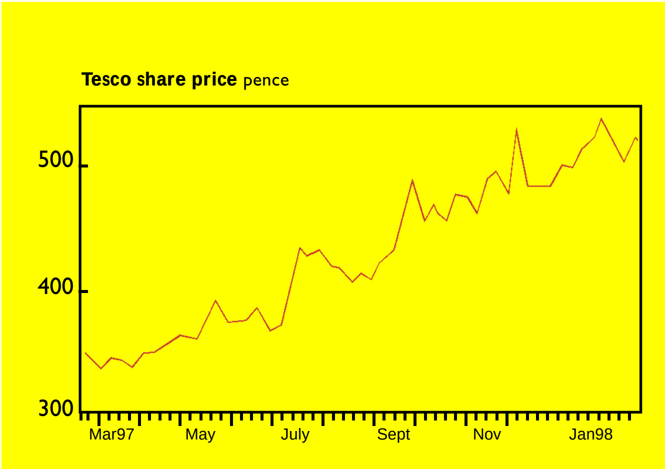
Shareholder returns and dividends

Adjusted fully diluted earnings per share (excluding the net loss on disposal of fixed assets and discontinued operations and integration costs) increased by 13.2% to 26.6p (1997 – 23.5p). This is on a 53 week basis compared to 52 weeks last year. On a comparable basis, fully diluted earnings per share would be up 11.1% to 26.1p.

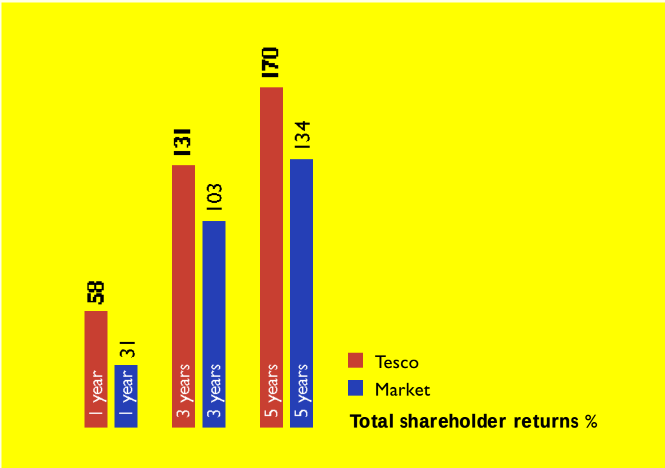
The Board has proposed a final net dividend of 8.05p giving a total dividend for the year of 11.60p (1997 – 10.35p). The dividend is covered 2.3 times by earnings and represents an increase of 12.1%.

Shareholders' funds reduced by £14m to £3,876m (1997 – £3,890m). This was due to goodwill write-off of £445m and losses on foreign currency translation of £14m. These were offset by retained profits of £250m, issue of new shares less expenses of £60m and £135m from write-back of goodwill. As a result, return on shareholders' funds was 21.4%.

The share price rose from 349p at the start of the financial year to 517p on 27 February 1998, giving a market capitalisation of approximately £11.4bn (1997 – £7.6bn).The share price reached a high of 539p on 30 January 1998.



Total shareholder return, which is measured as the percentage change in the share price plus the dividend, has been 170% over the last five years, compared to the market average of 134% and has been 131% over the last three years, compared to the market average of 103%. In the last year, total shareholder return in Tesco has been 58% compared to the market average of 31%. This reflects our efforts to grow the business while ensuring returns to shareholders are improved.



Year 2000

Formal procedures have been put in place worldwide to identify the full impact of the Year 2000 on the Group. A project group has been established and a timetable has been agreed. Progress against the timetable is monitored centrally and it allows for all Tesco systems which have been identified as requiring an upgrade to be made compliant well before the end of the century, to minimise any potential exposure to the Year 2000 effect. We anticipate that the incremental cost, including modifying existing software, will be approximately £30m.

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.

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.

Group Treasury uses financial instruments, including derivatives, to raise finance and to manage risk arising from its operations. Consistent with Group policy, Group Treasury do not engage in speculative activity and it is policy to avoid using the more complex financial instruments.

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

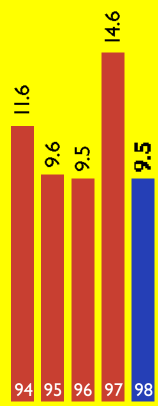
The Board establishes annually the policy which Group Treasury follows in managing credit risk: limited exposures are permitted only with banks or other institutions meeting required standards as assessed normally by reference to the major credit rating agencies. Deals are authorised only with banks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

Finance and interest rate risk

The Group's policy is to finance operating subsidiaries 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 our desired 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 taken within a 12 month horizon. At the year end, after taking account of interest rate swaps £614m (1997 – £310m) or 52% of our net debt, was fixed for a period of five years. A further £170m (1997 – £70m) or 14%, was covered by interest caps at an average rate of 8.2% for a period of four years.

The average rate of interest paid during the year was 8.1% (1997 – 7.8%). Excluding capitalised interest, interest is covered 9.5 times by profit before interest (1997 – 14.6 times). A 1% rise in interest rates would reduce profit before tax by less than 1%.



Interest cover (number of times)

The Group ensures continuity of funding by arranging for short term borrowings 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 £645m (1997 – £400m) and the average maturity of net debt, including these facilities, was over five years.

Foreign currency risk

The Group's policy is to use foreign currency borrowings, forward exchange rate transactions and swaps to offset a significant part of the impact on the Group's balance sheet of exchange rate movements on the small proportion of its net assets before financing (6%) which is not denominated in sterling.

The Group does not hedge exposure to currency movements on the translation of the 2% 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.

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 53 weeks ended 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, Northern Ireland, Republic of Ireland, Czech Republic, Slovakia, Hungary and Poland. 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 £2,565m to £16,452m, representing an increase of 18.5%. Group profit on ordinary activities before taxation, integration costs and loss on disposals was £832m compared with £750m for the previous year, an increase of 10.9%. Including integration costs and loss on disposals, Group profit on ordinary activities before taxation for the year was £728m. The amount allocated to the employee profit-sharing scheme this year was £35m as against £32m for last year. After provision for tax of £223m and dividends, paid and proposed, of £255m, profit retained for the financial year amounted to £250m.

Dividends

The directors recommend the payment of a final dividend of 8.05p per ordinary share to be paid on 1 July 1998 to members on the Register at the close of business on 1 May 1998. Together with the interim dividend of 3.55p per ordinary share paid in December 1997, the total for the year comes to 11.60p compared with 10.35p for the previous year, an increase of 12.1%.

Tangible fixed assets

Capital expenditure amounted to £841m compared with £731m during the previous year. In the directors' opinion, the properties of the Group have a market value in excess of the book value of £5,428m included in these financial statements.

Acquisitions

During the year the Group acquired, for a consideration of £643m, retailing businesses in Northern Ireland and the Republic of Ireland, a controlling interest in a Polish chain of stores for £4m, and a number of businesses in the UK for £10m. Details of acquisitions are set out in note 31 to the financial statements.

During the year, the company invested £20m for 50% of the shares of a joint venture, Tesco Personal Finance Group Limited, with The Royal Bank of Scotland plc, £12m for 50% of the shares in a joint venture, Tesco Personal Finance Life Limited, with Scottish Widows Fund and Life Assurance Society and £150m for 50% of the shares in a joint venture, Tesco British Land Property Partnership, with The British Land Company plc. Details of these investments are set out in note 12 to the financial statements.

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 22 to the financial statements. A bonus issue will be made on 3 July 1998 in order to bring the issued share capital of the company more into line with its operating assets. The bonus issue will be on the basis of two new shares for every one held on that date.

Company's shareholders

So far as the company is aware, at the date of this report Prudential Corporation holds 75,646,845 ordinary shares (3.4% of the total) on behalf of itself and others. The company is not aware of any other 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 R S Ager, Mrs L James, Mr J W Melbourn and Mr G F Pimlott retire from the Board by rotation according to the company's Articles of Association. Mr A T Higginson being appointed during the year will also retire. Being eligible, they offer themselves for re-election.

Lord MacLaurin retired from the Board of Directors on 6 June 1997.

The service contracts of Mr R S Ager, Mrs L James and Mr A T Higginson are terminable on two years' notice from the company.

Mr J W Melbourn and Mr G F Pimlott do not have service contracts.

The interests of directors and their immediate families in the shares of Tesco PLC, along with details of directors' share options, are set out in pages 10 to 14.

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. On-going 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 via the Tesco Charity Trust amounted to £1,259,000 (1997 – £972,000) 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 WCA 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

Price Waterhouse have expressed their willingness to continue in office. In accordance with section 384 of the Companies Act 1985, a resolution proposing the reappointment of Price Waterhouse 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 11 June 1998.

This report was approved by the Board on 20 April 1998.

By Order of the Board
Rowley Ager Secretary
20 April 1998

Tesco PLC
Registered Number: 445790

Corporate governance

The company has complied with all the provisions of the Cadbury Committee's Code of Best Practice ('the Code'). The Board is committed to proper standards of corporate governance and will continue to keep procedures under review should the Code develop.

Board and Board committees

The Board of Tesco PLC comprises five independent non-executive directors and eight executive directors.The full Board, which meets every month, manages overall control of the Group's affairs by the schedule of matters reserved for its decision.

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.

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. They are responsible for implementing Group policy, the monitoring and performance of the business and reporting to the full Board thereon.

The company has an Audit Committee, which meets a minimum of three times a year, whose terms of reference cover the points recommended by the Code. Its duties 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. The Committee is chaired by John Melbourn and consists entirely of non-executive directors.

The Remuneration Committee, also composed entirely of non-executive directors, is chaired by Baroness O'Cathain, and meets a minimum of three times a year. The report of the Remuneration Committee is given below.

The Nominations Committee, chaired by John Gardiner, is responsible for selecting and appointing the company's executive and non-executive directors, and meets as required.

Internal financial control

The Board of directors 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 company 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 company 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.

Policies and procedures

The Group employs 185,000 people including over 1,600 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 company 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

The Group maintains an internal audit function whose work is focused on areas of perceived highest risk, as identified by risk analysis, and who regularly provide reports to the Audit Committee. Our external auditors, Price Waterhouse, also 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.

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.

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 25 to the financial statements.

Report by the auditors to the directors of Tesco PLC on corporate governance matters

In addition to our audit of the financial statements, we have reviewed your statements on pages 8 and 9 concerning the Group's compliance with the paragraphs of the Code of Best Practice specified for our review by the London Stock Exchange and the adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with Listing Rules 12.43(j) and 12.43(v), if not otherwise disclosed.

Basis of opinion

We carried out our review having regard to the guidance issued by the Auditing Practices Board.That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the Group's system of internal financial control or corporate governance procedures nor on the ability of the Group to continue in operational existence.

Opinion

In our opinion, your statements on internal financial controls on pages 8 and 9 and on going concern on page 9, have provided the disclosures required by the Listing Rules referred to above and are consistent with the information which came to our attention as a result of our audit work on the financial statements.

In our opinion, based on enquiry of certain directors and officers of the company and examination of relevant documents, your statement on page 8 appropriately reflects the Group's compliance with the other aspects of the Code specified for our review by Listing Rule 12.43(j).

Price Waterhouse
Chartered Accountants
London
20 April 1998

Report of the Remuneration Committee

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 Section A of the best practice provisions of the Code of Best Practice of the 'Greenbury Committee'. In framing the remuneration policy, full consideration has been given to the best practice provisions set out in Section B, annexed to the Listing Rules.The auditors' report set out on page 15 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 on pages 10 to 14.

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, 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 Short term £000	Incentive scheme Long term £000	Total 1998 £000	Total 1997 £000
Lord MacLaurin (a)	243	8	8	–	–	**259**	1,185
Mr J A Gardiner	232	–	–	–	–	**232**	40
Mr T P Leahy	539	8	15	104	132	**798**	765
Mr D E Reid	488	8	31	95	121	**743**	719
Mr R S Ager	365	8	17	70	90	**550**	537
Mr V W Benjamin (b)	–	–	–	–	–	–	105
Mr J Gildersleeve	460	8	36	90	115	**709**	690
Mr A T Higginson (c)	265	–	2	–	–	**267**	–
Mrs L James	246	8	17	50	64	**385**	363
Dr M G Jones	33	–	–	–	–	**33**	32
Mr A D Malpas (b)	–	–	–	–	–	–	920
Mr T J R Mason	319	8	18	65	83	**493**	429
Mr J W Melbourn	31	–	–	–	–	**31**	23
Baroness O'Cathain	28	–	12	–	–	**40**	39
Mr G F Pimlott	28	–	–	–	–	**28**	27
Mr J M Wemms	391	8	18	76	96	**589**	581
	3,668	64	174	550	701	**5,157**	6,455

a) Lord MacLaurin retired from the Board on 6 June 1997.

b) Former directors.

c) Mr A T Higginson was appointed to the Board on 17 November 1997. His salary includes a joining sum of £170,000.

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)						Value realisable	
	217	217	210	232	Total	Price at exercise (pence)	1998 £000	1997 £000
Mr T P Leahy	–	51,153	–	–	51,153	461	**125**	–
Mr D E Reid	–	11,060	11,429	344,818	367,307	477	**903**	–
Mr R S Ager	–	–	75,714	106,835	182,549	422	**363**	56
Mr J Gildersleeve	–	14,747	320,911	–	335,658	385	**585**	–
Mrs L James	–	7,335	62,018	42,813	112,166	418	**223**	19
Mr T J R Mason	–	–	38,619	17,333	55,952	416	**111**	–
Mr J M Wemms	25,660	–	87,144	–	112,804	407	**228**	31
Date of grant	29/10/92	27/5/93	10/6/94	29/9/94				

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. Between 22 February 1997 and 6 June 1997, Lord MacLaurin exercised 27,650 share options with an exercise price of 217p, realising a value of £40,093.

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.

Table 3 Pension details of the directors

	Age at 28 February 1998	Years of service	Increase in accrued pension during the year (a) £000	Transfer value of increase during the year £000	**Accrued total pension at 28 February 1998 (b) £000**
Lord MacLaurin (c)	60	38	5	78	**498**
Mr T P Leahy	42	19	19	180	**166**
Mr D E Reid	51	13	21	283	**186**
Mr R S Ager	52	12	14	193	**143**
Mr J Gildersleeve	53	33	12	176	**234**
Mr A T Higginson (d)	40	0	3	24	**3**
Mrs L James	48	13	8	99	**87**
Mr T J R Mason	40	16	18	163	**93**
Mr J M Wemms	58	26	14	215	**230**

a) The increase in accrued pension during the year excludes any increase for inflation.
b) The accrued pension is that which would be paid annually on retirement at 60 based on service to 28 February 1998.
c) Lord MacLaurin retired on 6 June 1997.
d) The figures for Mr A T Higginson relate to the period from 17 November 1997 when he was appointed a director. In his case not all of the benefits shown above can be provided from the approved pension scheme; the balance is provided in the form of unapproved benefits.

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.

Table 4 Share options held by directors and not exercised at 28 February 1998

Executive share options schemes (1984), (1994) and (1996)

Number of shares at exercise price (pence)

	217.0 (a)	217.0 (b)	210.0 (b)	243.0 (b)	232.0 (b)	271.0	312.0	295.0	353.0 (c)	455.0 (c)	481.0 (c)	Total
Mr T P Leahy	20,737	17,050	139,048	157,124	–	132,841	82,752	174,576	–	40,220	–	**764,348**
Mr D E Reid	–	3,686	3,809	–	–	64,945	185,904	74,576	–	200,435	–	**533,355**
Mr R S Ager	23,041	17,051	25,238	–	35,611	39,852	85,104	83,390	31,445	99,968	–	**440,700**
Mr J Gildersleeve	–	–	–	–	14,656	85,608	207,719	40,678	–	168,333	–	**516,994**
Mr A T Higginson	–	–	–	–	–	–	–	–	–	–	137,214	**137,214**
Mrs L James	–	–	–	–	14,271	74,394	100,016	37,882	–	75,050	–	**301,613**
Mr T J R Mason	–	–	–	–	–	97,184	145,935	94,915	–	66,223	–	**404,257**
Mr J M Wemms	–	9,216	29,047	–	–	42,804	222,201	91,881	16,998	51,648	11,577	**475,372**
Date exercisable (d)	29/10/95	27/05/96	10/6/97	12/8/97	29/9/97	27/4/98	13/10/98	3/7/99	17/4/2000	7/10/2000	17/11/2000	

a) The options may be exercised at 185p as targets related to growth in earnings per share have been achieved in accordance with ABI guidelines.

b) The 217p, 210p, 243p and 232p options may be exercised at 185p, 179p, 207p and 198p 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 295p, 353p, 455p and 481p which expire four years from date exercisable.

On 6 June 1997, Lord MacLaurin held 701,040 and 89,299 share options with an exercise price of 210p and 271p respectively.

Table 5 Share options held by directors and not exercised at 28 February 1998

Savings-related share options schemes (1981)

	Number of shares					Value realisable	
	As at 22 February 1997	Granted	Exercised	As at 28 February 1998	Exercise price (pence)	1998 £000	1997 £000
Mr T P Leahy	8,365	–	–	**8,365**	185-249	**–**	6
Mr D E Reid	8,801	1,890	4,166	**6,525**	185-365	**15**	6
Mr R S Ager	7,715	–	–	**7,715**	161-249	**–**	6
Mr J Gildersleeve	9,979	2,835	6,250	**6,564**	185-365	**23**	–
Mrs L James	8,642	–	–	**8,642**	161-249	**–**	6
Mr T J R Mason	9,557	2,268	5,000	**6,825**	185-365	**18**	–
Mr J M Wemms	8,365	–	–	**8,365**	185-249	**–**	6

The savings-related share option scheme subscription price was 365p and the option matures in either 2001 (three-year scheme) or 2003 (five-year scheme).The shares relating to options exercised in the year were all retained.

On 6 June 1997, Lord MacLaurin held 9,979 options with an exercise price of 174p-185p.

Between 28 February 1998 and 20 April 1998 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 23.

Table 6 Disclosable interests of the directors,including family interests

	28 February 1998		22 February 1997	
	Ordinary shares	Options to acquire ordinary shares	Ordinary shares	Options to acquire ordinary shares
Mr J A Gardiner	**117,775**	**–**	117,775	–
Mr T P Leahy	**350,947**	**772,713**	239,483	783,646
Mr D E Reid	**404,031**	**539,880**	325,001	709,028
Mr R S Ager	**267,975**	**448,415**	184,238	499,551
Mr J Gildersleeve	**241,263**	**523,558**	184,916	694,298
Mr A T Higginson	**–**	**137,214**	–	–
Mrs L James	**158,764**	**310,255**	107,398	347,371
Dr M G Jones	**2,298**	**–**	2,237	–
Mr T J R Mason	**115,847**	**411,082**	86,469	403,543
Mr J W Melbourn	**2,190**	**–**	2,190	–
Baroness O'Cathain	**15,491**	**–**	6,300	9,191
Mr G F Pimlott	**8,522**	**–**	8,294	–
Mr J M Wemms	**221,037**	**483,737**	169,702	516,318

On 6 June 1997, Lord MacLaurin held 563,728 (1997 – 491,687) ordinary shares and 800,318 (1997 – 827,968) options to acquire ordinary shares. Mr A T Higginson was appointed a director on 17 November 1997 and at that date he held no 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 23).

Between 28 February 1998 and 20 April 1998 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 page 16 to 39 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 16 to 39 which have been prepared under the historical cost convention, the accounting policies set out on pages 20 and 21 and the directors' emoluments and share details included on pages 10 to 14.

Respective responsibilities of directors and auditors

As described above, the company's directors are responsible for the preparation of financial statements. It is our responsiblity to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

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 true and fair view of the state of affairs of the company and of the Group as at 28 February 1998 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.

Price Waterhouse

Chartered Accountants and Registered Auditors
London
20 April 1998

Group profit and loss account

53 weeks ended 28 February 1998	Note	Continuing operations 1998 £m	Continuing operations Acquisitions 1998 £m	Discontinued operations 1998 £m	Total 1998 £m	Total 1997 £m
Sales at net selling prices	1	**16,069**	**1,110**	**600**	**17,779**	14,984
Value added tax		**1,182**	**82**	**63**	**1,327**	1,097
Turnover excluding value added tax	1/2	**14,887**	**1,028**	**537**	**16,452**	13,887
Operating expenses						
– Normal operating expenses	2	**13,987**	**979**	**539**	**15,505**	13,081
– Employee profit-sharing	3	**35**	**–**	**–**	**35**	32
– Integration costs	2	**–**	**95**	**–**	**95**	–
Operating profit/(loss)	1/2	**865**	**(46)**	**(2)**	**817**	774
Loss on disposal of discontinued operations:	32			**(8)**	**(8)**	–
– Excess of consideration over net assets, and disposal costs				**127**		
– Goodwill previously offset against reserves				**(135)**		
Net loss on disposal of fixed assets	4	**–**	**–**	**(1)**	**(1)**	–
Loss from interests in associated undertakings		**(15)**	**–**	**–**	**(15)**	–
Profit/(loss) on ordinary activities before interest		**850**	**(46)**	**(11)**	**793**	774
Net interest payable	7				**(65)**	(24)
Profit on ordinary activities before taxation	4				**728**	750
Profit before integration costs, loss on disposal of discontinued operations and net loss on disposal of fixed assets					**832**	750
Integration costs					**(95)**	–
Loss on disposal of discontinued operations					**(8)**	–
Net loss on disposal of fixed assets					**(1)**	–
Tax on profit on ordinary activities	8				**223**	230
Profit for the financial year					**505**	520
Dividends	9				**255**	225
Retained profit for the financial year	24				**250**	295

	Note	pence	pence
Earnings per share	10	**23.1**	24.1
Adjusted for integration costs after taxation		**3.7**	–
Adjusted for net loss on disposal of fixed assets and loss on disposal of discontinued operations after taxation		**0.4**	–
Adjusted earnings per share	10	**27.2**	24.1
Fully diluted earnings per share	10	**22.6**	23.5
Adjusted for integration costs after taxation		**3.6**	–
Adjusted for net loss on disposal of fixed assets and loss on disposal of discontinued operations after taxation		**0.4**	–
Adjusted fully diluted earnings per share	10	**26.6**	23.5
Dividend per share	9	**11.60**	10.35
Dividend cover (times)		**2.3**	2.3

Accounting policies and notes forming part of these financial statements are on pages 20 to 39.

Statement of total recognised gains and losses

53 weeks ended 28 February 1998	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Profit for the financial year	**505**	520	**291**	332
Loss on foreign currency net investments	**(14)**	(12)	**–**	–
Total recognised gains and losses relating to the financial year	**491**	508	**291**	332

Reconciliation of movements in shareholders' funds

53 weeks ended 28 February 1998	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Profit for the financial year	**505**	520	**291**	332
Dividends	**255**	225	**255**	225
	250	295	**36**	107
Loss on foreign currency net investments	**(14)**	(12)	**–**	–
New share capital subscribed less expenses	**42**	31	**80**	31
Payment of dividends by shares in lieu of cash	**18**	18	**18**	18
Goodwill arising on acquisitions	**(445)**	(30)	**–**	–
Amount written back in respect of goodwill previously offset against reserves	**135**	–	**–**	–
Net (reduction in)/addition to shareholders' funds	**(14)**	302	**134**	156
Shareholders' funds at 22 February 1997	**3,890**	3,588	**2,355**	2,199
Shareholders' funds at 28 February 1998	**3,876**	3,890	**2,489**	2,355

Accounting policies and notes forming part of these financial statements are on pages 20 to 39.

Balance sheets

28 February 1998	Note	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Fixed assets					
Tangible assets	11	**6,311**	5,826	**–**	–
Investments	12	**185**	23	**4,218**	3,338
		6,496	5,849	**4,218**	3,338
Current assets					
Stocks	13	**584**	550	**–**	–
Debtors	14	**133**	78	**1,271**	781
Investments	15	**196**	80	**2**	2
Cash at bank and in hand		**29**	65	**–**	–
		942	773	**1,273**	783
Creditors:falling due within one year	16	**2,712**	2,101	**2,266**	1,278
Net current liabilities		**(1,770)**	(1,328)	**(993)**	(495)
Total assets less current liabilities		**4,726**	4,521	**3,225**	2,843
Creditors:falling due after more than one year	17	**812**	611	**736**	488
Provisions for liabilities and charges	20	**38**	20	**–**	–
		3,876	3,890	**2,489**	2,355
Capital reserves					
Called up share capital	22	**110**	109	**110**	109
Share premium account	24	**1,528**	1,431	**1,528**	1,431
Other reserves	24	**40**	40	**–**	–
Profit and loss account	24	**2,198**	2,310	**851**	815
Equity shareholders' funds		**3,876**	3,890	**2,489**	2,355

Terry Leahy
Andrew Higginson
Directors
Financial statements approved by the Board on 20 April 1998.

Accounting policies and notes forming part of these financial statements are on pages 20 to 39.

Group cash flow statement

53 weeks ended 28 February 1998		Note	1998 £m	1997 £m
Net cash inflow from operating activities		30	**1,156**	1,219
Returns on investments and servicing of finance				
	Interest received		**28**	44
	Interest paid		**(116)**	(84)
	Interest element of finance lease rental payments		**(6)**	(7)
Net cash outflow from returns on investments and servicing of finance			**(94)**	(47)
Taxation	Corporation tax paid (including advance corporation tax)		**(238)**	(228)
Capital expenditure and financial investment				
	Payments to acquire tangible fixed assets		**(805)**	(703)
	Receipts from sale of tangible fixed assets		**82**	91
	Increase in fixed asset investments		**–**	12
Net cash outflow for capital expenditure and financial investment			**(723)**	(600)
Acquisitions and disposals				
	Purchase of subsidiary undertakings	31	**(649)**	(112)
	Net cash acquired with subsidiary	31	**65**	3
	Sale of subsidiary undertakings	32	**259**	–
	Net cash disposed of as part of sale of subsidiary undertakings	32	**(2)**	–
	Purchase of interests in associated undertakings	29	**(32)**	(17)
Net cash outflow from acquisitions and disposals			**(359)**	(126)
Equity dividends paid			**(214)**	(194)
Cash (outflow)/inflow before use of liquid resources and financing			**(472)**	24
Management of liquid resources				
	Increase in short term deposits		**(116)**	(29)
Financing				
	Ordinary shares issued for cash		**38**	31
	Redemption of E.C.S.C. loans 1996		**–**	(74)
	Increase in other loans		**443**	60
	Capital element of finance leases repaid		**(21)**	(18)
Net cash inflow/(outflow) from financing			**460**	(1)
Decrease in cash in the period			**(128)**	(6)

Reconciliation of net cash flow to movement in net debt		Note	1998 £m	1997 £m
	Decrease in cash in period		**(128)**	(6)
	Cash (inflow)/outflow from (increase)/decrease in debt and lease financing		**(422)**	32
	Loans and finance leases acquired with subsidiary		**(20)**	–
	Loans and finance leases disposed of as part of sale of business		**10**	–
	Cash used to increase liquid resources		**116**	29
	Amortisation of 4% unsecured deep discount loan stock		**(3)**	(3)
	Foreign exchange differences		**5**	12
(Increase)/decrease in net debt			**(442)**	64
Net debt at 22 February 1997		33	**(749)**	(813)
Net debt at 28 February 1998		33	**(1,191)**	(749)

Accounting policies and notes forming part of these financial statements are on pages 20 to 39.

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 and its subsidiary undertakings, all of which are prepared to or around 28 February 1998 apart from Global T.H., Tesco Polska Sp. z o.o., Tesco Stores ČR a.s. and Tesco Stores SR a.s. which had 31 December 1997 year ends.The results of Catteau S.A. have been included to 24 February 1998, its date of disposal. In the opinion of the directors it is necessary for the Continental European companies 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.

Any excess or deficiency of purchase consideration in relation to the fair value of attributable net assets of subsidiary undertakings at the date of acquisition is adjusted in reserves.

The Group's share of associated undertakings' profits or losses is included in the Group profit and loss account and added to the cost of investments in the balance sheet. The accounting policies of associated undertakings are adjusted on consolidation to achieve consistent Group accounting policies.

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%.

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 and advance corporation tax

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.

Surplus advance corporation tax on dividends paid and proposed, which is expected to be recoverable, is included within debtors.

Pensions

The expected cost of pensions in respect of the Group's defined benefit pensions scheme 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. Premiums 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.

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, Northern Ireland, Republic of Ireland, Hungary, Poland, Czech Republic and Slovakia. Continental European operations' results are for the year ended 31 December 1997, with the exception of Catteau S.A. whose results are included to the date of disposal on 24 February 1998.

	1998				1997			
	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	**15,762**	**14,621**	**866**	**4,661**	14,024	13,034	760	4,364
Property development	**19**	**19**	**–**	**55**	92	84	–	60
Total UK	**15,781**	**14,640**	**866**	**4,716**	14,116	13,118	760	4,424
Food retailing – Ireland	**1,110**	**1,028**	**(46)**	**227**	–	–	–	–
Food retailing – Rest of Europe	**288**	**247**	**(1)**	**124**	224	191	3	83
Total continuing operations	**17,179**	**15,915**	**819**	**5,067**	14,340	13,309	763	4,507
Discontinued operations: Food retailing – France	**600**	**537**	**(2)**	**–**	644	578	11	132
	17,779	**16,452**			14,984	13,887		
Operating profit			**817**				774	
Loss on disposal of discontinued operations			**(8)**				–	
Loss from interests in associated undertakings			**(15)**				–	
Net loss on disposal of fixed assets			**(1)**				–	
Net interest payable			**(65)**				(24)	
Profit on ordinary activities before taxation			**728**				750	
Operating margin (pre-integration costs)			**5.5%**				5.6%	
Capital employed				**5,067**				4,639
Net debt (note 18)				**(1,191)**				(749)
Net assets				**3,876**				3,890

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.

Note 2 Analysis of operating profit

	1998				1997		
	Continuing operations		Discontinued operations	Total	Continuing operations	Discontinued operations	Total
	£m	Acquisitions £m	£m	£m	£m	£m	£m
Turnover excluding VAT	**14,887**	**1,028**	**537**	**16,452**	13,292	595	13,887
Cost of sales	**13,739**	**954**	**524**	**15,217**	12,276	570	12,846
Gross profit	**1,148**	**74**	**13**	**1,235**	1,016	25	1,041
Administration expenses	**283**	**120**	**15**	**418**	253	14	267
Operating profit/(loss)	**865**	**(46)**	**(2)**	**817**	763	11	774

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

Integration costs totalling £95m have been charged, reflecting the need to reorganise and integrate the Irish operations purchased from Associated British Foods plc.These include £35m relaunch costs, £12m redundancy costs, £28m asset write-downs and £20m for other integration costs.

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.

Note 4 Profit on ordinary activities before taxation

	1998 £m	1997 £m
Profit on ordinary activities is stated after charging/(crediting) the following:		
Depreciation	**358**	317
Operating lease costs (a)	**137**	124
Auditors' remuneration (b)	**–**	–
Employment costs (note 5)	**1,642**	1,354
Net loss on disposal of fixed assets (c)	**(1)**	–

a) Operating lease costs include £19m for hire of plant and machinery (1997 – £18m).
b) Auditors' remuneration amounted to £0.5m (1997 – £0.5m) and includes £0.1m (1997 – £0.1m) for the company. The auditors also received £1.6m (1997 – £0.6m) in respect of non-audit services of which £0.5m (1997 – £0.4m) related to overseas operations. These fees were principally in respect of acquisitions and Group restructuring.
c) Net loss on disposal of fixed assets has been arrived at after the offset of profits of £8m (1997 – £37m).

Notes to the financial statements

continued

Note 5 Employment costs	**1998 £m**	1997 £m
a) Employment costs during the year		
Wages and salaries	**1,481**	1,216
Social security costs	**99**	83
Other pension costs (note 25)	**62**	55
	1,642	1,354

b) Number of persons employed

The average number of employees per week during the year was: UK 159,109 (1997 – 143,694), Northern Ireland and Republic of Ireland 14,181 (1997 – nil), Rest of Europe 12,290 (1997 – 9,504) and the average number of full-time equivalents was: UK 99,997 (1997 – 89,649), Northern Ireland and Republic of Ireland 12,585 (1997 – nil) and Rest of Europe 11,590 (1997 – 8,791).

Note 6 Directors' emoluments and interests.

Details of directors' emoluments and interests are given in the Report of the Remuneration Committee on pages 10 to 14.

Note 7 Interest	**1998 £m**	1997 £m
Interest receivable and similar income on money market investments and deposits	**26**	34
Less interest payable on:		
Short term bank loans and overdrafts repayable within five years	**(52)**	(32)
Finance charges payable on finance leases	**(11)**	(8)
4% unsecured deep discount loan stock 2006 (a)	**(8)**	(8)
E.C.S.C. loans 1998-1999 (b)	**(1)**	(1)
10⅜% bonds 2002	**(21)**	(21)
7½% bonds 2007	**(11)**	–
8¾% bonds 2003	**(18)**	(17)
Interest capitalised	**31**	29
	(91)	(58)
	(65)	(24)

a) Interest payable on the 4% unsecured deep discount loan stock 2006 includes £3m (1997 – £3m) of discount amortisation.

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

Note 8 Taxation

	1998 £m	1997 £m
UK taxation:		
Corporation tax at 31.2% (1997 – 33.0%)	**251**	254
Share of associated undertakings' tax	**(5)**	–
Prior year items	**(20)**	(25)
Deferred taxation (see note 20) – current year	**(3)**	(2)
– prior year	**(8)**	–
	215	227
Overseas tax	**8**	3
	223	230

There was no material tax charge/credit arising from the disposal of the discontinued operations or the disposal of fixed assets. The tax credit on the integration costs was £16m.

Note 9 Dividends

	1998 £m	1997 £m
Declared interim – 3.55p per share (1997 – 3.25p)	**78**	70
Proposed final – 8.05p per share (1997 – 7.10p)	**177**	155
	255	225

Note 10 Earnings per share and fully diluted earnings per share

a) Earnings per share and fully diluted earnings per share, excluding integration costs and net loss on disposal of fixed assets, have been calculated in addition to the disclosures required by SSAP3 as amended by FRS3 since, in the opinion of the directors, this will allow shareholders to identify the underlying results of the trading operations of the business.

b) The calculation for earnings per share, including and excluding integration costs and net loss on disposal of fixed assets, is based on the profit on ordinary activities after taxation and after minority interests divided by the weighted average number of ordinary shares in issue during the year of 2,184m (1997 – 2,162m).

c) The calculation for fully diluted earnings per share, including and excluding integration costs and net loss on disposal of fixed assets, is based on the profit on ordinary activities after taxation and after adding the interest income, net of corporation tax, which would have arisen had all the various ordinary share options granted under the company's schemes been exercised on the first day of the financial year, or at the date granted if later, and the proceeds invested in 2½% consolidated stock on that day.

The amount so derived has been divided by the number of ordinary shares in issue at the beginning of the year together with the weighted average number of ordinary shares assumed to have been issued as indicated above.

Notes to the financial statements

continued

Note 11 Tangible fixed assets	Land and buildings £m	Plant equipment fixtures and fittings and vehicles £m	Total £m
Cost			
At 22 February 1997	5,697	1,948	7,645
Currency translation	(46)	(38)	(84)
Additions at cost (a)	529	312	841
Purchase of subsidiary undertakings	239	291	530
	6,419	2,513	8,932
Disposals (b)	(252)	(345)	(597)
At 28 February 1998	**6,167**	**2,168**	**8,335**
Depreciation			
At 22 February 1997	609	1,210	1,819
Currency translation	(18)	(10)	(28)
Charge for period	149	209	358
Purchase of subsidiary undertakings	29	168	197
	769	1,577	2,346
Disposals (b)	(30)	(292)	(322)
At 28 February 1998	**739**	**1,285**	**2,024**
Net book value (c) (d)			
At 28 February 1998	**5,428**	**883**	**6,311**
At 22 February 1997	5,088	738	5,826
Capital work in progress included above (e)			
At 28 February 1998	**118**	**17**	**135**
At 22 February 1997	108	31	139

a) Includes £20m (1997 – £16m) in respect of interest capitalised net of tax relief of £8m (1997 – £7m) principally relating to land and building assets.

b) Fully depreciated assets not in use in the business totalling £181m have been removed from fixed assets in the year.

c) Net book value includes capitalised interest, net of tax relief, at 28 February 1998 of £278m (1997 – £268m). 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 22 February 1997	202	155	47
Movement in the period	(23)	(6)	(17)
At 28 February 1998	**179**	**149**	**30**

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

	1998 £m	1997 £m
Freehold	**4,628**	4,245
Long leasehold – 50 years or more	**508**	544
Short leasehold – less than 50 years	**292**	299
At 28 February 1998	**5,428**	5,088

e) Capital work in progress does not include land.

f) Net book value is stated after charging £28m in respect of integration costs incurred on acquisition of the Irish businesses.

Note 12 Fixed asset investments

	Group: Associated undertakings (b) £m	Group: Other investments £m	Company: Share in Group undertakings (a) £m	Company: Loans to Group undertakings £m	Company: Associated undertakings (b) £m
At 22 February 1997	21	2	316	3,000	22
Additions	179	–	701	–	179
Share of loss of associated undertakings	(15)	–	–	–	–
Disposals	–	(2)	–	–	–
At 28 February 1998	**185**	**–**	**1,017**	**3,000**	**201**

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 SR a.s.	Food Retail	100%	Slovakia
Tesco Stores Hong Kong Limited	Purchasing	100%	Hong Kong

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

b) The Group's joint ventures/associated undertakings 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

Tesco British Land Property Partnership, Tesco Personal Finance Group Limited and Tesco Personal Finance Life Limited were formed during the year in partnership with The British Land Company plc,The Royal Bank of Scotland plc and Scottish Widows Fund and Life Assurance Society respectively.

An amount of £3m representing the unrealised 50% element of the profit on the sale of properties to the Tesco British Land Property Partnership has been offset against the cost of the investment of £179m shown above.

Note 12 Fixed asset investments *continued*

The net borrowings of the associated undertakings, as at 28 February 1998, were as follows:

	1998 £m	1997 £m
Cash and deposits	**510**	23
Term bank loan – repayable 1999	**–**	(48)
Debenture stock – repayable 2001	**(36)**	(36)
Term bank loan – repayable 2003	**(128)**	(119)
Other loans	**(621)**	(38)
	(275)	(218)

There is no recourse to Group companies in respect of the borrowings of the associated undertakings, apart from £15m (1997 – £14m) which has been guaranteed by Tesco PLC (note 28).

Details of transactions and balances with the associated undertakings are set out in note 29.

Note 13 Stocks

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Goods held for resale	**501**	490	**–**	–
Development property	**83**	60	**–**	–
	584	550	**–**	–

Additions to development property include £3m (1997 – £6m) of interest capitalised. Accumulated capitalised interest at 28 February 1998 was £12m (1997 – £11m).

Note 14 Debtors

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Amounts owed by Group undertakings	**–**	–	**1,002**	518
Prepayments and accrued income	**34**	21	**262**	258
Advance corporation tax recoverable	**3**	5	**3**	5
Other debtors	**96**	52	**4**	–
	133	78	**1,271**	781
Debtors falling due after one year included above:				
Advance corporation tax recoverable	**3**	5	**3**	5

Note 15 Investments

	Group		Company	
	1998 £m	1997 £m	1998 £m	1997 £m
Money market deposits	**176**	60	**–**	–
Bonds and certificates of deposit (market value £20m, 1997 – £20m)	**20**	20	**2**	2
	196	80	**2**	2

Note 16 Creditors falling due within one year	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Bank loans and overdrafts (a) (b)	**607**	285	**1,263**	931
Trade creditors	**972**	826	**–**	–
Amounts owed to Group undertakings	**–**	–	**796**	137
Other creditors	**387**	322	**–**	8
Corporation tax (c)	**256**	255	**15**	41
Other taxation and social security	**99**	90	**–**	–
Accruals and deferred income (d)	**197**	147	**15**	6
Finance leases (note 21)	**17**	21	**–**	–
Proposed final dividend	**177**	155	**177**	155
	2,712	2,101	**2,266**	1,278

a) Bank deposits at subsidiary undertakings of £750m (1997 – £663m) have been offset against borrowings in the parent company under a legal right of set-off.

b) Includes £8m (1997 – £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 £5m (1997 – £5m) attributable to these realised gains with £18m (1997 – £23m) being included in other creditors falling due after more than one year (note 17).

Note 17 Other creditors falling due after more than one year	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
4% unsecured deep discount loan stock 2006 (a)	**83**	80	**83**	80
Finance leases (note 21)	**25**	55	**–**	–
10⅜% bonds 2002 (b)	**200**	200	**200**	200
8¾% bonds 2003 (c)	**200**	200	**200**	200
7½% bonds 2007 (d)	**250**	–	**250**	–
E.C.S.C. loans 1998-1999	**3**	8	**3**	8
Other loans (e)	**31**	45	**–**	–
	792	588	**736**	488
Accruals and deferred income (note 16)	**20**	23	**–**	–
	812	611	**736**	488

a) The 4% unsecured deep discount loan stock is redeemable at a par value of £125m in 2006.

b) The 10⅜% 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 £250m in 2007.

e) Includes £31m (1997 – £38m) secured on various properties.

Note 18 Net debt

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Due within one year				
Bank and other loans	**607**	285	**1,263**	931
Finance leases	**17**	21	**–**	–
Due within one to two years				
Bank and other loans	**12**	13	**3**	8
Finance leases	**7**	19	**–**	–
Due within two to five years				
Bank and other loans	**422**	33	**400**	–
Finance leases	**17**	28	**–**	–
Due wholly or in part by instalments after five years				
Finance leases	**1**	8	**–**	–
Due otherwise than by instalments after five years				
Bank and other loans	**333**	487	**333**	480
Gross debt	**1,416**	894	**1,999**	1,419
Less: Cash at bank and in hand	**29**	65	**–**	–
Money market investments and deposits	**196**	80	**2**	2
Net debt	**1,191**	749	**1,997**	1,417

Note 19 Financial instruments

Analysis of interest rate exposure and currency of net debt.

The interest rate exposure and currency of Group net debt at 28 February 1998 after swaps was:

	Total £m	Floating rate debt £m	Fixed rate debt £m	Fixed rate debt: Weighted average interest rate 28 February 1998 %	Fixed rate debt: Weighted average time for which rate is fixed Years
Currency					
Sterling	**1,114**	**658**	**456**	**9.0**	**6**
Irish punt	**92**	**(66)**	**158**	**5.9**	**4**
Other	**(15)**	**(15)**	**–**	**–**	**–**
Net debt at 28 February 1998	**1,191**	**577**	**614**	**8.2**	**5**
% of net debt		**48%**	**52%**		
Net debt at 22 February 1997	749	439	310	8.3	6

The interest rate exposure of the Group has been managed by the purchase of interest rate caps with an aggregate notional principal of £170m (1997 – £70m), an average strike rate of 8.2% and a four 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 £158m, to Irish punt fixed debt for an average period of four years and interest rate of 5.9%.

ii) Swaps converting £353m net notional principal sterling denominated fixed rate debt into floating debt for an average period of six years and interest rate of 7.2%.

The current value of these contracts, if realised, would generate a profit of nil (1997 – loss of £7m). In addition, as set out in note 16, 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 £23m (1997 – £28m) has been deferred as at 28 February 1998.

Note 19 Financial instruments *continued*

Long-term debt over one year with a book value of £792m (1997 – £588m) has an estimated current value, considering only the movements in risk-free interest rates, of £866m (1997 – £629m). 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 28 February 1998 were:

		Financing	Net investment	
	Net assets before financing £m	Gross debt £m	1998 £m	1997 £m
Currency				
Sterling	**5,014**	**(1,219)**	**3,795**	3,796
Irish punt	**127**	**(182)**	**(55)**	–
Other	**151**	**(15)**	**136**	94
Total	**5,292**	**(1,416)**	**3,876**	3,890

The currency value shown is the year end value.

Other significant financial instruments outstanding at the year end are £77m 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.

Note 20 Provisions for liabilities and charges

	Deferred taxation £m	Integration costs £m	Total £m
At 22 February 1997	20	–	**20**
Integration costs charged in the year	–	67	**67**
Amount utilised in year (a)	(14)	(35)	**(49)**
At 28 February 1998	**6**	**32**	**38**

Details of the integration costs are included in note 2.

a) Deferred taxation includes £3m disposed of as part of the sale of Catteau S.A. (see note 32).

	Amount provided		Potential amount for deferred tax on all timing differences	
	1998 £m	1997 £m	1998 £m	1997 £m
Deferred taxation – Group				
Excess capital allowances over depreciation	**–**	10	**312**	294
Capital gains deferred by rollover relief	**–**	–	**–**	1
Short term timing differences	**6**	10	**(8)**	10
	6	20	**304**	305

Deferred taxation balances in Tesco PLC 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.

Notes to the financial statements

continued

Note 21 Leasing commitments

a) Finance leases

The future minimum finance lease payments to which the Group was committed at 28 February 1998 and which have been guaranteed by Tesco PLC are:

	£m
Gross rental obligations	**50**
Less finance charges allocated to future periods	**8**
	42

	1998 £m	1997 £m
Net amounts payable are:		
Within one year	**17**	21
Between one and five years	**24**	47
After five years	**1**	8
	42	76

b) Operating leases

Group commitments during the 52 weeks to 27 February 1999, in terms of lease agreements expiring, are as follows:

	1998 £m	1997 £m
Within one year	**4**	2
Between one and five years	**8**	10
After five years	**127**	121
	139	133

Note 22 Called up share capital

	Ordinary shares of 5p each	
	Number	£m
Authorised: 1998 and 1997	**2,710,000,000**	**136**
Allotted, issued and fully paid:		
Issued at 22 February 1997	**2,174,926,996**	**109**
Scrip dividend election	**4,639,480**	**–**
Share options exercised	**19,647,770**	**1**
Shares issued in consideration of purchase of UK businesses	**1,041,370**	**–**
Issued at 28 February 1998	**2,200,255,616**	**110**

During the year, 25m shares were issued for an aggregate consideration of £98m, which comprised £17m for scrip dividend, £76m for share options and £5m for the purchase of UK businesses (note 31).

Between 28 February 1998 and 20 April 1998, options on 339,867 ordinary shares and 937,164 ordinary shares have been exercised under the terms of the savings-related share option scheme (1981) and the executive share option scheme (1984) respectively.

As at 28 February 1998 the directors were authorised to purchase up to a maximum in aggregate of 220,025,561 ordinary shares.

Note 23 Share options

Company schemes

The company had four 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 ten years on 9 November 1994. Options were generally exercisable between three and ten 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.

Note 23 Share options *continued*

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

Savings-related share option scheme (1981)

Date of grant	Number of executives and employees	Shares under option 28 February 1998	Subscription price (pence)
29.10.92	688	930,116	174.0
22.10.93	8,974	10,243,288	161.0
26.10.94	12,823	12,586,082	185.0
27.10.95	17,404	12,120,516	250.0
31.10.96	30,604	17,824,463	249.0
30.10.97	40,104	17,271,652	365.0

Executive share option scheme (1984)

Date of grant	Number of executives and employees	Shares under option 28 February 1998	Subscription price (pence)
01.11.89	134	533,801	192.1
17.05.91	7	83,334	274.0
22.10.91	1	5,000	254.0
29.05.92	210	2,636,260	277.0
29.10.92	6	108,767	217.0
27.05.93	6	92,450	217.0
10.06.94	310	2,212,125	210.0
12.08.94	1	157,124	243.0
29.09.94	19	256,882	232.0

The subscription price and number of shares have been adjusted as a result of the rights issue in 1991.

Executive share option scheme (1994)

Date of grant	Number of executives	Shares under option 28 February 1998	Subscription price (pence)
27.04.95	23	1,373,922	271.0
13.10.95	978	9,959,879	312.0
23.05.96	3	158,391	286.0

Executive share option scheme (1996)

Date of grant	Number of executives	Shares under option 28 February 1998	Subscription price (pence)
03.07.96	29	1,231,759	295.0
23.09.96	1,014	9,315,580	299.0
17.04.97	1,079	7,038,911	353.0
07.10.97	168	2,345,890	455.0
17.11.97	2	148,791	481.0

Note 24 Reserves

	Group		Company	
	1998 £m	1997 £m	**1998 £m**	1997 £m
a) Share premium account				
At 22 February 1997	**1,431**	1,383	**1,431**	1,383
Premium on issue of shares less costs	**79**	30	**79**	30
Scrip dividend election	**18**	18	**18**	18
At 28 February 1998	**1,528**	1,431	**1,528**	1,431
b) Other reserves				
At 28 February 1998 and 22 February 1997	**40**	40	**–**	–
c) Profit and loss account				
At 22 February 1997	**2,310**	2,057	**815**	708
Goodwill arising on acquisition of subsidiary undertakings	**(445)**	(30)	**–**	–
Amount written back in respect of goodwill previously offset against reserves	**135**	–	**–**	–
Loss on foreign currency net investments	**(14)**	(12)	**–**	–
Issue of shares	**(38)**	–	**–**	–
Retained profit for the financial year	**250**	295	**36**	107
At 28 February 1998	**2,198**	2,310	**851**	815

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 28 February 1998 amounted to £718m (1997 – £408m).

During the year the company received £54m on the issue of 10m shares in respect of the exercise of options awarded under the savings-related share option scheme. Employees paid £16m to the Group for the issue of these shares and the balance of £38m comprised contributions to the qualifying share ownership trust (QUEST) from subsidiary undertakings.

Note 25 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 acturial 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 on-going 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 £44m (1997 – £39m).

Note 25 Pension commitments *continued*

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 £15m (1997 – £13m). 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 France. The contributions payable under these schemes of £3m (1997 – £3m) have been fully expensed against profits in the current year.

Note 26 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 pensions 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 (1997 – £1m) has been charged to the profit and loss account. A provision of £4m (1997 – £3m) 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 27 Capital commitments

At 28 February 1998 there were commitments for capital expenditure contracted for but not provided of £214m (1997 – £233m).

Note 28 Contingent liabilities

Certain bank loans and overdraft facilities of associated undertakings have been guaranteed by Tesco PLC. At 28 February 1998, the amounts outstanding on these facilities were £15m (1997 – £14m).

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 29 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 associated undertakings, 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 £32m (£20m in Tesco Personal Finance Group Limited and £12m in Tesco Personal Finance Life Limited).
ii) The sale of seven properties to Tesco British Land Property Partnership worth £213m. The company received £63m from the Partnership, resulting in a net investment of £150m. In addition the Group purchased back one property from Shopping Centres Limited for £33m and one property from BLT Properties Limited for £12m.
iii) The Group made rental payments of £3m (1997 – £4m) and £9m (1997 – £2m) to Shopping Centres Limited and BLT Properties Limited respectively.
iv) The Group has charged Tesco Personal Finance Limited (a 100% subsidiary of Tesco Personal Finance Group Limited) an amount totalling £6m in respect of services and assets transferred, of which £4m was outstanding at 28 February 1998. Tesco Personal Finance Limited received fees totalling £5m from the Group for managing certain financial products, £1m of this was outstanding at 28 February 1998. In addition, the Group charged Tesco Personal Finance Limited £6m for a licensing agreement to operate within Tesco stores. At 28 February 1998, £5m of this was outstanding.

Note 30 Reconciliation of operating profit to net cash inflow from operating activities

	Continuing £m	Discontinued £m	1998 Total £m	1997 Total £m
Operating profit	**819**	**(2)**	**817**	774
Depreciation	**348**	**10**	**358**	317
Increase in goods held for resale	**(6)**	**–**	**(6)**	(19)
(Increase)/decrease in development property	**(108)**	**–**	**(108)**	44
(Increase)/decrease in debtors	**(40)**	**4**	**(36)**	(7)
Increase in trade creditors	**88**	**9**	**97**	74
Increase in other creditors	**31**	**3**	**34**	36
(Increase)/decrease in working capital	**(35)**	**16**	**(19)**	128
Net cash inflow from operating activities	**1,132**	**24**	**1,156**	1,219

Note 31 Acquisitions

On 8 May 1997 the company acquired the Irish food retailing and related businesses of Associated British Foods plc for £643m. The results of these businesses from this date to 28 February 1998 have been consolidated within the Group profit and loss account. In the period from 15 September 1996 to 8 May 1997 they made a profit after taxation of £9m, and in the year to 14 September 1996 they made a profit after taxation of £38m with no minority interests.

The company also acquired a controlling interest in the Polish chain of stores called Madex and Minor on 10 March 1997 for £4m, and retailing businesses in the UK, during the year, for £10m.

All of the Group's acquisitions have been accounted for using acquisition accounting.

The acquisitions of the Irish businesses, the Polish chain and UK businesses have been consolidated into the Tesco Group balance sheet as follows:

	Balance sheet at acquisition		Fair value adjustments	Fair value balance sheet
	Ireland £m	Other £m	£m	£m
Fixed assets	304	10	19	333
Stock	64	2	–	66
Debtors	21	–	12	33
Net cash	65	–	–	65
Loans	(20)	–	–	(20)
Creditors	(245)	(9)	–	(254)
Taxation	(11)	–	–	(11)
Shareholders' funds	178	3	31	212
Goodwill				445
Total purchase consideration				657

The fair value adjustments all relate to the Irish businesses and comprise £19m on the revaluation of the property portfolio and £12m in respect of the recognition of pension surpluses.There were no material adjustments to achieve consistency of accounting policies. Included within the Ireland acquisition balance sheet was £9m in respect of the Lifestyle businesses which were subsequently sold (see note 32).This included fixed assets totalling £5m and stock totalling £4m.There were no fair value adjustments in respect of these assets.

Note 31 Acquisitions *continued*

The outflow of cash for the purchase of the Irish businesses comprises:

	£m
Cash consideration	**498**
Bank overdraft of acquired subsidiary undertakings	**145**
	643

The consideration for the Polish businesses was for cash of which £1m was paid in the year and £3m is deferred until 26 March 1999. For the UK businesses, £5m was raised in shares (see note 22) and £5m was for cash.

Fair values at acquisition, total purchase consideration and goodwill are analysed as follows:

	Fair value balance sheet £m	Total purchase consideration £m	Goodwill £m
Irish businesses	**209**	**643**	**434**
Polish chain	**(2)**	**4**	**6**
UK businesses	**5**	**10**	**5**
	212	**657**	**445**

The acquisition of the Irish businesses qualifies as a substantial transaction. As such the following additional analysis is provided for the businesses acquired for the period from 15 September 1996 to 8 May 1997.

	£m
Turnover	731
Operating profit	21
Interest	(1)
Profit on sale of fixed assets	2
Profit before tax	22
Taxation	13
Profit after taxation	9

The Irish businesses purchased contributed £130m to the Group's net operating cash flows, paid £10m in respect of net returns on investments and servicing of finance, paid £10m in respect of taxation, had a cash outflow of £81m from financing and utilised £53m for capital expenditure.

Five-year record

Year ended February	1994	1995	1996	1997	**1998 (1)**
Financial statistics £m					
Turnover excluding VAT					
UK	8,347	9,655	11,560	13,118	**14,640**
Northern Ireland and Republic of Ireland	–	–	–	–	**1,028**
Rest of Europe	253	446	534	769	**784**
	8,600	10,101	12,094	13,887	**16,452**
Operating profit – pre-integration costs					
UK	513	600	713	760	**866**
Northern Ireland and Republic of Ireland	–	–	–	–	**49**
Rest of Europe	8	17	11	14	**(3)**
	521	617	724	774	**912**
Operating margin [2]					
UK	6.1%	6.2%	6.2%	5.8%	**5.9%**
Northern Ireland and Republic of Ireland	–	–	–	–	**4.8%**
Rest of Europe	3.2%	3.8%	2.1%	1.8%	**–**
Total Group	6.1%	6.1%	6.0%	5.6%	**5.5%**
Share of loss from associated undertakings	–	–	–	–	**(15)**
Net interest (payable)/receivable	7	(22)	(43)	(24)	**(65)**
Underlying profit [3]	528	595	681	750	**832**
Wm Low/Ireland integration costs	–	(39)	–	–	**(95)**
Loss on disposal of discontinued activities	–	–	–	–	**(8)**
Net loss on disposal of fixed assets [4]	(93)	(5)	(6)	–	**(1)**
Profit before taxation	435	551	675	750	**728**
Taxation	(136)	(170)	(209)	(230)	**(223)**
Profit after taxation	299	381	466	520	**505**
Underlying fully diluted earnings per share [3]	18.8p	20.1p	21.9p	23.5p	**26.6p**
Earnings per share	15.2p	18.9p	22.2p	24.1p	**23.1p**
Dividend per share	7.75p	8.60p	9.60p	10.35p	**11.60p**
Net worth – £m [5]	2,749	3,104	3,588	3,890	**3,876**
Return on shareholders' funds [6]	19.4%	20.3%	20.4%	20.1%	**21.4%**
Return on capital employed [7]	15.7%	16.2%	16.9%	17.1%	**18.4%**
Net assets per share [8]	140p	151p	167p	179p	**176p**
UK food retail productivity £					
Turnover per employee [9]	138,658	140,842	143,335	146,326	**146,404**
Profit per employee [9]	8,522	8,752	8,841	8,478	**8,660**
Wages per employee [9]	13,922	13,941	13,948	14,222	**14,500**
Weekly sales per sq ft [10/11]	16.37	17.00	18.31	19.74	**21.12**
UK food retail statistics					
Market share in food and drink shops [12]	10.7%	12.0%	13.7%	14.6%	**15.2%**
Number of stores	430	519	545	568	**586**
Total sales area – '000 sq ft [11]	11,006	12,641	13,397	14,036	**14,585**
Sales area opened in year – '000 sq ft	790	830	685	603	**680**
Average store size (sales area) – '000 sq ft [13]	25,700	24,900	25,600	26,300	**26,600**
Average sales area of stores opened in year – '000 sq ft [13]	33,100	28,200	30,700	25,800	**26,700**
Full-time equivalent employees [14]	60,199	68,552	80,650	89,649	**99,997**
Share price – pence					
Highest	260	255	338	370	**539**
Lowest	179	202	245	263	**339**
Year end	223.5	252	271	349	**517**

Notes

1 53 week period.

2 Based upon turnover exclusive of VAT.

3 Underlying profit and fully diluted earnings per share excludes net loss on disposal of fixed assets, loss on disposal of discontinued activities and Wm Low and Ireland integration costs.

4 Net loss on the disposal of fixed assets for 1994 includes £85m in respect of the write down of surplus development sites to their estimated net realisable value.

5 Total shareholders' funds 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/Central Statistical Office data for the year to the previous December. The figures have all been restated following a change in the IGD market definition. The figure for 1998 is estimated.

13 Average store sizes exclude Metro and Express stores.

14 Based on average number of full-time equivalent employees in the UK.

Designed and produced by Michael Peters Literature 0171-371 3714 • Printed by CTD Printers

TESCO

Tesco PLC, Tesco House, Delamare Road, Cheshunt, Hertfordshire EN8 9SL

Front cover photograph: customers at our Sutton Cheam Park store, which opened in June 1997.