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## Our strategy at work

"I give the type of service  
I would like to receive  
and the customers love it"



Adrian Poscoe, General Assistant, Handforth

"The best quality  
at the lowest price,  
that's Unbeatable Value"



Chris Trevains, Baker, Penzance

"Clubcard lets us talk to our customers  
with information and offers  
which are directly relevant to them"



Liz Sinclair, Clubcard Manager, Head Office

"Customers really enjoy shopping  
in our terrific new store"

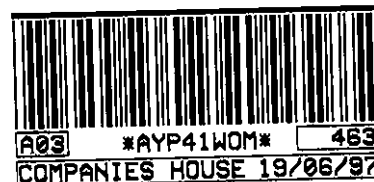


Paula Hasani, Customer Assistant, Pinner

"The product range  
keeps getting bigger and better -  
you can buy so much more here now"



Ian McDougall, Store Manager, Oban



TESCO

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## Annual Accounts

This publication includes the corporate governance statement, the directors' report, the accounts and the auditors' report for the 52 weeks ended 22 February 1997. The Chairman's statement and review of the business are contained in a separate statement entitled Annual Review and Summary Financial Statement 1997.

These Annual Accounts together with the Annual Review and Summary Financial Statement 1997 comprise the full Annual Report and Accounts of Tesco PLC for 1997, 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.

## 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 Gardiner 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 Lord MacLaurin, 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 153,000 people including over 1,200 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. Price Waterhouse have confirmed that, in their opinion, the group are complying with the Companies Act 1985 requirement to keep proper books and records.

### **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.

**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 32 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 in note 6 to the financial statements on pages 15 to 18.

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 and benefits (which comprises car benefits, life, disability and health insurance) of executive directors and other senior executives and other remuneration differentials are normally reviewed annually by the Committee, having regard to competitive market practice supported by two external, independent surveys.

**Executive incentive scheme** The executive incentive scheme comprises both long term and short term share bonuses and was introduced in March 1993.

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.

## **Corporate governance** *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.

**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.

**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 dependent upon service. The scheme also provides for dependants' pensions and lump sums on death in service.

**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 only be exercised subject to the achievement of performance criteria related to growth in earnings per share, in accordance with ABI guidelines.

**Service agreements** Executive directors have service contracts with entitlement to notice of 24 months. This notice period 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. Mr John Gardiner, a Deputy Chairman, receives a further fee for his extra duties and responsibilities and Baroness O'Cathain has the benefit of the use of a company car.

### **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 on page 30.

## **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 2 to 4 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 systems 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 2 and 3 and on going concern on page 4, 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 2 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  
7 April 1997

## Directors' report

The directors present their annual report to shareholders on the affairs of the group together with the audited consolidated financial statements of the group for the 52 weeks ended 22 February 1997.

### Principal activity and business review

The principal activity of the group is the operation of food stores and associated activities in the United Kingdom, France, 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 £1,793m to £13,887m, representing an increase of 14.8%. Group profit on ordinary activities before taxation for the year was £750m compared with £675m for the previous year. The amount allocated to the employee profit sharing scheme this year was £32m as against £29m for last year. After provision for tax of £230m and dividends, paid and proposed, of £225m, profit retained for the financial year amounted to £295m.

### Dividends

The directors recommend the payment of a final dividend of 7.10p per ordinary share to be paid on 1 July 1997 to members on the Register at the close of business on 18 April 1997. Together with the interim dividend of 3.25p per ordinary share paid in December 1996 the total for the year comes to 10.35p compared with 9.60p for the previous year, an increase of 7.8%.

### Tangible fixed assets

Capital expenditure amounted to £731m compared with £649m during the previous year. Changes in fixed assets are summarised in note 11 to the financial statements on page 21. In the directors' opinion, the properties of the group have a market value in excess of the book value of £5,088m included in these financial statements.

### Acquisitions

During the year the group acquired, for a total consideration of £112m, two retailing businesses in the Czech Republic and Slovakia, additional shares in the Hungarian food retailer Global, and a number of small businesses in France through Cateau. Details of acquisitions are set out in note 31 to the financial statements on page 31.

During the year the company invested £17m for 50% of the shares of a joint venture BLT Properties Limited with British Land Company PLC. Details of this investment are set out in note 12 in the financial statements on page 22.

### Post balance sheet events

On 13 February 1997 the Board announced that it had agreed with the Royal Bank of Scotland to establish a joint venture in financial services. The Royal Bank Group and Tesco will have broadly equal shares in the joint venture.

On 21 March 1997 the Board announced that it will acquire the food retailing and related businesses in Northern Ireland and the Republic of Ireland of Associated British Foods plc for £630m in cash. The acquisition will be completed after merger approval from the European Commission is obtained.

On 10 March 1997 Tesco acquired a controlling interest in 23 stores in Poland for a total consideration of £4m.

### 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 on page 27.

### Company's shareholders

So far as the company is aware, at the date of this report Prudential Corporation holds 67,158,418 ordinary shares (3.1% 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 J A Gardiner, Mr D E Reid, Mr J M Wemms and Baroness O'Cathain retire from the Board by rotation according to the company's Articles of Association. Being eligible, they offer themselves for re-election.

Mr V W Benjamin and Mr A D Malpas retired from the Board of Directors on 7 June 1996 and 21 February 1997 respectively.

The service contracts of Mr D E Reid and Mr J M Wemms are terminable on two years' notice from the company. Mr J A Gardiner and Baroness O'Cathain do not have a service contract.

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 note 6 to the financial statements on pages 15 to 18.

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

### **Employment policies**

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

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

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

Internal communications are designed to ensure that employees are well informed about the business of the group. These include a staff magazine, 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 and the savings-related share option scheme.

### **Political and charitable donations**

Contributions to community projects and to charity via the Tesco Charity Trust amounted to £972,000 (1996-£727,000). There were no political donations.

### **Income and Corporation Taxes Act 1988**

The company is not a close company for the purposes of this Act. This status has not changed from 22 February 1997 to the date of this report.

### **Supplier Payment Policy**

Tesco PLC is a signatory to the CBI Code of Prompt Payment. Copies of the Code may be obtained from the CBI, Centre Point, 103 New Oxford Street, London WC1A 1DU.

### **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 re-appointment of Price Waterhouse as auditors of the company will be put to the Annual General Meeting.

### **Annual General Meeting**

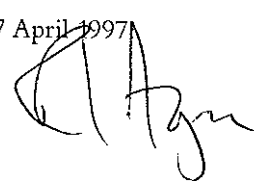
A separate circular accompanying the Annual Accounts explains the special business to be considered at the Annual General Meeting on 6 June 1997.

This report was approved by the Board on 7 April 1997

By Order of the Board

**Rowley Ager** Secretary

7 April 1997

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Tesco PLC  
Registered Number: 445790



## Group profit and loss account

52 weeks ended 22 February 1997	Note	1997 £m	1996 £m
<b>Sales at net selling prices</b>	1	<b>14,984</b>	13,028
Value added tax		<b>1,097</b>	934
<b>Turnover</b> excluding value added tax	1 & 2	<b>13,887</b>	12,094
Operating expenses	2	<b>13,081</b>	11,341
Employee profit sharing	3	<b>32</b>	29
<b>Operating profit</b>	1 & 2	<b>774</b>	724
Net loss on disposal of fixed assets	4	—	(6)
Net interest payable	7	<b>(24)</b>	(43)
<b>Profit on ordinary activities before taxation</b>	4	<b>750</b>	675
Profit before net loss on fixed assets		<b>750</b>	681
Net loss on disposal of fixed assets		—	(6)
Tax on profit on ordinary activities	8	<b>230</b>	209
<b>Profit on ordinary activities after taxation</b>		<b>520</b>	466
Minority equity interests		—	—
<b>Profit for the financial year</b>		<b>520</b>	466
Dividends	9	<b>225</b>	206
<b>Retained profit for the financial year</b>	24	<b>295</b>	260
		pence	pence
<b>Earnings per share</b>	10	<b>24.1</b>	22.2
Adjustment for net loss on disposal of fixed assets after taxation		—	0.3
<b>Adjusted earnings per share</b>	10	<b>24.1</b>	22.5
<b>Fully diluted earnings per share</b>	10	<b>23.5</b>	21.6
Adjustment for net loss on disposal of fixed assets after taxation		—	0.3
<b>Adjusted fully diluted earnings per share</b>	10	<b>23.5</b>	21.9
<b>Dividends per share</b>	9	<b>10.35</b>	9.60
<b>Dividend cover (times)</b>		<b>2.3</b>	2.3

Accounting policies and notes forming part of these financial statements are on pages 12 to 31.  
All group operations for the financial period are continuing.

## Statement of total recognised gains and losses

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
<i>52 weeks ended 22 February 1997</i>				
<b>Profit for the financial year</b>	<b>520</b>	466	<b>332</b>	307
Loss on foreign currency translation	(12)	(1)	—	—
<b>Total recognised gains and losses relating to the financial year</b>	<b>508</b>	465	<b>332</b>	307

## Reconciliation of movements in shareholders' funds

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
<i>52 weeks ended 22 February 1997</i>				
<b>Profit for the financial year</b>	<b>520</b>	466	<b>332</b>	307
Dividends	225	206	225	206
	<b>295</b>	260	<b>107</b>	101
Loss on foreign currency translation	(12)	(1)	—	—
New share capital subscribed less expenses	31	22	31	22
Conversion of capital bonds	—	200	—	200
Payment of dividends by shares in lieu of cash	18	14	18	14
Goodwill arising on acquisitions	(30)	(11)	—	—
<b>Net addition to shareholders' funds</b>	<b>302</b>	484	<b>156</b>	337
Shareholders' funds at 24 February 1996	<b>3,588</b>	3,104	<b>2,199</b>	1,862
<b>Shareholders' funds at 22 February 1997</b>	<b>3,890</b>	3,588	<b>2,355</b>	2,199

Accounting policies and notes forming part of these financial statements are on pages 12 to 31.

## Balance sheets

22 February 1997	Note	Group		Company	
		1997 £m	1996 £m	1997 £m	1996 £m
<b>Fixed assets</b>					
Tangible assets	11	5,826	5,466	—	—
Investments	12	23	19	3,338	3,224
		<u>5,849</u>	<u>5,485</u>	<u>3,338</u>	<u>3,224</u>
<b>Current assets</b>					
Stocks	13	550	559	—	—
Debtors	14	78	80	781	1,093
Investments	15	80	54	2	31
Cash at bank and in hand		65	38	—	—
		<u>773</u>	<u>731</u>	<u>783</u>	<u>1,124</u>
<b>Creditors: falling due within one year</b>	16	<u>2,101</u>	<u>2,002</u>	<u>1,278</u>	<u>1,581</u>
<b>Net current liabilities</b>		<u>(1,328)</u>	<u>(1,271)</u>	<u>(495)</u>	<u>(457)</u>
<b>Total assets less current liabilities</b>		<u>4,521</u>	<u>4,214</u>	<u>2,843</u>	<u>2,767</u>
<b>Creditors: falling due after more than one year</b>	17	611	598	488	485
<b>Provisions for liabilities and charges</b>	20	20	22	—	83
		<u>3,890</u>	<u>3,594</u>	<u>2,355</u>	<u>2,199</u>
<b>Capital and reserves</b>					
Called up share capital	22	109	108	109	108
Share premium account	24	1,431	1,383	1,431	1,383
Other reserves	24	40	40	—	—
Profit and loss account	24	2,310	2,057	815	708
<b>Equity shareholders' funds</b>		<u>3,890</u>	<u>3,588</u>	<u>2,355</u>	<u>2,199</u>
<b>Minority equity interests</b>		—	6	—	—
		<u>3,890</u>	<u>3,594</u>	<u>2,355</u>	<u>2,199</u>

Lord MacLaurin

D E Reid, C.A.

Directors

Financial statements approved by the Board on 7 April 1997

Accounting policies and notes forming part of these financial statements are on pages 12 to 31.

## Group cash flow statement

52 weeks ended 22 February 1997

	Note	1997 £m	1996 £m
<b>Net cash inflow from operating activities</b>	30	1,219	1,046
<b>Returns on investments and servicing of finance</b>			
Interest received		44	61
Interest paid		(84)	(125)
Interest element of finance lease rental payments		(7)	(9)
<b>Net cash outflow from returns on investments and servicing of finance</b>		(47)	(73)
<b>Taxation</b>			
Corporation tax paid (including advance corporation tax)		(228)	(182)
<b>Capital expenditure and financial investment</b>			
Payments to acquire tangible fixed assets		(703)	(624)
Receipts from sale of fixed assets		91	51
Decrease/(increase) in fixed asset investments		12	(9)
<b>Net cash outflow from capital expenditure and financial investment</b>		(600)	(582)
<b>Acquisitions</b>			
Purchase of subsidiary undertakings	31	(112)	(30)
Net cash acquired with subsidiary		3	—
Purchase of interest in joint venture		(17)	—
<b>Net cash outflow from acquisitions</b>		(126)	(30)
<b>Equity dividends paid</b>		(194)	(172)
<b>Cash inflow before use of liquid resources and financing</b>		24	7
<b>Management of liquid resources</b>			
(Increase)/decrease in short term deposits		(29)	77
<b>Financing</b>			
Ordinary shares issued for cash		31	22
Redemption of E.C.S.C. loans 1996		(74)	—
Redemption of 1/8% deep discount bonds		—	(50)
Increase/(decrease) in other loans		60	(52)
Capital element of finance leases repaid		(18)	(9)
<b>Net cash outflow from financing</b>		(1)	(89)
<b>Decrease in cash in the period</b>		(6)	(5)
<b>Reconciliation of net cash flow to movement in net debt</b>			
Decrease in cash in the period		(6)	(5)
Cash outflow from decrease in debt and lease financing		32	111
Conversion of capital bonds		—	200
Cash used to increase/(decrease) liquid resources		29	(77)
Amortisation of 4% unsecured deep discount loan stock		(3)	(2)
Foreign exchange differences		12	—
<b>Decrease in net debt</b>	32	64	227
Net debt at 24 February 1996		(813)	(1,040)
<b>Net debt at 22 February 1997</b>		(749)	(813)

Accounting policies and notes forming part of these financial statements are on pages 12 to 31.

## 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 made up to or around 22 February 1997 apart from Catteau S.A., Global T.H., Tesco Polska Sp. z o.o., Tesco Stores ČR a.s. and Tesco Stores SR a.s. which have a 31 December 1996 year end. 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 pension 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.

**Interest rate swaps**

Income and expenditure arising from swap transactions is recognised over the term of the swap as if it were interest receivable or payable. Profits or losses on the early termination of agreements are spread over the life of replacement swaps which are simultaneously arranged for an equal contract amount and covering the remaining period to maturity.

## 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 United Kingdom, France, Czech Republic, Slovakia, Hungary and Poland. Continental European operations' results are for the year ended 31 December 1996.

	1997				1996			
	Sales including VAT	Turnover excluding VAT	Profit	Assets	Sales including VAT	Turnover excluding VAT	Profit	Assets
	£m	£m	£m	£m	£m	£m	£m	£m
<b>Continuing operations</b>								
Food retailing – United Kingdom	14,024	13,034	760	4,364	12,430	11,558	713	4,164
Property development	92	84	–	60	2	2	–	99
Total United Kingdom	14,116	13,118	760	4,424	12,432	11,560	713	4,263
Food retailing – Rest of Europe	868	769	14	215	596	534	11	138
	<u>14,984</u>	<u>13,887</u>			<u>13,028</u>	<u>12,094</u>		
Operating profit			774				724	
Net loss on disposal of fixed assets			–				(6)	
Net interest payable			(24)				(43)	
Profit on ordinary activities before taxation			<u>750</u>				<u>675</u>	
Operating margin			5.6%				6.0%	
Capital employed			4,639				4,401	
Net debt (note 18)			(749)				(813)	
Net assets			<u>3,890</u>				<u>3,588</u>	

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 continuing operations

	1997			1996
	Continuing operations	Acquisitions	Total	Total
	£m	£m	£m	£m
Turnover	13,763	124	13,887	12,094
Cost of sales	12,732	114	12,846	11,140
Gross profit	1,031	10	1,041	954
Administration expenses	231	4	235	201
Employee profit sharing	32	–	32	29
Operating profit	<u>768</u>	<u>6</u>	<u>774</u>	<u>724</u>

Cost of sales includes warehouse and transportation costs and all store operating costs.

**Note 3 Employee profit sharing**

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

**Note 4 Profit on ordinary activities before taxation**

Profit on ordinary activities is stated after charging the following:

	1997 £m	1996 £m
Depreciation and amortisation	317	285
Operating lease costs	124	114
Auditors' remuneration (a)	—	—
Employment costs (note 5)	1,354	1,184
Net loss on disposal of fixed assets (b)	—	6

a) Auditors' remuneration amounted to £0.5m (1996 – £0.5m) and includes £0.1m (1996 – £0.1m) for the company. The auditors also received £0.6m (1996 – £0.6m) in respect of non-audit services of which £0.4m (1996 – £0.3m) related to overseas operations principally in respect of acquisitions and group restructuring.

b) Net loss on disposal of fixed assets has been arrived at after the offset of profits of £37m (1996 – £10m).

**Note 5 Employment costs****a) Employment costs during the year**

	1997 £m	1996 £m
Wages and salaries	1,216	1,065
Social security costs	83	73
Other pension costs (note 25)	55	46
	1,354	1,184

**b) Number of persons employed**

The average number of employees per week during the year was: UK 143,694 (1996 – 130,308), Europe 9,504 (1996 – 4,729) and the average number of full-time equivalents was: UK 89,649 (1996 – 80,650), Europe 8,791 (1996 – 4,245).

**Note 6 Directors' emoluments and interests**

Aggregate emoluments of the directors of the parent company were as follows:

	1997 £000	1996 £000
Directors' emoluments	4,450	4,213
Performance related incentives		
– short term bonuses	1,274	1,262
– long term bonuses	731	839
	6,455	6,314
Pension contributions (including – £201,000 in respect of the chairman (1996 – £186,000))	1,032	932
	7,487	7,246

In addition, the company contributed amounts totalling £145,500 to the Tesco PLC Pension Scheme on behalf of two directors who retired from office during the year.



## Notes to the financial statements *continued*

### Note 6 Directors' emoluments and interests *continued*

Emoluments of the directors, including the Chairman who was the highest paid director, but excluding pension contributions were as follows:

	Salary £000	Profit sharing £000	Benefits £000	Incentive scheme		Total	
				Long term £000	Short term £000	1997	1996
						£000	£000
Lord MacLaurin	766	8	25	141	245	1,185	1,194
Mr J A Gardiner	40	—	—	—	—	40	40
Mr D E Reid	453	8	25	85	148	719	680
Mr R S Ager	338	8	18	63	110	537	526
Mr V W Benjamin	77	8	20	—	—	105	274
Mr J Gildersleeve	435	8	27	80	140	690	682
Mrs L James	223	8	17	42	73	363	346
Dr M G Jones	32	—	—	—	—	32	29
Mr T P Leahy	485	8	18	93	161	765	671
Mr A D Malpas	594	8	21	108	189	920	897
Mr T J R Mason	260	8	19	52	90	429	348
Mr J W Melbourn	23	—	—	—	—	23	—
Baroness O'Cathain	27	—	12	—	—	39	35
Mr G F Pimlott	27	—	—	—	—	27	25
Mr J M Wemms	364	8	24	67	118	581	567
	4,144	80	226	731	1,274	6,455	6,314

### Executive share options exercised by directors in the financial year

	Number of shares at exercise price (pence)			Value realised	
	217.0	Total	Price at exercise (pence)	1997	1996
				£000	£000
Lord MacLaurin	—	—	—	—	144
Mr D E Reid	—	—	—	—	79
Mr R S Ager	51,153	51,153	327	56	91
Mr V W Benjamin	—	—	—	—	191
Mr J Gildersleeve	—	—	—	—	132
Mrs L James	22,005	22,005	305	19	40
Mr T P Leahy	—	—	—	—	79
Mr A D Malpas	—	—	—	—	113
Mr T J R Mason	—	—	—	—	66
Mr J M Wemms	27,650	27,650	330	31	313

Date of grant 27.05.93

The value realised from shares acquired on exercise is the difference between the fair market value at exercise and the exercise price of the options. Where individual directors exercised options on different dates the price at exercise shown represents an average of the prices on these dates weighted to the number of options exercised.

**Note 6 Directors' emoluments and interests** *continued*

**Share options held by directors and not exercised at 22 February 1997**

**Executive share option schemes (1984), (1994) and (1996)**

	Number of shares at exercise price (pence)								Total
	217.0(a)	217.0(b)	210.0(b)	243.0(b)	232.0(b)	271.0	312.0	295.0(c)	
Lord MacLaurin	—	27,650	701,040	—	—	89,299	—	—	817,989
Mr D E Reid	—	14,746	15,238	—	344,818	64,945	185,904	74,576	700,227
Mr R S Ager	23,041	17,051	100,952	—	142,446	39,852	85,104	83,390	491,836
Mr J Gildersleeve	—	14,747	320,911	—	14,656	85,608	207,719	40,678	684,319
Mrs L James	—	7,335	62,018	—	57,084	74,394	100,016	37,882	338,729
Mr T P Leahy	20,737	68,203	139,048	157,124	—	132,841	82,752	174,576	775,281
Mr A D Malpas	—	20,277	538,778	—	—	67,896	—	—	626,951
Mr T J R Mason	—	—	38,619	—	17,333	97,184	145,935	94,915	393,986
Mr J M Wemms	25,660	9,216	116,191	—	—	42,804	222,201	91,881	507,953
Date exercisable (d)	29.10.95	27.05.96	10.06.97	12.08.97	29.09.97	27.04.98	13.10.98	03.07.99	

a) The options may be exercised at 185p providing 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 217p.

b) Except in the case of Lord MacLaurin, one quarter of the outstanding options granted at 217p (or in the case of Mr R S Ager, Mr T P Leahy and Mr J M Wemms all of the outstanding options), 210p (or in the case of Mr R S Ager, Mrs L James, Mr T P Leahy and Mr J M Wemms all of the outstanding options), 243p and 232p may be exercised at 185p, 179p, 207p and 198p respectively, providing 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.

**Savings-related share option scheme (1981)**

	Number of shares				Exercise price (pence)	Value realised	
	As at 24 Feb 96	Granted	Exercised	As at 22 Feb 97		1997 £000	1996 £000
Lord MacLaurin	9,979	—	—	9,979	174 – 185	—	—
Mr D E Reid	9,706	2,771	3,676	8,801	174 – 249	6	—
Mr R S Ager	9,825	1,566	3,676	7,715	161 – 249	6	3
Mr J Gildersleeve	9,979	—	—	9,979	174 – 185	—	—
Mrs L James	9,547	2,771	3,676	8,642	161 – 249	6	—
Mr T P Leahy	9,270	2,771	3,676	8,365	185 – 249	6	—
Mr A D Malpas	9,979	—	—	9,979	174 – 185	—	—
Mr T J R Mason	9,557	—	—	9,557	174 – 250	—	2
Baroness O'Cathain	9,191	—	—	9,191	204	—	—
Mr J M Wemms	9,270	2,771	3,676	8,365	185 – 249	6	—

The savings-related share option scheme subscription price was 249p and the option matures in either 2000 (3 year scheme) or 2002 (5 year scheme).

Mr V W Benjamin retired on 7 June 1996. At that date he held 9,270 options with an exercise price of 185p – 204p.

On 5 March 1997 Baroness O'Cathain exercised options on 9,191 shares. Between 22 February 1997 and 7 April 1997 there have been no other changes in the number of share options held by the directors.

For further details on the company share option schemes see note 23.

## Notes to the financial statements *continued*

### Note 6 Directors' emoluments and interests *continued*

The disclosable interests of the directors, including family interests, were as follows:

	22 February 1997		24 February 1996	
	Ordinary shares	Options to acquire ordinary shares	Ordinary shares	Options to acquire ordinary shares
<b>Beneficial</b>				
Lord MacLaurin	491,687	827,968	412,112	827,968
Mr J A Gardiner	117,775	—	17,775	—
Mr D E Reid	325,001	709,028	222,752	635,357
Mr R S Ager	184,238	499,551	105,395	469,424
Mr J Gildersleeve	184,916	694,298	147,377	653,620
Mrs L James	107,398	347,371	59,921	332,399
Dr M G Jones	2,237	—	2,163	—
Mr T P Leahy	239,483	783,646	140,054	609,975
Mr A D Malpas	430,798	636,930	299,345	636,930
Mr T J R Mason	86,469	403,543	49,784	308,628
Mr J W Melbourn	2,190	—	—	—
Baroness O'Cathain	6,300	9,191	4,329	9,191
Mr G F Pimlott	8,294	—	8,020	—
Mr J M Wenms	169,702	516,318	110,607	452,992
<b>Non-beneficial</b>				
Lord MacLaurin	93,075	—	93,075	—

Mr V W Benjamin retired on 7 June 1996. On that date he held 125,809 (1996–123,041) ordinary shares and 9,270 (1996–9,270) options to acquire ordinary shares.

Mr J W Melbourn was appointed as a director on 15 April 1996 and at that date held 2,190 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 22 February 1997 and 7 April 1997 there were the following changes in the number of shares held by the directors:

Baroness O'Cathain, a non executive director, held 15,491 ordinary shares after exercising options on 9,191 shares.

Mr R S Ager sold 18 shares to cover the cost of a matched sale and purchase to transfer shares into a personal equity plan.

Share bonuses awarded to directors under the executive incentive scheme (page 3) are included in the directors' interests shown above. The shares on allocation are held in trust and released to directors, after two years in the case of short term share bonuses or four years for long term share bonuses, both conditional on continuous service with the company.

**Note 7 Net interest payable**

	1997 £m	1996 £m
Interest receivable and similar income on money market investments and deposits (a)	34	63
Deduct interest payable on:		
Short term bank loans and overdrafts repayable within five years	(32)	(49)
Finance charges payable on finance leases	(8)	(9)
9% convertible capital bonds 2005	-	(8)
4% unsecured deep discount loan stock 2006 (b)	(8)	(7)
E.C.S.C. loans 1998-1999 (c)	(1)	(5)
10¾% bonds 2002	(21)	(21)
½% deep discount bonds 2012 (a)	-	(23)
8¾% bonds 2003	(17)	(17)
Interest capitalised	29	33
	(58)	(106)
	(24)	(43)

a) The ½% deep discount bonds 2012 were redeemed in June 1995. Interest payable for 1996 comprised £3m of discount amortisation and £20m loss on redemption. Gains on cancellation of the associated deposit and financing arrangement of £26m were included within interest receivable.

b) Interest payable on the 4% unsecured deep discount loan stock 2006 includes £3m (1996 – £2m) of discount amortisation.

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

## Notes to the financial statements *continued*

### Note 8 Taxation

United Kingdom taxation:

Corporation tax at 33% (1996 – 33%)

Prior year items

Deferred taxation (see note 20)

Overseas taxes

1997 £m	1996 £m
254	293
(25)	(14)
(2)	(73)
227	206
3	3
230	209

### Note 9 Dividends

Declared interim – 3.25p per share (1996 – 3.05p)

Proposed final – 7.10p per share (1996 – 6.55p)

1997 £m	1996 £m
70	64
155	142
225	206

### Note 10 Earnings per share and fully diluted earnings per share

a) Earnings per share and fully diluted earnings per share excluding 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 results of the trading operations of the business.

b) The calculation of earnings per share, including and excluding 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 2,162m (1996 – 2,095m).

c) The calculation of fully diluted earnings per share, including and excluding 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 various 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.

# **Note 11 Tangible fixed assets**

	Total land and buildings	Plant equipment fixtures & fittings and vehicles	Total
	£m	£m	£m
<b>Cost</b>			
At 24 February 1996	5,260	1,739	6,999
Currency translation	(31)	(21)	(52)
Additions at cost (a)	498	233	731
Purchase of subsidiary undertakings	73	21	94
	5,800	1,972	7,772
Deduct disposals	(103)	(24)	(127)
<b>At 22 February 1997</b>	<b>5,697</b>	<b>1,948</b>	<b>7,645</b>
<b>Depreciation and amortisation</b>			
At 24 February 1996	492	1,041	1,533
Currency translation	(5)	(14)	(19)
Charge for period	126	191	317
Purchase of subsidiary undertakings	16	8	24
	629	1,226	1,855
Deduct disposals	(20)	(16)	(36)
<b>At 22 February 1997</b>	<b>609</b>	<b>1,210</b>	<b>1,819</b>
<b>Net book value (b) (c)</b>			
<b>At 22 February 1997</b>	<b>5,088</b>	<b>738</b>	<b>5,826</b>
At 24 February 1996	4,768	698	5,466
<b>Capital work in progress included above (d)</b>			
<b>At 22 February 1997</b>	<b>108</b>	<b>31</b>	<b>139</b>
At 24 February 1996	110	18	128

## **Notes**

a) Includes £16m (1996 – £18m) in respect of interest capitalised net of tax relief of £7m (1996 – £9m) principally relating to land and building assets.

b) Net book value includes capitalised interest, net of tax relief, at 22 February 1997 of £268m (1996 – £266m). Plant, equipment, fixtures and fittings and vehicles subject to finance leases included in net book value is:

	Cost	Depreciation	Net book value
	£m	£m	£m
At 24 February 1996	202	138	64
Movement in the period	—	17	(17)
<b>At 22 February 1997</b>	<b>202</b>	<b>155</b>	<b>47</b>

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

	1997 £m	1996 £m
Freehold	4,245	3,954
Long leasehold – 50 years or more	544	541
Short leasehold – less than 50 years	299	273
<b>At 22 February 1997</b>	<b>5,088</b>	<b>4,768</b>

d) Capital work in progress does not include land.

# Notes to the financial statements *continued*

## Note 12 Fixed asset investments

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Subsidiary undertakings – shares at cost,				
less amounts written off (a)	–	–	316	207
Loans to group undertakings	–	–	3,000	3,000
Associated undertakings (b)	21	5	22	5
Own shares (c)	–	12	–	12
Other investments	2	2	–	–
	<b>23</b>	<b>19</b>	<b>3,338</b>	<b>3,224</b>

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 Stores Hong Kong Limited	Purchasing	100%	Hong Kong
Spenn Hill Properties Limited	Property development	100%	Registered in England
Carteau S.A.	Food retail	100%	France
Global T.H.	Food retail	97%	Hungary
Tesco Distribution Limited	Distribution	100%	Registered in England
Tesco Polska Sp. z o.o.	Food retail	96%	Poland
Tesco Stores ČR a.s.	Food retail	100%	Czech Republic
Tesco Stores SR a.s.	Food retail	100%	Slovakia

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

b) The group's associated undertakings are:

	Business	Share of equity and preference share capital	Country of incorporation
Shopping Centres Limited	Property investment	50%	Registered in England
BLT Properties Limited	Property investment	50%	Registered in England

BLT Properties Limited was formed during the year. An amount of £1m representing the unrealised 50% element of the profit on the sale of seven of the group's properties to BLT Properties Limited has been offset against the cost of the investment.

The net debt of the associated undertakings, as at 22 February 1997, was as follows:

	1997 £m	1996 £m
Cash and deposits	23	18
Term bank loan – repayable 1999	(48)	(48)
Debenture stock – repayable 2001	(36)	(34)
Term bank loan – repayable 2003	(119)	–
Other loans (£19m from group undertakings)	(38)	(20)
	<b>(218)</b>	<b>(84)</b>

There is no recourse to group companies in respect of the debts of the associated undertakings, apart from £14m (1996 – £2m) which has been guaranteed by Tesco PLC (note 28).

c) In a previous year the company established an employee share ownership trust. The purpose of the trust was to hold shares in the company for the benefit of group employees. The trust had not waived dividend rights on these shares and the costs of operating the plan were charged to the profit and loss account in the previous year.

The shares held by the trust at 24 February 1996 totalling £12m were unconditionally gifted to group employees and the related funding was repaid.

**Note 13 Stocks**

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Goods held for resale	490	461	—	—
Development property	60	98	—	—
	<b>550</b>	<b>559</b>	<b>—</b>	<b>—</b>

Additions to development property include £6m (1996 – £6m) of interest capitalised. Accumulated capitalised interest at 22 February 1997 was £11m (1996 – £11m).

**Note 14 Debtors**

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Amounts owed by group undertakings	—	—	518	830
Prepayments and accrued income	21	34	258	260
Advance corporation tax recoverable	5	3	5	3
Other debtors	52	43	—	—
	<b>78</b>	<b>80</b>	<b>781</b>	<b>1,093</b>

Debtors falling due after one year included above:

Advance corporation tax recoverable	5	3	5	3
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**Note 15 Investments**

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Money market deposits	60	51	—	28
Bonds and certificates of deposit (market value £20m, 1996 – £3m)	20	3	2	3
Money market investments and deposits	<b>80</b>	<b>54</b>	<b>2</b>	<b>31</b>



# Notes to the financial statements *continued*

## Note 16 Creditors falling due within one year

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
Bank loans and overdrafts (a) (b)	285	241	931	776
Trade creditors	826	764	—	—
Amounts owed to group undertakings	—	—	137	561
Other creditors	322	288	8	26
Corporation tax (c)	255	259	41	67
Other taxation and social security	90	86	—	1
Accruals and deferred income (d)	147	128	6	8
E.C.S.C. loans 1996	—	74	—	—
Finance leases (note 21)	21	20	—	—
Proposed final dividend	155	142	155	142
	<b>2,101</b>	<b>2,002</b>	<b>1,278</b>	<b>1,581</b>

a) Bank deposits at subsidiary undertakings of £663m (1996 – £675m) have been offset against debts in the parent company under a legal right of set-off.

b) Includes £8m (1996 – nil) 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 (1996 – £5m) attributable to these realised gains with £23m (1996 – £28m) being included in creditors falling due after more than one year (note 17).

## Note 17 Creditors falling due after more than one year

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
4% unsecured deep discount loan stock 2006 (a)	80	77	80	77
Finance leases (note 21)	55	76	—	—
10¾% bonds 2002 (b)	200	200	200	200
8¾% bonds 2003 (c)	200	200	200	200
E.C.S.C. loans 1998-1999	8	8	8	8
Other loans (d)	45	9	—	—
	<b>588</b>	<b>570</b>	<b>488</b>	<b>485</b>
Accruals and deferred income (note 16 (d))	23	28	—	—
	<b>611</b>	<b>598</b>	<b>488</b>	<b>485</b>

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

b) The 10¾% bonds are redeemable at a par value of £200m in 2002.

c) The 8¾% bonds are redeemable at a par value of £200m in 2003.

d) Includes £38m (1996 – nil) secured on various properties.

# **Note 18 Net debt**

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
<b>Due within one year</b>				
Bank and other loans	285	315	931	776
Finance leases	21	20	—	—
<b>Due within one to two years</b>				
Bank and other loans	13	—	8	—
Finance leases	19	21	—	—
<b>Due within two to five years</b>				
Bank and other loans	33	8	—	8
Finance leases	28	44	—	—
<b>Due wholly or in part by instalments after five years</b>				
Finance leases	8	11	—	—
<b>Due otherwise than by instalments after five years</b>				
Bank and other loans	487	486	480	477
Gross debt	894	905	1,419	1,261
Deduct:				
Cash at bank and in hand	65	38	—	—
Money market investments and deposits	80	54	2	31
Net debt	749	813	1,417	1,230

# **Note 19 Financial instruments**

## **Analysis of interest rate exposure and currency of net debt**

The interest rate exposure and currency of group net debt as at 22 February 1997 after swaps was:

Currency	Total £m	Floating rate debt £m	Fixed rate debt £m	Fixed rate debt	
				Weighted average interest rate 22 February 1997 %	Weighted average time for which rate is fixed Years
Sterling	638	436	202	9.2	6
French franc	138	30	108	6.7	4
Other	(27)	(27)	—	—	—
<b>Net debt at 22 February 1997</b>	<b>749</b>	<b>439</b>	<b>310</b>	<b>8.3</b>	<b>6</b>
% of net debt		59%	41%		
Net debt at 24 February 1996	813	682	131	9.5	6

The interest rate exposure of the group has been further managed by the purchase of interest rate caps with an aggregate notional principal of £70m (1996 – nil) and an average strike rate of 8.14% for the period to October 2001. The current value of these contracts, if realised, would generate a gain of £1m.

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

Swaps converting French franc floating debt, with a notional principal sterling equivalent at year end rates of £85m, to French franc fixed debt for an average period of 4 years at a weighted average rate of 5.8%.

Swaps converting £385m net notional principal sterling denominated fixed rate debt into floating debt for an average period of 5 years at a weighted average rate of 7.1%.

The current value of these contracts, if realised, would generate a 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 £28m has been deferred as at 22 February 1997.

## Notes to the financial statements *continued*

### Note 19 Financial instruments *continued*

Long term debt over one year with a book value of £588m has an estimated current value, considering only the movements in risk-free interest rates, of £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 and debt by currency on 22 February 1997 were:

	Financing			Net investment	
	Net assets before financing £m	Effect of currency swaps £m	Gross debt £m	1997 £m	1996 £m
<b>Currency</b>					
Sterling	4,531	62	(797)	3,796	3,562
French franc	132	(55)	(86)	(9)	—
Other	121	(7)	(11)	103	26
<b>Total</b>	<b>4,784</b>	<b>—</b>	<b>(894)</b>	<b>3,890</b>	<b>3,588</b>

The currency swaps are shown above at year end value which is equal to their current value.

Other significant financial instruments outstanding at the year end are £64m nominal value forward foreign exchange contracts hedging the cost of currency denominated purchases. On a mark-to-market basis these contracts show a loss of £1m.

### Note 20 Provisions for liabilities and charges

	Amount provided		Potential amount for deferred tax on all timing differences	
	1997 £m	1996 £m	1997 £m	1996 £m
<b>Deferred taxation – group</b>				
Excess capital allowances over depreciation	10	10	294	259
Capital gains deferred by rollover relief	—	—	1	3
Short term timing differences	10	12	10	12
	<b>20</b>	<b>22</b>	<b>305</b>	<b>274</b>

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 taxes acts.

## Note 21 Leasing commitments

### a) Finance leases

The future minimum finance lease payments to which the group was committed at 22 February 1997 and which have been guaranteed by Tesco PLC are:

	£m
Gross rental obligations	96
Deduct finance charges allocated to future periods	20
	<u>76</u>

Net amounts payable are:

	1997 £m	1996 £m
Within one year	21	20
Between one and five years	47	65
After five years	8	11
	<u>76</u>	<u>96</u>

### b) Operating leases

Group commitments during the 53 weeks to 28 February 1998 in terms of lease agreements expiring are as follows:

	1997 £m	1996 £m
Within one year	2	4
Between one and five years	10	10
After five years	121	104
	<u>133</u>	<u>118</u>

## Note 22 Called up share capital

	Ordinary shares of 5p each	
	Number	£m
Authorised: 1997 and 1996	2,710,000,000	136
Allotted, issued and fully paid:		
Issued at 24 February 1996	2,154,506,199	108
Scrip dividend election	6,054,211	—
Share options exercised	14,366,586	1
<b>Issued at 22 February 1997</b>	<b>2,174,926,996</b>	<b>109</b>

Between 22 February 1997 and 7 April 1997, options on 184,696 ordinary shares and 122,739 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 22 February 1997 the directors were authorised to purchase up to a maximum in aggregate of 217,492,699 ordinary shares.

## Notes to the financial statements *continued*

### 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 only take advantage of that discount 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.

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 22 Feb 97	Subscription price (pence)
29.10.92	8,286	11,057,441	174.0
22.10.93	9,537	10,809,905	161.0
26.10.94	13,751	13,410,162	185.0
27.10.95	19,295	13,455,727	250.0
31.10.96	33,537	19,609,504	249.0

#### Executive share option scheme (1984)

Date of grant	Number of executives	Shares under option 22 Feb 97	Subscription price (pence)
06.07.87	12	113,342	177.9
01.11.89	251	1,134,061	192.1
17.05.91	23	235,411	274.0
22.10.91	1	5,000	254.0
29.05.92	404	5,550,025	277.0
29.10.92	7	138,650	217.0
27.05.93	11	249,163	217.0
11.10.93	3	185,164	210.0
10.06.94	552	5,646,057	210.0
12.08.94	1	157,124	243.0
29.09.94	30	861,599	232.0

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

**Note 23 Share options** *continued*

**Executive share option scheme (1994)**

Date of grant	Number of executives	Shares under option 22 Feb 97	Subscription price (pence)
27.04.95	25	1,531,117	271.0
13.10.95	1,013	10,271,113	312.0
23.05.96	3	158,391	286.0

**Executive share option scheme (1996)**

Date of grant	Number of executives	Shares under option 22 Feb 97	Subscription price (pence)
03.07.96	30	1,245,495	295.0
23.09.96	1,034	9,487,911	299.0

**Note 24 Reserves**

	Group		Company	
	1997 £m	1996 £m	1997 £m	1996 £m
<b>a) Share premium account</b>				
At 24 February 1996	1,383	1,152	1,383	1,152
Conversion of capital bonds	—	196	—	196
Premium on issue of shares less costs	30	21	30	21
Scrip dividend election	18	14	18	14
At 22 February 1997	1,431	1,383	1,431	1,383
<b>b) Other reserves</b>				
At 22 February 1997 and 24 February 1996	40	40	—	—
<b>c) Profit and loss account</b>				
At 24 February 1996	2,057	1,809	708	607
Goodwill arising on acquisition of subsidiary undertakings	(30)	(11)	—	—
Loss on foreign currency translation	(12)	(1)	—	—
Retained profit for the financial year	295	260	107	101
At 22 February 1997	2,310	2,057	815	708

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 22 February 1997 amounted to £408m (1996 – £378m).

## Notes to the financial statements *continued*

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### 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. 7

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

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

Benefit improvements to members have been agreed with the trustees which have resulted in an increased company cost. This increasing ongoing cost has been offset by the amortisation of the surplus as a level percentage of pay over nine years.

The pension cost of this scheme to the group was £39m (1996 – £34m).

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 £13m (1996 – £10m). There were no material amounts outstanding to the insurance company at the year end.

The group also operates defined contribution schemes in France. The contributions payable under these schemes of £3m (1996 – £2m) have been fully expensed against profits in the current year.

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### 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 pension schemes.

The liability as at 24 February 1996 of £10m, which was determined in accordance with the advice of qualified actuaries, is being spread forward over the service lives of relevant employees and £1m (1996 – £1m) has been charged to the profit and loss account. A provision of £3m (1996 – £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.

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### Note 27 Capital commitments

At 22 February 1997:

- a) There were commitments for capital expenditure of £233m (1996 – £200m).
- b) Capital expenditure authorised by the Board, but not contracted for, amounted to £291m (1996 – £380m).

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### Note 28 Contingent liabilities

Certain bank loans and overdraft facilities of associated undertakings have been guaranteed by Tesco PLC. At 22 February 1997, the amounts outstanding on these facilities were £14m (1996 – £2m).

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### 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 two associated undertakings, Shopping Centres Limited and BLT Properties Limited. The main transactions were equity funding of £17m into BLT Properties Limited, the sale of properties for £60m to BLT Properties Limited and rental payment on properties owned by both companies of £6m.

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

	1997 £m	1996 £m
Operating profit	774	724
Depreciation and amortisation	317	285
Increase in goods held for resale	(19)	(44)
Decrease/(increase) in development property	44	(24)
(Increase)/decrease in debtors	(7)	25
Increase in trade creditors	74	41
Increase in other creditors	36	40
Decrease in working capital	128	38
Miscellaneous items	-	(1)
Net cash inflow from operating activities	1,219	1,046

**Note 31 Acquisitions**

On 17 April 1996 the group acquired Kmart ČR a.s. and Kmart SR a.s. for £79m. In addition, the group paid £3m to increase its holding from 74% to 97% in the Hungarian food retailer Global T.H. and acquired two new stores as trading businesses in France through Carreau S.A. for £27m.

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

The acquisitions have been consolidated into the Tesco group balance sheet as follows:

	Balance sheet at acquisition £m	Fair value adjustments £m	Fair value balance sheet £m
Fixed assets	74	(4)	70
Working capital including cash	10	(2)	8
Taxation	1	-	1
Minority interests	3	-	3
Shareholders' funds	88	(6)	82
Goodwill			30
Total purchase consideration			112
Cash acquired			3
Purchase consideration paid			109

**Note 32 Analysis of changes in net debt**

	At 24 February 1996 £m	Cash flow £m	Other non cash changes £m	Exchange movements £m	At 22 February 1997 £m
Cash at bank and in hand	38	30	-	(3)	65
Overdrafts	(4)	(36)	-	2	(38)
	34	(6)	-	(1)	27
Money market investments and deposits	54	29	-	(3)	80
Bank and other loans	(237)	(23)	-	13	(247)
E.C.S.C. loans 1996	(74)	74	-	-	-
Finance leases	(20)	18	(19)	-	(21)
Debt due within one year	(331)	69	(19)	13	(268)
Bank and other loans	(494)	(37)	(3)	1	(533)
Finance leases	(76)	-	19	2	(55)
Debt due after one year	(570)	(37)	16	3	(588)
	(813)	55	(3)	12	(749)



## Directors' responsibilities for the preparation of the financial statements

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

The directors consider that in preparing the financial statements on pages 8 to 31 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 8 to 31 which have been prepared under the historical cost convention and the accounting policies set out on pages 12 and 13.

### Respective responsibilities of directors and auditors

As described above, the company's directors are responsible for the preparation of financial statements. It is our responsibility 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 a true and fair view of the state of affairs of the company and of the group as at 22 February 1997 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

7 April 1997

*Price Waterhouse*

